



THE SEDONA CONFERENCE JOURNAL®

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A R T I C L E S

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“Possession, Custody, or Control”** The Sedona Conference

**The Potential Impact of Article 48 of the General Data Protection
Regulation on Cross Border Discovery From the United States**
. David J. Kessler, Jamie Nowak & Sumera Khan

**Limits on Limiting Inherent Authority: Rule 37(e) and the Power to
Sanction.** Hon. James C. Francis IV & Eric P. Mandel

**Litigating Standard Essential Patents at the U.S. International
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**A Clear and Present Danger: Mitigating the Data Security Risk
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. John Thomas A. Malatesta III & Sarah S. Glover

**Death by a Thousand Cuts: The Slow Erosion of the Right to Trial by
Jury in Patent Cases** Patrick M. Arenz & Ari B. Lukoff



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PUBLISHER'S NOTE

Welcome to Volume 17, Number 2, of *The Sedona Conference Journal* (ISSN 1530-4981), published by The Sedona Conference, a nonprofit 501(c)(3) research and educational institute dedicated to the advanced study of law and policy in the areas of antitrust law, complex litigation, and intellectual property rights. The mission of The Sedona Conference is to move the law forward in a reasoned and just way through the creation and publication of nonpartisan consensus commentaries and through advanced legal education for the bench and bar.

The various Working Groups in The Sedona Conference Working Group Series (WGS) pursue in-depth study of tipping point issues with the goal of producing high-quality, nonpartisan consensus commentaries that provide guidance of immediate and practical benefit to the bench and bar. The Sedona Conference conducts a “regular season” of limited attendance conferences that are dialogue based mini-sabbaticals for the nation’s leading jurists, lawyers, academics, and experts to examine cutting edge issues of law and policy. The Sedona Conference also conducts continuing legal education programs under The Sedona Conference Institute (TSCI) banner, an annual International Programme on Cross-Border Discovery and Data Protection Laws, and webinars on a variety of topics.

Volume 17, Number 2, of the *Journal* contains one nonpartisan consensus commentary from The Sedona Conference Working Group 1 on Electronic Document Retention and Production (WG1), one article from our 2016 International Programme on Cross-Border Discovery and Data Protection Laws, and four articles from individual authors written specifically for the *Journal*. The views expressed in the articles (as opposed to the nonpartisan consensus commentary) are those of the individual authors. I hope you find these articles to be thought provoking pieces that may stimulate further dialogue and ultimately serve to move the law forward.

For more information about The Sedona Conference and its activities, please visit the website at www.thesedonaconference.org.

Craig Weinlein
Executive Director
The Sedona Conference
November 2016

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THE SEDONA CONFERENCE COMMENTARY ON RULE 34
AND RULE 45 “POSSESSION, CUSTODY, OR CONTROL”*

A Project of The Sedona Conference Working Group on Electronic Document Retention & Production (WG1)

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PREFACE

Welcome to the final, July 2016, version of The Sedona Conference *Commentary on Rule 34 and Rule 45 "Possession, Custody, or Control,"* a project of The Sedona Conference Working Group on Electronic Document Retention and Production (WG1). The Sedona Conference is a 501(c)(3) research and educational institute that exists to allow leading jurists, lawyers, experts, academics, and others, at the cutting edge of issues in the areas of antitrust law, complex litigation, and intellectual property rights, to come together in conferences and mini-think tanks called Working Groups to engage in true dialogue, not debate, in an effort to move the law forward in a reasoned and just way.

The public comment version of The Sedona Conference *Commentary on Rule 34 and Rule 45 "Possession, Custody, or Control"* was published in April 2015 after two years of dialogue, review, and revision, including discussion at two of our WG1 midyear meetings. The public comment period closed June 15, 2015, and was cited six months later by the United States District Court in *Matthew Enterprise, Inc. v. Chrysler Group LLC*, No. 12-cv-04236, 2015 WL 8482256 (N.D. Cal. Dec. 10, 2015). The editors reviewed the public comments received and, where appropriate, incorporated those into this final version. I thank once again all of the drafting team members for their dedication and contribution to this project. Team members that participated and deserve recognition for their work are: Victor L. Cardenas Jr., Alitia Faccone, Susan Barrett Harty, Mark Kindy, Edwin Lee, Lauren E. Schwartzreich, Ronni D. Solomon, Martin T. Tully, Cheryl Vollweiler, Kelly M. Warner, W. Lawrence Wescott II, and James S. Zucker. The Sedona Conference also thanks The Honorable Kristen L. Mix for her participation as a Judicial Observer. Finally, The Sedona Conference thanks Paul D. Weiner for serving as both the Editor-in-Chief and Steering Committee Liaison.

We hope our efforts will be of immediate and practical assistance to judges, parties in litigation and their lawyers, and database management professionals. We continue to welcome comments for consideration in future updates. If you wish to submit feedback, please email us at comments@sedonaconference.org. The Sedona Conference hopes and anticipates that the output of its Working Groups will evolve into authoritative statements of law, both as it is and as it should be.

Craig Weinlein
Executive Director
The Sedona Conference
July 2016

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I. ABSTRACT

Rule 26(a) of the Federal Rules of Civil Procedure allows for the discovery of “documents, electronically stored information, and tangible things” in the responding party’s “possession, custody, or control.” Similarly, Rule 34(a) and Rule 45(a) obligate a party responding to a document request or subpoena to produce “documents, electronically stored information, and tangible things” in that party’s “possession, custody, or control.” Yet, the Rules are silent on what the phrase “possession, custody, or control” means. Therefore, parties must look to case law for a definition. Unfortunately, the case law across circuits (and often within circuits themselves) is unclear and, at times, inconsistent as to what is meant by “possession, custody, or control,” resulting in a lack of reliable legal—and practical—guidance. The inconsistent interpretation and application of Rules 34 and 45 in this context are especially problematic because parties remain absolutely responsible for preserving and producing information within their “possession, custody, or control” and face material consequences, including sanctions, for their failure to do so.

Furthermore, in today’s digital world, the determination of whether and when information should be considered to be in a responding party’s “possession, custody, or control” has become more complex. New technologies and organizational initiatives have further blurred the legal and operational lines of who actually “controls” data for purposes of preservation and production, and have multiplied the practical problems associated with preserving and producing data that a party does not directly control. The proliferation, use, and transfer of vast quantities of digital information, deciding how and where to store that information, and increasingly complex business relationships aimed at addressing the creation and storage of information, have all spawned multiple issues that have profoundly

affected the issue of “possession, custody, or control” under the discovery rules.

This Commentary is intended to provide practical, uniform, and defensible guidelines regarding when a responding party should be deemed to have “possession, custody, or control” of documents and all forms of electronically stored information (hereafter, collectively referred to as “Documents and ESI”) subject to Rule 34 and Rule 45 requests for production. A secondary, corollary purpose of this Commentary is to advocate abolishing use of the common-law “Practical Ability Test” for purposes of determining Rule 34 and Rule 45 “control” of Documents and ESI. Simply stated, this common-law test has led to inequitable situations in which courts have held that a party has Rule 34 “control” of Documents and ESI even though the party did not have the *actual ability* to obtain the Documents and ESI. Therefore, this Commentary recommends that courts should interpret and enforce Rule 34 “possession, custody, or control” obligations in ways that do not lead to sanctions for unintended and uncontrollable circumstances. To support that recommendation, this Commentary also looks to several well-established legal doctrines upon which to model the contemporary scope of a party’s duty to identify, preserve, and collect Documents and ESI, such as reliance upon a modified version of the business judgment rule. Helping resolve the disparity among circuits to bring a uniform, national standard to this important area of the law is consistent with Sedona’s mission of moving the law forward in a just and reasoned way.

II. THE SEDONA CONFERENCE PRINCIPLES ON POSSESSION, CUSTODY, OR CONTROL

- Principle 1:** A responding party will be deemed to be in Rule 34 or Rule 45 “possession, custody, or control” of Documents and ESI when that party has actual possession or the legal right to obtain and produce the Documents and ESI on demand.
- Principle 2:** The party opposing the preservation or production of specifically requested Documents and ESI claimed to be outside its control, generally bears the burden of proving that it does not have actual possession or the legal right to obtain the requested Documents and ESI.
- Principle 3(a):** When a challenge is raised about whether a responding party has Rule 34 or Rule 45 “possession, custody, or control” over Documents and ESI, the Court should apply modified “business judgment rule” factors that, if met, would allow certain, rebuttable presumptions in favor of the responding party.
- Principle 3(b):** In order to overcome the presumptions of the modified business judgment rule, the requesting party bears the burden to show that the responding party’s decisions concerning the location, format, media, hosting, and access to Documents and ESI lacked a good faith basis and were not reasonably related to the responding party’s legitimate business interests.
- Principle 4:** Rule 34 and Rule 45 notions of “possession, custody, or control” should never be construed to override conflicting state or federal privacy or other statutory obligations, including foreign data protection laws.

Principle 5: If a party responding to a specifically tailored request for Documents or ESI (either prior to or during litigation) does not have actual possession or the legal right to obtain the Documents or ESI that are specifically requested by their adversary because they are in the “possession, custody, or control” of a third party, it should, in a reasonably timely manner, so notify the requesting party to enable the requesting party to obtain the Documents or ESI from the third party. If the responding party so notifies the requesting party, absent extraordinary circumstances, the responding party should not be sanctioned or otherwise held liable for the third party’s failure to preserve the Documents or ESI.

III. BACKGROUND

A. Rules 34 and 45 Impose Important Obligations on Parties Deemed to Control Documents and ESI and the Law Prescribes Consequences for not Meeting Those Obligations

If a responding party has possession, custody, or control of relevant¹ Documents and ESI, it has a duty to preserve² and produce³ them in discovery. If a party fails to do so, it may be sanctioned.⁴ This outcome makes sense if a party has physical possession or actual custody of its own Documents and ESI; for example, Documents and ESI stored on its servers on the company's premises or a computer that an individual owns. The preservation and production requirement also makes sense if a party enters into a direct contractual relationship with another to handle its Documents and ESI, such as when a party outsources all of its payroll functions to a third party and retains the legal right to obtain Documents and ESI on demand and/or can set the terms and conditions on which it may retrieve those Documents and ESI, or when an individual signs up with an ISP (internet service provider) for his/her personal email account. In those circumstances, the Rule 34 and Rule 45 terms "possession" and "custody" are fairly straightforward and do not present a problem. Indeed, when Rules 34 and 45 were amended in 2006 to specifically include "electronically stored information," it

1. See FED. R. CIV. P. 26(b) (setting forth the scope and limits of discovery, including that: discovery must be proportional to the needs of the case; discovery of ESI must be limited from sources that are not reasonably accessible due to undue burden or cost; and privileged matters are not subject to discovery).

2. *Zubulake v. UBS Warburg LLC*, 220 F.R.D. 212, 217–18 (S.D.N.Y. 2003).

3. See FED. R. CIV. P. 34(a).

4. *Metropolitan Opera Ass'n v. Local 100*, 212 F.R.D. 178 (S.D.N.Y. 2003).

was far easier to enforce these Rules along bright lines without the further need to specifically define possession, custody, or control.⁵

However, in today's dynamic and ever-expanding digital information landscape, potential unfairness develops when an overly expansive definition of "control" is applied. Simply put, in today's digital world, the relationship between a *party in litigation* and the individual or entity that *actually possesses* potentially relevant Documents and ESI has become far more complex and multi-faceted.⁶ In many instances, Documents and ESI

5. While the Federal Rules of Civil Procedure were amended in December 2015, those amendments did not specifically address the issues of Rule 34 and 45 "possession, custody, or control." The December 2015 amendments did, however, recognize that the data explosion that created the need for rule amendments in 2006 to specifically address "electronically stored information" has continued unabated, thus supporting the need for additional rule amendments in 2015:

[T]he explosion of ESI in recent years has presented new and unprecedented challenges in civil litigation. . . . [T]he remarkable growth of ESI will continue and even accelerate. One industry expert reported to the Committee that there will be some 26 billion devices on the Internet in six years – more than three for every person on earth.

See Memorandum from Chair of the Advisory Committee on Federal Rules of Civil Procedure Judge David G. Campbell to Chair of the Standing Committee on Rules of Practice and Procedure Judge Jeffrey Sutton, p. B-15 (Sept. 2014), <http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0ahUKEwjV9c7KrfMAhWq5IMKHVVHDQEQFggcMAA&url=http%3A%2F%2Fwww.uscourts.gov%2Ffile%2F18218%2Fdownload&usg=AFQjCNEiQyk8P6qPY5YW1PgfM-spZBn4Vg&bvm=bv.122676328,d.amc> [hereinafter Advisory Committee Report].

6. The drafters of the 2015 federal rule amendments specifically took note of how new technologies were impacting litigation:

Significant amounts of ESI will be created and stored not only by sophisticated entities with large IT departments, but also by unsophisticated persons whose lives are recorded on

are in the possession or custody of non-parties to a lawsuit, creating scenarios more difficult for courts and parties to navigate. Some everyday examples of these challenges include the following:

- If a service provider has no legal right to obtain information from one of its customers, should it be required to preserve, search, and produce the customer's information that it does not have in litigation on the threat of sanctions for failure to do so?
- If a subsidiary corporation that is a separate legal entity from its parent corporation has no legal right to obtain Documents and ESI from its parent, should the subsidiary be required to preserve, search, and produce Documents and ESI from its parent in litigation on the threat of sanctions for failure to do so?
- Should the same obligations exist if that same parent corporation is also located in a foreign jurisdiction where it is subject to data privacy or blocking statutes that do not contain exceptions for American litigation?
- If an employer has neither the actual ability nor legal right to obtain Documents and ESI from its employee's personal devices—because doing so may violate important public policy interests and statutes (including social media password protection laws that have

their phones, tablets, cars, social media pages, and tools not even presently foreseen. Most of this information will be stored somewhere on remote servers, often referred to as the "cloud," complicating the preservation task.

See Advisory Committee Report, *supra* note 5.

been enacted in many states) or for other reasons—should the employer be required to preserve, search, and produce that information in litigation on the threat of sanctions for failure to do so?

The crux of the matter is that Rules 34 and 45 require the responding party to produce Documents and ESI within a party's possession, custody, or control, yet, nowhere in the Federal Rules are the terms possession, custody, or control defined.⁷ As a result, different circuits across the country have created an inconsistent body of case law and standards about what constitutes "control" over data.⁸

B. Interpretation of Rule 34 and Rule 45 Possession, Custody, or Control is Inconsistent across Federal Circuits, Leading to Irreconcilable Standards

1. The Three Standards for Rule 34 and Rule 45 Possession, Custody, or Control

The federal circuits have taken differing approaches to what constitutes possession, custody, or control under Rules 34 or 45. This has led to a lack of clarity for lawyers and litigants that must manage discovery or advise clients regarding the production of Documents and ESI in multiple jurisdictions.⁹ This is

7. FED. R. CIV. P. 34(a), 45(a).

8. See, e.g., *Goodman v. Praxair Servs., Inc.*, 632 F. Supp. 2d 494, 514 (D. Md. 2009) ("What is meant by [Rule 34] 'control' . . . has yet to be fully defined.").

9. As discussed below, one of the primary drivers of the 2015 amendments to Rule 37(e) was to "provide a uniform standard in federal courts." See FED. R. CIV. P. 37(e)(2), Committee Note (Dec. 15, 2015). See also Advisory Committee Report, *supra* note 5, at B-14, B-17 ("Resolving the circuit split with a more uniform approach . . . has been recognized by the Committee as

especially problematic given that in today's digital world, borders have broken down and many businesses and individuals live their lives and conduct business nationwide.

As a general matter, the case law in this area has coalesced into three broad interpretations of when the producing party will be deemed to have Rule 34 "control" over Documents and ESI in the hands of a third party. The result is to impose an obligation on the litigant to preserve, collect, search, and produce the Documents and ESI in the hands of the third party, even though the producing party does not actually possess or have actual custody of the Documents and ESI at issue. These three interpretations are:

- **Legal Right Standard:** When a party has the legal right to obtain the Documents and ESI (the "Legal Right Standard");
- **Legal Right Plus Notification:** When a party has the legal right to obtain the Documents and ESI. Plus, if the party does not have the legal right to obtain the Documents and ESI that have been specifically requested by its adversary but is aware that such evidence is in the hands of a third party, it must so notify its adversary (the "Legal Right Plus Notification Standard"); and
- **Practical Ability Standard:** When a party does not have the legal right to obtain the Documents and ESI but has the "practical ability" to do so (the "Practical Ability Standard" or "Practical Ability Test").

a worthwhile goal. . . . [The] primary purpose of [amended Rule 37(e)] is to eliminate the circuit split on [a key aspect of the rules].").

The Legal Right Standard requires a party to preserve, collect, search, and produce Documents and ESI which the party has a legal right to obtain. The Legal Right Standard has been followed by some federal courts in the Third, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, and Eleventh Circuits.^{10 11}

10. *See, e.g.*, **3rd Circuit:** *Brewer v. Quaker State Oil Ref. Co.*, 72 F.3d 326, 334 (3d Cir. 1995); **5th Circuit:** *Wiwa v. Royal Dutch Petroleum Co.*, 392 F.3d 812, 821 (5th Cir. 2004) (finding plaintiff's subpoena requesting all documents to which the defendant had "access" overly broad, and limiting the scope of documents requested pursuant to Fed. R. Civ. P. 34(a) to those over which the defendant had "control"); **6th Circuit:** *In re Bankers Trust Co.*, 61 F.3d 465, 469 (6th Cir. 1995) (explaining that a party has possession, custody, or control only when the party has the legal right to obtain the documents upon demand); *accord* *Flagg v. City of Detroit*, 252 F.R.D. 346, 353 (E.D. Mich. 2008) ("documents are deemed to be within the 'control' of a party if it 'has the legal right to obtain the documents on demand'"); *Pasley v. Caruso*, No. 10-cv-11805, 2013 WL 2149136, at *5 (E.D. Mich. May 16, 2013) (concluding that the Sixth Circuit had not adopted the "expansive notion of control" constituting the Practical Ability Test); **7th Circuit:** *Chaveriat v. Williams Pipe Line Co.*, 11 F.3d 1420, 1427 (7th Cir. 1993) (affirming party's failure to produce documents not in its possession and to which it had no legal right); *United States v. Approximately \$7,400 in U.S. Currency*, 274 F.R.D. 646, 647 (E.D. Wis. 2011) (holding that a party is obligated to produce records when it has a legal right to obtain those records even if it does not have actual possession); *DeGeer v. Gillis*, 755 F. Supp. 2d 909, 924 (N.D. Ill. 2010) (same, in Rule 45 context); **8th Circuit:** *Beyer v. Medico Ins. Grp.*, No. CIV. 08-5058, 2009 WL 736759, at *5 (D.S.D. Mar. 17, 2009) ("The rule that has developed is that if a party 'has the legal right to obtain the document,' then the document is within that party's 'control' and, thus, subject to production under Rule 34."); *United States v. Three Bank Accounts Described as: Bank Account # 9142908 at First Bank & Trust, Brookings, S. Dakota*, No. CIV. 05-4145-KES, 2008 WL 915199, at *7 (D.S.D. Apr. 2, 2008) ("To the extent the government's subpoena asks for documents from Mr. Dockstader which he does not have in his possession or custody, and as to which he has no legal right to obtain the document, Mr. Dockstader's objection is sustained."); *New All. & Grain Co. v. Anderson Commodities, Inc.*, No. 8:12CV197, 2013 WL 1869832, at *8 (D. Neb. May 2, 2013) (concluding that defendants had gone "above and be-

The Legal Right Plus Notification Standard similarly requires that a party preserve, collect, search, and produce Documents and ESI which it has a legal right to obtain, but also requires that the party must notify its adversary about potentially relevant Documents and ESI held by third parties.¹² The obligation to notify the adversary about evidence in the hands of third

yond their obligation under the Federal Rules of Civil Procedure” by requesting and obtaining documents that they did not have the “right or authority” to demand); **9th Circuit:** 7-UP Bottling Co. v. Archer Daniels Midland Co. (*In re Citric Acid Litig.*), 191 F.3d 1090 (9th Cir. 1999), *cert. denied sub nom.* Gangi Bros. Packing Co. v. Cargill, Inc., 529 U.S. 1037 (2000); **10th Circuit:** Am. Maplan Corp. v. Heilmayr, 203 F.R.D. 499, 502 (D. Kan. 2001) (rejecting the Practical Ability Test and explaining that “[a]s it is undisputed that defendant does not have actual possession of the VET documents, he can be required to produce only those documents that he has ‘legal right’ to obtain on demand”); *accord* Noaimi v. Zaid, 283 F.R.D. 639, 641 (D. Kan. 2012) (same); Kickapoo Tribe of Indians of Kickapoo Reservation in Kansas v. Nemaha Brown Watershed Joint District No. 7, 294 F.R.D. 610 (D. Kan. 2013) (holding that plaintiff had not met its burden of proving defendant had necessary control because it “ha[d] not shown that the District has the legal right to obtain the documents requested on demand from former District Board members, staff, or employees”); **11th Circuit:** Searock v. Stripling, 736 F.2d 650, 653 (11th Cir. 1984) (“Under Fed. R. Civ. P. 34, control is the test with regard to the production of documents. Control is defined not only as possession, but as the legal right to obtain the documents requested upon demand.”).

11. Note that some courts in the 11th Circuit have also applied the Practical Ability Standard. *See, e.g.,* Anz Advanced Techs. v. Bush Hog, LLC, No. CIV.A. 09-00228-KD-N, 2011 WL 814663, at *9 (S.D. Ala. Jan. 26, 2011), report and recommendation adopted *sub nom.* Anz Advanced Techs., LLC v. Bush Hog, LLC, No. CIV.A. 09-00228-KD-N, 2011 WL 814612 (S.D. Ala. Mar. 3, 2011) (“[C]ontrol’ has been ‘construed broadly by the courts’ to include not just a legal right, but also a ‘practical ability to obtain the materials’ on demand.”). In one public comment, it was noted that the decision in the 11th Circuit Case of *Searock v. Stripling*, 736 F.2d 650, 653 (11th Cir. 1984), that followed the Legal Right Standard, “has been ignored by some district courts in the Circuit.”

12. *See, e.g.,* Silvestri v. Gen. Motors Corp., 271 F.3d 583, 591 (4th Cir. 2001) (“If a party cannot fulfill this duty to preserve because he does not own

parties can be traced to products liability litigation, in which the defendant manufacturer would be unable to inspect the product, or otherwise assert defenses based on plaintiffs' "misuse, alteration or poor maintenance" of the product.¹³ The Legal

or control the evidence, he still has an obligation to give the opposing party notice of access to the evidence or of the possible destruction of the evidence if the party anticipates litigation involving that evidence.").

13. *Anderson v. Schwartz*, 179 Misc. 2d 1001, 1003, 687 N.Y.S.2d 232, 237 (Sup. Ct. 1999).

Right Plus Notification Standard has been followed by some federal courts in the First, Fourth, Sixth,¹⁴ and Tenth Circuits.¹⁵

14. Note that some courts in the 6th Circuit have applied both the Legal Right and Legal Right Plus Notification Standard, thus:

- [Legal Right]: *In re Bankers Trust Co.*, 61 F.3d 465, 469 (6th Cir. 1995) (holding that a party has possession, custody, or control only when the party has the legal right to obtain the documents upon demand); *Pasley v. Caruso*, No. 10-cv-11805, 2013 WL 2149136, at *5 (E.D. Mich. May 16, 2013) (holding that the Sixth Circuit had not adopted the “expansive notion of control” constituting the Practical Ability Test).
- [Legal Right Plus Notification]: *Lexington Ins. Co. v. Tubbs*, No. 06–2847–STA, 2009 WL 1586862, at *3 (W.D. Tenn. June 3, 2009) (holding “federal law of spoliation governs cases filed in federal court” and “[e]ven where a party does not own or control the evidence, the party still has a duty ‘to give the opposing party notice of access to the evidence or of the possible destruction of the evidence if the party anticipates litigation involving that evidence’” (citing *Silvestri v. Gen. Motors Corp.*, 271 F.3d 583, 591 (4th Cir. 1991) and sanctioning plaintiff for failure to preserve evidence)). *Cf. Adkins v. Wolever*, 692 F.3d 499, 505 (6th Cir. 2012) (reasoning that the “cases from around the country” plaintiff cites, including *Silvestri*, for the proposition that a spoliation sanction is proper “even though [defendant] was not personally responsible for the destruction of evidence . . . are not binding precedent requiring the district court to impose a spoliation sanction in this instance. [Courts] owe substantial deference to the professional judgment of prison administrators.” (citing *Beard v. Banks*, 548 U.S. 521, 522 (2006) and holding “[t]he ultimate determination of culpability is within the district court’s discretion so long as it is not a clearly erroneous interpretation of the facts”).

15. *See, e.g., 1st Circuit*: *Perez v. Hyundai Motor Co.*, 440 F. Supp. 2d 57, 61 (D.P.R. 2009) (citing *Silvestri*, 271 F.3d at 591, as the spoliation of evidence standard):

The duty to preserve material evidence arises not only during litigation but also extends to that period before the litigation when a party reasonably should know that the evidence may be relevant to anticipated litigation If a party cannot fulfill this duty to preserve because he does not own

The Practical Ability Standard requires a party to preserve, collect, search, and produce Documents and ESI *irrespective of that party's legal entitlement or actual physical possession of the documents* if a party has the "practical ability" (what that means is discussed in greater detail below) to obtain the Documents or ESI.¹⁶ The Practical Ability Standard is followed by

or control the evidence, he still has an obligation to give the opposing party notice of access to the evidence or of the possible destruction of the evidence if the party anticipates litigation involving that evidence.

4th Circuit: *Silvestri v. Gen. Motors Corp.*, 271 F.3d 583, 591 (4th Cir. 1991); **6th Circuit:** *Lexington Ins. Co. v. Tubbs*, No. 06-2847-STA, 2009 WL 1586862, at *3 (W.D. Tenn. June 3, 2009); *compare* *Adkins v. Wolever*, 692 F.3d 499, 505 (6th Cir. 2012); **10th Circuit:** *Chavez v. Hatterman*, No. CIV.06-cv-02525-WYD-MEH, 2009 WL 807440, at *2 (D. Colo. Jan. 20, 2009) (noting the *Silvestri* standard, but finding that plaintiff was not aware of relevancy of data at the time it should have been preserved).

16. *In re NTL, Inc. Securities Litigation*, 244 F.R.D. 179, 195 (S.D.N.Y. 2007), *aff'd sub nom.* *Gordon Partners v. Blumenthal*, No. 02 CIV 7377LAK, 2007 WL 1518632 (S.D.N.Y. May 17, 2007).

some federal courts in the Second, Fourth,¹⁷ Eighth,¹⁸ Tenth,¹⁹ Eleventh,²⁰ and District of Columbia Circuits.²¹

17. Note that courts in the 4th Circuit have applied both the Practical Ability Standard and Legal Right Plus Notification Standard:

- [Practical Ability]: *Digital Vending Services International, Inc. v. The University of Phoenix*, No. 2:09cv555, 2013 WL 311820, at *6 (E.D. Va. Oct. 3, 2013) (ability to control is defined as “when that party has the right, authority, or practical ability to obtain the documents from a non-party to the action”) (internal citation omitted); *Grayson v. Cathcart*, No. 2:07-00593-DCN, 2013 WL 1401617, at *3 (D.S.C. Apr. 8, 2013) (“Control does not require legal ownership or actual physical possession of documents at issue; rather ‘documents are considered to be under a party’s control when that party has the right, authority, or practical ability to obtain the documents from a non-party to the action.’”); *Ayers v. Sheetz, Inc.*, No.: 3:11-cv-00434, 2012 WL 5331555, at *1 (S.D.W. Va. Oct. 26, 2012) (“Control may be inferred, even when a party does not have possession or ownership of the evidence, ‘when that party has the right, authority, or practical ability to obtain [the evidence] from a non-party to the action.’”).
- [Legal Right Plus Notification]: *King v. American Power Conversion Corp.*, 181 F. App’x 373, 377–87 (4th Cir. May 17, 2006) (“Accordingly, the Kings failed to discharge their duty to afford American Power sufficient notice. ‘If a party cannot fulfill this duty to preserve [evidence] . . . , he still has an obligation to give the opposing party notice of access to the evidence or of the possible destruction of the evidence if the party anticipates litigation involving that evidence.’”) (quoting *Silvestri v. Gen. Motors Corp.*, 271 F.3d 583, 591 (4th Cir. 2001)); *Ayers v. Sheetz, Inc.*, No. 3:11-CV-00434, 2012 WL 5183561, at *2 (S.D.W. Va. Oct. 18, 2012), *aff’d*, No. 3:11-CV-00434, 2012 WL 5331555 (S.D.W. Va. Oct. 26, 2012) (“This duty [to preserve] requires the party to ‘identify, locate, and maintain information that is relevant to specific, predictable, and identifiable litigation’ and to ‘notify the opposing party of evidence in the hands of third parties.’”) (internal citation omitted).

18. Note that courts in the 8th Circuit have applied both the Practical Ability Standard and the Legal Right Standard:

- [Practical Ability]: *Prokosch v. Catalina Lighting, Inc.*, 193 F.R.D. 633, 636 (D. Minn. 2000) (“Therefore, under Rule 34, control does not

require that the party have legal ownership or actual physical possession of the documents at issue; rather, documents are considered to be under a party's control when that party has the right, authority, or practical ability, to obtain the documents from a non-party to the action.") (citation and quotations omitted); *Handi-Craft v. Action Trading, S.A.*, No. 4:02 CV 1731 LMB, 2003 WL 26098543, at *6 (E.D. Mo. Nov. 25, 2003) ("Thus, the appropriate test is not of legal entitlement, but of control or practical ability to obtain the documents.").

- [Legal Right]: *Beyer v. Medico Ins. Group*, No. CIV. 08-5058, 2009 WL 736759, at *5 (D.S.D. Mar. 17, 2009) ("The rule that has developed is that if a party 'has the legal right to obtain the document' then the document is within that party's 'control' and, thus, subject to production under Rule 34.") (internal citation omitted); *United States v. Three Bank Accounts Described as: Bank Account # 9142908 at First Bank & Trust, Brookings, S. Dakota*, No. CIV. 05-4145-KES, 2008 WL 915199, at *7 (D.S.D. Apr. 2, 2008) ("To the extent the government's subpoena asks for documents from Mr. Dockstader which he does not have in his possession or custody, and as to which he has no legal right to obtain the document, Mr. Dockstader's objection is sustained."); *New All. & Grain Co. v. Anderson Commodities, Inc.*, No. 8:12CV197, 2013 WL 1869832, at *5 (D. Neb. May 2, 2013) (concluding that defendants had gone "above and beyond their obligation under the Federal Rules of Civil Procedure" by requesting and obtaining documents that they did not have the "right or authority" to demand).

19. Note that courts in the 10th Circuit have applied both the Practical Ability Standard, Legal Right Standard, and Legal Right Plus Notification Standard, thus:

- [Practical Ability]: *Tomlinson v. El Paso Corp.*, 245 F.R.D. 474, 476 (D. Colo. 2007) ("Control 'comprehends not only possession, but also the right, authority, or ability to obtain the documents.'"); *Ice Corp. v. Hamilton Sundstrand Corp.*, 245 F.R.D. 513, 517 (D. Kan. 2007) ("Production of documents not in a party's possession is required if a party has the *practical ability* to obtain the documents from another, irrespective of legal entitlements to the documents.") (internal quotation omitted).
- [Legal Right]: *Am. Maplan Corp. v. Heilmayr*, 203 F.R.D. 499, 501-02 (D. Kan. 2001) (rejecting the Practical Ability Test and explaining

that, “[a]s it is undisputed that defendant does not have actual possession of the VET documents, he can be required to produce only those documents that he has ‘legal right’ to obtain on demand”); *accord* *Noaimi v. Zaid*, 283 F.R.D. 639, 641 (D. Kan. 2012) (criticizing *Ice Corporation v. Hamilton Sundstrand Corp.*, 245 F.R.D. 513 (D. Kan. 2007) and reaching the same conclusion); *Kickapoo Tribe of Indians of Kickapoo Reservation in Kansas v. Nemaha Brown Watershed Joint Dist. No. 7*, 294 F.R.D. 610, 614 (D. Kan. 2013) (holding that plaintiff had not met its burden of proving defendant had necessary control because it “ha[d] not shown that the District has the legal right to obtain the documents requested on demand from former District Board members, staff, or employees”).

- [Legal Right Plus Notification]: *Chavez v. Hatterman*, No. 06-cv-02525-WYD-MEH, 2009 WL 807440, at *2 (Jan. 20, 2009) (noting the *Silvestri* standard, but finding that plaintiff was not aware of relevancy of data at the time it should have been preserved).

20. *Anz Advanced Techs. v. Bush Hog, LLC*, No. CIV.A. 09-00228-KD-N, 2011 WL 814663, at *9 (S.D. Ala. Jan. 26, 2011) (“‘[C]ontrol’ has been ‘construed broadly by the courts’ to include not just a legal right, but also a ‘practical ability to obtain the materials’ on demand.”).

21. *See, e.g., 2nd Circuit: Shcherbakovskiy v. Da Capo Al Fine, Ltd.*, 490 F.3d 130, 138 (2d Cir. 2007) (“If a party has access and the practical ability to possess documents not available to the party seeking them, production may be required.”); *GenOn Mid-Atl v. Stone & Webster*, 282 F.R.D. 346, 354 (S.D.N.Y. 2012), *aff’d sub nom. GenOn Mid-Atl., LLC v. Stone & Webster, Inc.*, No. 11 CV 1299 HB, 2012 WL 1849101 (S.D.N.Y. May 21, 2012); **4th Circuit: Digital Vending Services International, Inc. v. The University of Phoenix, No. 2:09cv555, 2013 WL 311820 at *6 (E.D. Va. Oct. 3, 2013); *Grayson v. Cathcart*, No. 2:07-00593-DCN, 2013 WL 1401617 at *3 (D.S.C. Apr. 8, 2013); *Ayers v. Sheetz, Inc.*, No. 3:11-CV-00434, 2012 WL 5183561, at *2 (S.D.W. Va. Oct. 18, 2012); **8th Circuit: Prokosch v. Catalina Lighting, Inc., 193 F.R.D. 633, 636 (D. Minn. 2000):****

Therefore, under Rule 34, control does not require that the party have legal ownership or actual physical possession of the documents at issue; rather, documents are considered to be under a party’s control when that party has the right, authority, or practical ability, to obtain the documents from a non-party to the action.

2. Variances in Application of the Three Standards

The different rules and corresponding circuit splits are set forth in the charts below, which also reflect that federal courts in some circuits have applied more than one standard.

CATEGORY	CIRCUIT											
	1	2	3	4	5	6	7	8	9	10	11	D.C.
Legal Right			X		X	X	X	X	X	X	X	
Legal Right Plus Notification	X			X		X				X		
Practical Ability		X		X				X		X	X	X

(citation and quotations omitted); *Handi-Craft v. Action Trading, S.A.*, No. 4:02 CV 1731 LMB, 2003 WL 26098543, at *6 (E.D. Mo. Nov. 25, 2003) (“Thus, the appropriate test is not of legal entitlement, but of control or practical ability to obtain the documents.”); **10th Circuit:** *Tomlinson v. El Paso Corp.*, 245 F.R.D. 474, 475 (D. Colo. 2007) (“Therefore, Rule 34(a) enables a party seeking discovery to require production of documents beyond the actual possession of the opposing party if such party has retained any right or ability to influence the person in whose possession the documents lie.”); **11th Circuit:** *Anz Advanced Techs. v. Bush Hog, LLC*, No. CIV.A. 09-00228-KD-N, 2011 WL 814663, at *9 (S.D. Ala. Jan. 26, 2011); *cf. also Searock v. Stripling*, 736 F.2d 650, 654 (11th Cir. 1984) (despite espousing the Legal Right Standard, stating “[w]e do not, however, completely rest our holding on this factor of ‘control.’ We find instead that the primary dispositive issue is whether [the defendant] made a good faith effort to obtain the documents over which he may have indicated he had ‘control’ in whatever sense, and whether after making such a good faith effort he was unable to obtain and thus produce them.”); **District of Columbia Circuit:** *Bush v. Ruth’s Chris Steak House, Inc.*, 286 F.R.D. 1, 5 (D.D.C. 2012) (“Control does not require that the party have legal ownership or actual physical possession of the documents at issue, but rather ‘the right, authority or practical ability to obtain the documents from a non-party to the action.’”).

To further complicate matters, even within these general categories there are differences in the ways in which federal courts within the circuits define and apply the standards:²²

LEGAL RIGHT STANDARD	
CIRCUIT	STANDARD
3 rd Circuit	“within the party’s control” ²³
5 th Circuit	“the legal right to obtain the documents upon demand” ²⁴

22. See *Victor Stanley, Inc. v. Creative Pipe, Inc.*, 269 F.R.D. 497, 540 (D. Md. 2010).

23. *Gerling Int’l Ins. Co. v. C.I.R.*, 839 F.2d 131, 140 (3d Cir. 1988) (The Third Circuit defines “control” as the “legal right to obtain documents on demand.”) (internal quotation omitted); *Sanofi-Aventis v. Sandoz, Inc.*, 272 F.R.D. 391, 395 (D.N.J. 2011) (“The control test articulated by the Third Circuit in *Gerling International* ‘focuses on the relationship between the two parties.’”); *Power Integrations, Inc. v. Fairchild Semiconductor Int’l Inc.*, 233 F.R.D. 143, 146 (D. Del. 2005) (“Control is defined as the legal right to obtain the documents required on demand.”). *But see* *Barton v. RCI, LLC*, No. CIV.A. 10-3657 PGS, 2013 WL 1338235, at *6 (D.N.J. Apr. 1, 2013) (noting “[i]f the producing party has the legal right or practical ability to obtain the documents, then it is deemed to have ‘control’ . . . even if the documents are actually in the possession of a non-party”) (internal citation omitted).

24. *Enron Corp. Savings Plan v. Hewitt Associates, LLC*, 258 F.R.D. 149, 164 (S.D. Tex. 2009) (“Under Rule 34 documents are deemed within the possession, custody, or control of a party and subject to a request for production if the party has actual possession, custody, or control or has the legal right to obtain the documents on demand.”). *But see* *Piazza’s Seafood World, L.L.C. v. Odom*, No. CIV.A. 07-413-BAJ-CN, 2011 WL 3664437, at *3 n.6 (M.D. La. Aug. 19, 2011), *adhered to on reconsideration*, No. CIV.A. 07-413-BAJ-CN, 2011 WL 4565436 (M.D. La. Sept. 29, 2011) (“Federal courts have consistently held that documents are deemed to be within the ‘possession, custody, or control’ of a party for purposes of Rule 34 if the party has ‘actual possession, custody, or control, or has the legal right to obtain the documents on demand or has the practical ability to obtain the documents from a non-party to the

LEGAL RIGHT STANDARD	
CIRCUIT	STANDARD
6 th Circuit	“the legal right to obtain the documents upon demand” ²⁵
7 th Circuit	“control or custody of a document or thing” ²⁶
8 th Circuit	“if a party ‘has the legal right to obtain the document,’ then the document is within that party’s ‘control’ and, thus, subject to production under Rule 34” ²⁷

action.”). *See also* Wood Group Pressure Control, L.P. v. B&B Oilfield Services, Inc., Civ. No. 06-3002 SECTION: “N” (4), 2007 U.S. Dist. LEXIS 83708 at *43–44 n.15 (E.D. La. 2007) (“Courts have extended the affirmative duty to preserve evidence to instances when that evidence is not directly within the party’s custody or control so long as the party has access to or indirect control over such evidence.”).

25. *In re Bankers Trust Co.*, 61 F.3d 465, 469 (6th Cir. 1995) (holding that a party has possession, custody, or control only when the party has the legal right to obtain the documents upon demand); *Pasley v. Caruso*, No. 10-cv-11805, 2013 WL 2149136, at *5 (E.D. Mich. May 26, 2013) (holding that the Sixth Circuit had not adopted the “expansive notion of control” constituting the Practical Ability Test).

26. *Chaveriat v. Williams Pipe Line Co.*, 11 F.3d 1420, 1427 (7th Cir. 1993) (affirming party’s failure to produce documents not in its possession and to which it had no legal right); *United States v. Approximately \$7,400 in U.S. Currency*, 274 F.R.D. 646, 647 (E.D. Wis. 2011) (holding that a party is obligated to produce records when it has a legal right to obtain those records even if it does not have actual possession); *DeGeer v. Gillis*, 755 F. Supp. 2d 909, 924 (N.D. Ill. 2010) (same, in Rule 45 context); *McBryar v. Int’l Union of United Auto. Aerospace & Agr. Implement Workers of Am.*, 160 F.R.D. 691, 694 (S.D. Ind. 1993).

27. *See Beyer v. Medico Ins. Group*, No. CIV. 08-5058, 2009 WL 736759, at *5 (D.S.D. Mar. 17, 2009).

LEGAL RIGHT STANDARD	
CIRCUIT	STANDARD
9 th Circuit	“the legal right to obtain the documents upon demand” ²⁸
10 th Circuit	“legal right to obtain the documents on demand” ²⁹
11 th Circuit	“Under Fed. R. Civ. P. 34 . . . Control is defined not only as possession, but as the legal right to obtain the documents requested upon demand.” ³⁰

LEGAL RIGHT PLUS NOTIFICATION STANDARD	
CIRCUIT	STANDARD
1 st Circuit	“owns and controls” and duty to notify opposing party of evidence in the hands of third parties ³¹

28. *Dugan v. Lloyds TSB Bank, PLC*, No. 12CV02549WHANJV, 2013 WL 4758055, at *2 (N.D. Cal. Sept. 4, 2013) (“In the Ninth Circuit, ‘control’ is defined as ‘the legal right to obtain documents upon demand.’”); *Ubiquiti Networks, Inc. v. Kozumi USA Corp.*, No.12-cv-2582 CW JSC, 2013 WL 1767960, at *1 (N.D. Cal. Apr. 15, 2013) (same).

29. *Noaimi v. Zaid*, 283 F.R.D. 639, 641 (D. Kan. 2012).

30. *Searock v. Stripling*, 736 F.2d 650, 654 (11th Cir. 1984).

31. *In re New Eng. Compounding Pharm., Inc.*, No. 13-cv-2419, 2013 U.S. Dist. LEXIS 161652 (D. Mass. Nov. 13, 2013) (Respondent recipients of Rule 45 subpoenas were required to produce responsive documents in their “possession custody or control,” and “[t]o the extent that a respondent does not have responsive documents within its possession, custody, or control, it may simply state so.”); *Correia v. Town of Framingham*, No. CIV. 12-10828-NMG, 2013 WL 952332, at *3 (D. Mass. Mar. 8, 2013) (defendant police officer was found to have “control” under Rule 34 over his employment personnel file in the possession of the state, because pursuant to state law he could obtain his personnel file upon demand, whereas information maintained in

LEGAL RIGHT PLUS NOTIFICATION STANDARD	
CIRCUIT	STANDARD
4 th Circuit	“owns and controls’ and duty to notify opposing party of evidence in the hands of third parties” ³²
6 th Circuit	“Even where a party does not own or control the evidence, the party still has a duty ‘to give the opposing party notice of access to the evidence or of the possible destruction of the evidence if the party anticipates litigation involving that evidence.’” ³³

“other sorts of employee files . . . that are maintained separately from a ‘personnel file’” were not under the officer’s control); *Bringuier v. AVCO Corp.*, No. CIV. 09-2140 ADC, 2011 WL 6372456, at *1 (D.P.R. Dec. 20, 2011) (defendant investment corporation did not have “right, authority, or ability to obtain [plane wreckage] upon demand” where it denied having possession, custody, or control over the wreckage and disclosed in correspondence with plaintiffs’ counsel that the wreckage was in the possession, custody, and control of a claims supervisor under an insurance policy held by the owner of the aircraft—defendant was also insured by the same insurance carrier but under a different policy—and plaintiffs failed to rebut the assertion that defendant had no control); *Rosie D. v. Romney*, 256 F. Supp. 2d 115, 119 (D. Mass. 2003) (explaining that “control” under Rule 34 exists where a party has a “legal right to obtain documents,” and “control” may be established by the existence of a principal–agent relationship or a legal right pursuant to a contractual provision and finding that defendant had the right to control and obtain the documents that were in the possession of various third party subcontractors because undisputed language in contracts with similar subcontractors allowed the defendant to examine and copy the same kind of documents at issue; and rejecting defendants’ argument that plaintiffs should subpoena the third parties for the documents they seek).

32. *Ayers v. Sheetz, Inc.*, No. 3:11-CV-00434, 2012 WL 5183561, at *2 (S.D.W. Va. Oct. 18, 2012).

33. *Lexington Ins. Co. v. Tubbs*, No. 06–2847–STA, 2009 WL 1586862, at *3 (W.D. Tenn. June 3, 2009).

LEGAL RIGHT PLUS NOTIFICATION STANDARD	
CIRCUIT	STANDARD
10 th Circuit	possession, but if relinquished ownership or custody, must contact new custodian to preserve ³⁴

PRACTICAL ABILITY STANDARD	
CIRCUIT	STANDARD
2 nd Circuit	“right, authority or practical ability to obtain the documents at issue” ³⁵
4 th Circuit	“right, authority or practical ability to obtain documents from non-party to the action” ³⁶
8 th Circuit	“right, authority or practical ability to obtain documents from non-party to the action” ³⁷

34. *Chavez v. Hatterman*, No. CIV.A06-cv-02525-WYD-MEH, 2009 WL 807440, at *2 (D. Colo. Jan. 20, 2009).

35. *Alexander Interactive, Inc. v. Adorama, Inc.*, No. 12 CIV. 6608 PKC JCF, 2014 WL 61472, at *1 (S.D.N.Y. Jan. 6, 2014).

36. *Digital Vending Services International, Inc. v. The University of Phoenix*, No. 2:09cv555, 2013 WL 311820, at *6 (E.D. Va. Oct. 3, 2013).

37. *New All. & Grain Co. v. Anderson Commodities, Inc.*, No. 8:12CV197, 2013 WL 1869832, at *3 (D. Neb. May 2, 2013) (“A party does not need to have legal ownership or actual possession of documents, ‘rather documents are considered to be under a party’s control when that party has the right, authority, or practical ability to obtain the documents from a non-party to the action.’”); *E*Trade Securities LLC v. Deutsche Bank AG*, Civil No. 02-3711 RHK/AJB, 2005 U.S. Dist. LEXIS 3038, at *8 n.2 (D. Minn. Jan. 31, 2005) (“[C]ourts have sometimes interpreted Rule 34 to require production if the party has practical ability to obtain the documents from another, irrespective of his legal entitlement to the documents.”); *Prokosch v. Catalina Lighting, Inc.*, 193 F.R.D. 633, 636 (D. Minn. 2000) (quoting *Bank of New York v. Meridien BIAO Bank Tanzania, Ltd.*, 171 F.R.D. 135, 146 (S.D.N.Y. 1997)).

PRACTICAL ABILITY STANDARD	
CIRCUIT	STANDARD
10 th Circuit	“any right or ability to influence the person in whose possession the documents lie” ³⁸
11 th Circuit	“practical ability to obtain the materials on demand” ³⁹
D.C. Circuit	“the right, authority or practical ability to obtain the documents from a non-party to the action” ⁴⁰

The varying standards and the often inconsistent definition and application of these standards have left parties and courts with conflicting guidance to consider when making defensible discovery decisions.

C. A Deeper Look at the Practical Ability Standard Demonstrates that it Produces Potentially Unfair Results

Most courts applying the Practical Ability Standard rely on the following assumption: Rule 34 “control” does not require a party to have *legal ownership* or *actual physical possession* of any

38. Tomlinson v. El Paso Corp., 245 F.R.D. 474, 477 (D. Colo. 2007); Ice Corp. v. Hamilton Sundstrand Corp., 245 F.R.D. 513, 521 (D. Kan. 2007).

39. ANZ Advanced Techs. v. Bush Hog, LLC, No. CIV.A. 09-00228-KD-N, 2011 WL 814663, at *9 (S.D. Ala. Jan. 26, 2011) (“[C]ontrol’ has been ‘construed broadly by the courts’ to include not just a legal right, but also a ‘practical ability to obtain the materials’ on demand.”).

40. Bush v. Ruth’s Chris Steak House, Inc., 286 F.R.D. 1, 5 (D.D.C. 2012) (“Control does not require that the party have legal ownership or actual physical possession of the documents at issue, but rather ‘the right, authority or practical ability to obtain the documents from a non-party to the action.’”).

Documents and ESI at issue.⁴¹ Instead, “documents are considered to be under a party’s control when that party has the right, authority, or *practical ability* to obtain the documents from a non-party to the action.”⁴² Some courts have expanded the meaning of “practical ability” to mean the possibility that a party could potentially obtain the documents on demand.⁴³ In contrast, under the Legal Right Standard, the *possibility* of obtaining the Documents and ESI without the concomitant *legal right* to do so would be insufficient to establish Rule 34 “control.”⁴⁴ Highlighted below are select areas where application of the Practical Ability Standard has led to unfair results.⁴⁵ We also note that the

41. See, e.g., *Golden Trade, S.r.L. v. Lee Apparel Co.*, 143 F.R.D. 514, 525 (S.D.N.Y. 1992) (The courts have “interpreted Rule 34 to require production if the party has the practical ability to obtain the documents from another, irrespective of his legal entitlement to the documents.”).

42. *Goodman v. Praxair Servs.*, 632 F. Supp. 2d 494, 515 (D. Md. 2009) (quoting *In re NTL, Inc. Secs. Litig.*, 244 F.R.D. 179, 195 (S.D.N.Y. 2007)).

43. See *Steele Software Sys. Corp. v. DataQuick Info. Sys. Inc.*, 237 F.R.D. 561 (D. Md. 2006) (“control has been construed broadly by the courts as the legal right, authority, or practical ability to obtain the materials sought on demand”) (internal quotation omitted); *S.E.C. v. Credit Bancorp, Ltd.*, 194 F.R.D. 469, 471 (S.D.N.Y. 2000) (“control” construed to include the “practical ability to obtain the materials sought upon demand”).

44. See *Chaveriat v. Williams Pipe Line Co.*, 11 F.3d 1420, 1427 (7th Cir. 1993) (noting that even though a third party in possession of the documents likely would have provided the documents to plaintiffs upon plaintiffs’ request, as this third party did at a later date, and that plaintiffs could have purchased the documents, such factors did not establish control; and explaining that “the fact that a party could obtain a document if it tried hard enough and maybe if it didn’t try hard at all does not mean that the document is in its possession, custody, or control; in fact it means the opposite”).

45. Our research has revealed 206 cases that have either applied or referenced the Rule 34 “practical ability” test. To download an easy-to-use, sortable spreadsheet of these cases, see The Sedona Conference, “*Compendium of Practical Ability Cases: A Resource for Understanding the Sedona Conference Commentary on Rule 34 and 45 Possession, Custody, or Control*,” THE SEDONA

lack of a precise, commonly-accepted definition of “practical ability” results in an unfair lack of predictability with respect to how the Practical Ability Standard will be applied in a given case.

1. The Practical Ability Standard may Compromise the Ability of Parties with Cross-Border Operations to Comply with Their Legal Obligations, and Gives Short Shrift to Corporate Formalities of Legally Distinct Entities

Courts have applied the Practical Ability Standard to require parties with cross-border obligations to produce Documents and ESI from related entities with foreign operations, even when such production causes the entity to violate foreign data privacy laws. For example, one court ordered a domestic parent corporation to produce those documents it could obtain from its foreign subsidiary by ‘picking up the telephone’ or, in the alternative, to file an affidavit attesting to why it could not access those documents.⁴⁶ In this regard, the inequity of the

CONFERENCE (July 2016), <https://s3.amazonaws.com/IGG/publications/Sedona+Practical+Ability+Cases+080516.xlsx>.

46. *S2 Automation LLC v. Micron Tech., Inc.*, No. CIV 11-0884 JB/WDS, 2012 WL 3656454, at *12 (D.N.M. Aug. 9, 2012) (“It may be that S2 Automation does not have the legal or practical right to obtain documents from S2 Israel. If that is the case, it must file an affidavit from a corporate official to that effect.”). *See also In re Ski Train Fire of Nov. 11, 2000 Kaprun Austria*, No. MDL 1428(SAS)THK, 2006 WL 1328259, at *78 (S.D.N.Y. May 16, 2006) (applying Practical Ability Standard to hold parent company based in Germany must produce documents from wholly owned, non-party subsidiary company based in Austria: “Although the evidence demonstrates that Siemens [Germany] cannot legally compel Siemens Austria to produce its documents, there is evidence which strongly suggests that, as a practical matter, Siemens [Germany] can secure documents from Siemens Austria. . . . [Thus] the Court concludes that the only reasonable conclusion to draw is that if Siemens [Germany] needed the assistance or cooperation of Siemens

Practical Ability Standard is perhaps felt most acutely by organizations that are subject to international privacy laws that operate to legally preclude discovery and/or movement of private

Austria in a matter of concern to the company, it would receive such assistance, be it in the form of providing documents in Siemen's Austria's custody, or otherwise."); *Orthoarm, Inc. v. Forestadent USA, Inc.*, No. 4:06-CV-730, 2007 WL 1796214, at *2 (E.D. Mo., June 19, 2007) (applying Practical Ability Standard, U.S. subsidiary ordered to produce documents from German parent because both companies had "interlocking management structures," and subsidiary had produced other parent documents without claiming no control, "thereby demonstrating the ability to obtain documents from the parent company upon request"). *But see*, *Pitney Bowes, Inc. v. Kern Int'l, Inc.*, 239 F.R.D. 62 (D. Conn. 2006) (applying Practical Ability Standard but finding no control where plaintiff failed to offer evidence that the documents in the possession of defendant's foreign parent were necessary for the defendant's business or were routinely provided to it in the course of business and denying motion to compel).

data across the border and into the United States.⁴⁷ The consequences for violating international laws can be severe.⁴⁸ Even so,

47. See, e.g., *In re Flag Telecom Holdings, Ltd. Sec. Litig.*, 236 F.R.D. 177, 181 (S.D.N.Y. 2006) (applying Practical Ability Standard to hold individual defendant was obligated to obtain documents from his former employer because he “is a senior executive of [his former employer], a former party [that is ‘one of India’s largest private sector enterprises’ that had been dismissed with prejudice] to the litigation, and certainly has the practical ability to obtain the documents sought by plaintiffs’ Request,” and rejecting defendants’ argument that plaintiffs themselves should seek production from the non-party former employer located in India via the procedures set forth in the Hague Convention: “McCormack is a party who has control over the corporation’s documents irrespective of their location . . . therefore . . . plaintiffs are not required to proceed under the Hague Convention”); *Ssangyong Corp. v. Vida Shoes Int’l, Inc.*, No. 03 CIV.5014 KMW DFE, 2004 WL 1125659, at *12–13 (S.D.N.Y. May 20, 2004) (applying Practical Ability Standard and ordering production of documents where New York branch of Hong Kong bank resisted subpoena of documents located in Hong Kong headquarters, court finds control and, as part of a comity analysis, observes that Hong Kong’s interest in bank secrecy was not strong (the court characterized arguments that the bank faced the possibility of a Hong Kong injunction, a Hong Kong judgment for civil liability to accountholders, and potential criminal sanctions if it violated the injunction, as “quite remote on the facts of this case”), that “a strict confidentiality” order would reduce any hardship on the bank and its accountholders, that the documents sought via the subpoena were “very important” to the litigation, and that plaintiff who served subpoena had made a strong *prima facie* showing of bad faith by the accountholders (who may have participated in the fraud at issue in the underlying case)). *But see Tiffany (NJ) LLC v. Qi Andrew*, 276 F.R.D. 143, 151 (S.D.N.Y. 2011), *aff’d sub nom. Tiffany (NJ) LLC v. Andrew*, No. 10 CIV. 9471 WHP, 2011 WL 11562419 (S.D.N.Y. Nov. 14, 2011) (finding control where subpoenas were issued to New York branches of Chinese banks, despite the fact that branches were on separate computer systems from the Chinese offices that held the documents, but refusing to compel production pending exhaustion of Hague Convention based upon a comity analysis due to “true conflict” between United States and Chinese law (which prohibited production)); *Tiffany (NJ) LLC v. Andrew*, No. 10 CIV. 9471 RA HBP, 2012 WL 5451259, at *2 (S.D.N.Y. Nov. 7, 2012) (Following production of certain information from Chinese

banks under the Hague Convention, the court subsequently declined to enforce the subpoena asking for production of additional information, noting “the centerpiece of plaintiffs’ futility argument last year was . . . the People’s Republic of China would either not respond at all to a request pursuant to the Hague Convention or would take an inordinate amount of time to do so. Experience has now proven both arguments to be unfounded.”). *Accord In re Warrant to Search a Certain E-Mail Account Controlled & Maintained by Microsoft Corp.*, 15 F. Supp. 3d. 466, 472 (S.D.N.Y. 2014) (denying motion to quash search warrant directed to Microsoft to produce the contents of one of its customer’s emails where that information is stored on a server located in Dublin, Ireland, reasoning that the Stored Communications Act, passed as part of the Electronic Communications Privacy Act of 1986, 18 U.S.C. § 2701–2712, does not implicate principles of extraterritoriality, and “it has long been the law that a subpoena requires the recipient to produce information in its possession, custody, or control regardless of the location of that information,” (citing *Tiffany (NJ) LLC v. Qi Andrew*, 276 F.R.D. 143, 147–48 (S.D.N.Y. 2011) (“If the party subpoenaed has the practical ability to obtain the documents, the actual physical location of the documents—even if overseas—is immaterial”))), *rev’d*, ___ F.3d. ___, No. 14-2985 (2nd Cir. July 14, 2016) (holding the Stored Communications Act “neither explicitly nor implicitly [] envisions the application of its Warrant provisions overseas,” without reaching the issues of Rule 34 control, and rejecting the government’s arguments to treat the SCA Warrant as equivalent to a subpoena and that “similar to a subpoena, [an SCA warrant] require[es] the recipient to deliver records, physical objects, and other materials to the government’ no matter where those documents are located, so long as they are subject to the recipient’s custody or control,” that relied upon “a collection of court rulings construing properly served subpoenas as imposing that broad obligation to produce without regard to a document’s location”).

48. See The Sedona Conference, *Framework for Analysis of Cross-Border Discovery Conflicts: A Practical Guide to Navigating the Competing Currents of International Data Privacy and e-Discovery*, THE SEDONA CONFERENCE, at 20–22 (Aug. 2008), <https://thesedonaconference.org/publications> (describing criminal conviction for violation of French statute prohibiting disclosure of information required in foreign judicial proceedings).

the relatively broad discovery permitted by U.S. federal courts is in tension with international restrictions on data movement.⁴⁹

Similarly, courts applying the Practical Ability Standard have given short shrift to corporate structures that apply to legally distinct entities.⁵⁰

49. *Id.* at 23–26 (noting U.S. courts have held that they were not bound to use Hague Convention procedures over the Federal Rules of Civil Procedure).

50. *See, e.g., In re Ski Train Fire of Nov. 11, 2000 Kaprun Austria*, No. MDL 1428(SAS)THK, 2006 WL 1328259, at *1, 6 (S.D.N.Y. May 16, 2006) (After court dismissed Siemens Austria as a party to the case “because it has insufficient jurisdictional contacts with this District,” court applied the Practical Ability Standard and held Siemens Germany—the parent company of Siemens Austria—must produce documents in the possession of Siemens Austria—even though the court did not have jurisdiction over Siemens Austria—because “the test for determining whether a corporate entity is the alter ego or a ‘mere department’ of another, are distinct from the issue of whether a parent has legal or practical access to its subsidiary’s documents,” and rejected defendant’s argument that Siemens Germany and Siemens Austria are “distinct entities and that Siemens [Germany] does not have legal control over Siemens Austria,” despite the court’s prior findings when dismissing Siemens Austria “that the two companies do not operate as a single entity and that they observe all of the legal formalities of a distinct company.”); *Dietrich v. Bauer*, No. 95 CIV. 7051 (RWS), 2000 WL 1171132, at *3 (S.D.N.Y. Aug. 16, 2000), *on reconsideration in part*, 198 F.R.D. 397 (S.D.N.Y. 2001) (Court finds Hague Convention procedures not required and New York branch of U.S. division was required to produce documents pursuant to Rule 45 subpoena in the possession of a branch of U.K. division, because parent company incorporated in Ireland exercised sufficient control over its wholly owned subsidiary, reasoning: “[c]ontrol has been construed broadly by the courts as the legal right, authority, or practical ability to obtain the materials sought upon demand. This Principle applies where discovery is sought from one corporation regarding materials which are in the physical possession of another, affiliated corporation.” (internal quotation omitted); The court also rejected the argument that the “[c]ourt does not have personal jurisdiction over the corporate entity which has actual possession of the documents sought, namely, AIB Group (UK) . . . [because] personal jurisdiction and ‘control’ of documents are distinct issues in that court can compel discovery

However, courts in Legal Right Standard jurisdictions have given greater deference to international considerations, as well as corporate formalities that apply to legally distinct entities, especially when considering affiliate/"control" issues.⁵¹ Toward this end, courts in Legal Right Standard jurisdictions have rejected the Practical Ability Standard, denying a motion to compel a U.S. corporation to produce documents in the possession of its German parent, explaining that ordering discovery from an entity beyond its jurisdiction would be "a futile gesture."⁵² In rejecting the plaintiff's request to apply the Practical

of documents in 'control' of a party although in 'possession' of person over whom there is no personal jurisdiction.").

51. For example, in *United States v. Deloitte & Touche USA LLP*, 623 F. Supp. 2d 39, 41 (D.D.C. 2009), *aff'd* in part and vacated in part on other grounds, remanded sub nom. *United States v. Deloitte LLP*, 610 F.3d 129 (D.C. Cir. 2010), a civil tax refund case, the government moved to compel production of documents in response to a subpoena aimed at the opposing party's (Chemtech) auditing firm (Deloitte), even though the documents were in the possession of the firm's so-called affiliate in Switzerland. The court rejected the government's argument that the auditing firm had sufficient control over its Swiss affiliate and denied the government's motion to compel. Though both Deloitte USA and Deloitte Switzerland were members of a Swiss *verein*, the government failed to establish that Deloitte U.S.A. had "the legal right, authority or ability to obtain the documents on demand" from Deloitte Switzerland/the affiliate. The court also rejected the government's argument to use the Practical Ability Standard and order production based upon the "close working relationship" in connection with Deloitte Switzerland's audit work for Chemtech, reasoning:

[c]lose cooperation on a specific project does not, per se, establish an ability, let alone a legal right or authority, on Deloitte USA's part to acquire documents maintained solely by a legally distinct entity. In fact, upon Deloitte USA's request for the documents, Deloitte Switzerland refused to produce them absent an order from a Swiss court.

Id. (citations omitted).

52. *Ehrlich v. BMW of N. Am., LLC*, No. CV 10-1151-ABC PJWX, 2011 WL 3489105, at *1 (C.D. Cal. May 2, 2011).

Ability Standard, that court also reasoned: “[c]ontrol must be firmly placed in reality, not in an esoteric concept such as ‘inherent relationship.’”⁵³

Likewise, one court in a Legal Right Standard jurisdiction specifically rejected a requesting party’s suggestion to “go beyond ‘corporate formalities’” via the application of the Practical Ability Standard to order a U.S. subsidiary to produce documents in the possession of its parent company, a Korean corporation with a principal place of business in Seoul, reasoning:

the separate and distinct corporate identities of a parent and its subsidiary are not readily disregarded, except in rare circumstances justifying the application of the alter ego doctrine to pierce the corporate veil of the subsidiary.⁵⁴

2. The Practical Ability Standard may Compel an Entity to Produce Documents and ESI in Violation of an Existing Contract

Courts in Practical Ability jurisdictions have ordered parties to produce documents even though that production would require the party to breach an existing contract with a non-party to the case that expressly prohibits the use of the non-party’s documents for unauthorized purposes or disclosure. In

53. *Id.* (citing *U.S. v. Int’l Union of Petroleum and Indus. Workers, FFL-CIO*, 870 F.2d 1450, 1453–54 (9th Cir. 1989)).

54. *Power Integrations, Inc. v. Fairchild Semiconductor Int’l, Inc.*, 233 F.R.D. 143 (D. Del. 2005) (rejecting Practical Ability Standard and quashing subpoena to subsidiary seeking documents in possession of Korea-based parent corporation and noting that party seeking production could pursue a subpoena through Hague Convention procedures).

this instance, the court reasoned that a discovery order requiring a party to violate the terms of its contractual agreement trumped “most other commitments.”⁵⁵

3. The Practical Ability Standard Often Fails to Recognize Distinctions between Separate Sister Corporations

Courts have applied the Practical Ability Standard to obligate sister corporations to obtain documents from each other when each has ties to a common parent corporation, notwithstanding the fact that the entities may lack a sufficient relationship to warrant the imposition. Courts applying the Practical Ability Standard frequently bypass a thorough corporate veil analysis and order production of documents in the possession and custody of non-party sister entities. For example, one court relied on the Practical Ability Standard to order production of documents in the possession and custody of a non-party sister entity.⁵⁶ In that instance, the court did not consider or apply an “alter-ego” or veil-piercing analysis and, without discussion or analysis, simply concluded “as between the parties, Defendant has a ‘practical ability’ to obtain the information Plaintiffs seek on demand.”⁵⁷ In contrast, courts that apply the Legal Right Standard analysis provide for a narrower scope of discovery among sister entities.⁵⁸

55. *S.E.C. v. Strauss*, No. 09 CIV. 4150 RMB/HBP, 2009 WL 3459204, at *1 (S.D.N.Y. Oct. 28, 2009).

56. *Wells v. FedEx Ground Package Sys., Inc.*, No. 4:10-CV-02080-JAR, 2012 WL 4513860, at *1 (E.D. Mo. Oct. 1, 2012).

57. *Id.* at *4–5. *See also In re Ski Train Fire of Nov. 11, 2000 Kaprun Austria*, No. MDL 1428(SAS)THK, 2006 WL 1328259 (S.D.N.Y. May 16, 2006); *Dietrich v. Bauer*, No. 95 CIV. 7051 (RWS), 2000 WL 1171132, at *3 (S.D.N.Y. Aug. 16, 2000).

58. For example, in *In re Citric Acid*, the court applied a Legal Right analysis and denied discovery of information in the possession and custody

Other courts have combined the Practical Ability Standard and the Legal Right Standard with elements of a veil-piercing analysis to reach a more equitable determination of whether

of a foreign co-member of an international accounting organization. *In re Citric Acid Litig.*, 191 F.3d 1090 (9th Cir. 1999). Similarly, in a civil tax refund case, the court denied the government's motion to compel the production of documents in the possession and custody of the party's Swiss affiliate because it was not clear that the party had the legal right, authority, or ability to demand and obtain the documents. *United States v. Deloitte & Touche USA LLP*, 623 F. Supp. 2d 39 (D.D.C. 2009). *Cf. also*, *Ehrlich v. BMW of N. Am., LLC*, No. CV 10-1151-ABC PJWX, 2011 WL 3489105, at *1 (C.D. Cal. May 2, 2011); *Gerling Int'l Ins. Co. v. C.I.R.*, 839 F.2d 131, 140 (3d Cir. 1988) (The two corporate entities at issue had a common president who also was the chairman of the board of directors of one of the corporations (Universale) and a minority stockholder in the other (GIIS). The court declined to find that GIIS had sufficient control over Universale to require production of its books and records: "Where the litigating corporation is the subsidiary and the parent possesses the records, control has been found to exist where the "alter ego" doctrine warranted piercing the corporate veil. . . . The few cases involving sister corporations under common control follow the same pattern as the cases involving a litigating subsidiary. The requisite control has been found only where the sister corporation was found to be the alter ego of the litigating entity. In this case, the Tax Court seems to have regarded GIIC and Universale as sister corporations under common control. It did so, however, only on the basis of an improper presumption that Gerling controlled Universale and a tacit assumption that Gerling controlled GIIC despite his minority stockholder status. Moreover, even if these corporations had been properly presumed or assumed to be under common control, there was no finding, and no record to support a finding, that their corporate entities had been disregarded by themselves or Gerling in the course of their businesses or that GIIC had acted for the benefit of Universale either in the transactions giving rise to the alleged tax liability or in conducting this litigation. In such circumstances, we conclude that there was no foundation for the Tax Court's conclusion that GIIC had sufficient control over Universale to require production of its books and records in the United States." *Id.* at 141-42.)

Rule 34 “control” existed concerning discovery sought from related sister entities.⁵⁹

Additionally, in certain cases construing the relationship among a corporate family for purposes of adjudicating Rule 34 “control,” the court’s decision has turned on whether a party had access for business purposes to documents in the possession and custody of a corporate sister. For example, one court denied discovery sought from a non-party sister entity because the party upon whom discovery was propounded did not have access to the information in the normal course of business.⁶⁰

59. See, e.g., *Handi-Craft Co. v. Action Trading, S.A.*, No. 4:02 CV 1731 LMB, 2003 WL 26098543 (E.D. Mo. Nov. 25, 2003) (ordered discovery after considering commonality of ownership, intermingling of directors, officers, employees, documents exchanged in the normal course of business and the involvement of non-party entity in the litigation). See also *Uniden Am. Corp. v. Ericsson Inc.*, 181 F.R.D. 302, 305–07 (M.D.N.C. 1998) (ordering party to produce documents in custody of non-party sister corporation after applying “control” factors and noting that to determine Rule 34 control, courts consider (i) “legal right” to obtain documents; (ii) “actual ability” to obtain documents; (iii) existence of “alter ego” relationship; (iv) amount of parent’s ownership in subsidiary and control factors, including (a) commonality of ownership, (b) exchange or intermingling of directors, officers, or employees of the two corporations, (c) exchange of documents between the corporations in the ordinary course of business, (d) any benefit or involvement by the non-party corporation in the transaction, and (e) involvement of the non-party corporation in the litigation. The court stated that Rule 34 control for discovery among members of corporate families is broader than “control” for the purpose of determining liability); *E.I. DuPont de Nemours & Co. v. Kolon Indus., Inc.*, 286 F.R.D. 288 (E.D. Va. 2012) (construing Rule 34 control based in part on assessment of corporate veil factors); cf. *Doe Run Peru S.R.L. v. Trafigura AG*, No. 3:11mc77, 2011 U.S. Dist. LEXIS 154559 (D. Conn. Aug. 23, 2011) (denying discovery because affiliate relationship and arms-length transactions failed to establish practical ability to obtain documents).

60. See, e.g., *S.E.C. v. Credit Bancorp, Ltd.*, 194 F.R.D. 469 (S.D.N.Y. 2000) (denying discovery request because party did not have regular business access to information in possession and custody of non-party sister entity).

4. The Practical Ability Standard may Compel Individuals to Produce Documents and ESI in the Possession of Companies they Own but that are not Parties to a Case

Ownership in a company, regardless of the percentage of ownership or involvement in that company's day-to-day business, has been found to be sufficient to establish a "practical ability" to obtain Documents and ESI from the company, even where the company is not a party to the case. For example, courts have applied the Practical Ability Standard to order individuals to obtain and produce information in the possession and custody of non-party companies where the individuals are partial owners. In one case, the court compelled production from a joint-venture ("JV") entity of which the individual owned 49% on the basis of contract, and based upon testimony that the JV entity had provided documents upon request 90% of the time.⁶¹ Likewise, another court cited the Second Circuit's broad standard of "control" and ordered an individual to obtain and produce documents in the possession and custody of a subsidiary in which the individual was a 50% owner.⁶² Courts applying the Legal Right Standard to similar factual scenarios reached the opposite conclusion.⁶³

61. *Kamatani v. Benq Corp.*, No. CIV.A. 2:03-CV-437, 2005 WL 2455825, at *1 (E.D. Tex. Oct. 4, 2005).

62. *Am. Rock Salt Co. v. Norfolk S. Corp.*, 228 F.R.D. 426 (W.D.N.Y. 2005), *objection denied by, stay denied by*, 371 F. Supp. 2d 358 (W.D.N.Y. 2005).

63. *Noaimi v. Zaid*, 283 F.R.D. 639 (D. Kan. 2012) (denying a discovery request seeking corporate documents in the possession and custody of a corporation because the individual's 20% ownership interest failed to establish 'control' under the Legal Right Standard applied in Kansas); *Am. Maplan Corp. v. Heilmayr*, 203 F.R.D. 499 (D. Kan. 2001) (reversing magistrate judge's grant of motion to compel defendant to produce corporate documents in the possession of a third-party corporation for which defendant was president and a minority shareholder, finding that although defendant might

5. The Practical Ability Standard may Compel Corporate Parties to Produce Documents and ESI in the Possession of Former or Current Employees or Employers even if the Employers have no Legal Right to Demand or Obtain such Documents and ESI

Courts have applied the Practical Ability Standard to find that employers have Rule 34 “control” over documents in the possession of former employees. For example, a court ordered defendants, including former corporate officers and directors, to produce documents in the possession of the former corporate secretary, even though the former secretary had not worked for the defendants in five years, and to submit an affidavit detailing their efforts.⁶⁴ However, applying a Legal Right Standard, at least one court reached the opposite conclusion and denied a motion to compel production of documents in the possession and custody of non-party former directors.⁶⁵ Likewise, a court applying a Legal Right Standard denied plaintiffs’ Motion

have the practical ability to obtain the documents he did not have legal authority and the third party retained the right to confidentiality of the documents sought).

64. *Scovin v. Great W. Life & Annuity Ins. Co.*, No. 3:02CV1161, 2006 U.S. Dist. LEXIS 71386 (D. Conn. Sept. 29, 2006). *See also In re Folding Carton Antitrust Litig.*, 76 F.R.D. 420, 423 (N.D. Ill. 1977) (suggesting that an employer may have control over documents in the possession of a former employee if that individual is still receiving economic benefits from the employer).

65. *Miniace v. Pac. Maritime Ass’n*, No. C 04-03506 SI. 2006 WL 335389 (N.D. Cal. Feb. 13, 2006) (applying Legal Right Standard and, on that basis, denying production of documents in custody of former directors). *Accord In re Lululemon Athletica Inc.*, 220 Litig., No. CV-9039-VCP, 2015 WL 1957196, at *4–7 (Del. Ch. Apr. 30, 2015) (finding it unwarranted to search the personal email accounts of a company’s non-employee directors for documents responsive to discovery requests).

to Compel text messages sent or received by a corporate-defendant's employees' personal cell phones because the corporate defendant did not issue the cell phones to the employees, the employees did not use the cell phones for any work-related purpose, and the corporate-defendant otherwise did not have any legal right to obtain employee text messages on demand.⁶⁶ Moreover, while no court has squarely held that the Practical Ability Standard can compel corporate parties to produce documents and ESI in the possession of current employees, the Practical Ability Standard could arguably put employers in the awkward position of asking for the personal documents and ESI of their employees (and former employee) which may be deemed improper or "coercive."⁶⁷

In some instances, former employees have been found to have the practical ability to obtain documents in the possession of their former employer, or an entity over which they used to exercise some degree of control, even though the former employer/entity was not a party to the case. For example, a defendant/former senior executive was ordered to produce documents in the possession of his former employer, even though the employee handbook stated that such documents were the employer's property and employees could not take documents

66. *Cotton v. Costco Wholesale Corp.*, No. 12-2731-JW, 2013 WL 3819974, at *1 (D. Kan. July 24, 2013); *see also* *Matthew Enter., Inc. v. Chrysler Grp. LLC*, No. 12-cv-04236, 2015 WL 8482256 (N.D. Cal. Dec. 10, 2015) (applying the Legal Right Standard, denying motion filed against corporate party to compel production from employees' personal email accounts).

67. *See, e.g.,* Debbie Kaminer, *Can Employers Ask Applicants for Social Media Login Information*, N.Y.L.J. (July 27, 2012), <http://www.newyorklawjournal.com/id=1202564023558/Can-Employers-Ask-Workers-Applicants-for-Social-Media-Login-Information?slreturn=20160428100635>.

home unless necessary for work.⁶⁸ The court found that employees were permitted to utilize documents, thus, the defendant, as a senior officer, had the practical ability to obtain them. Yet, even where courts have applied the Practical Ability Standard in this context, they have reached inconsistent results.⁶⁹ In contrast, some courts applying the Legal Right Standard have found that former employees did not have Rule 34 “control” over documents in the possession of their former employer.⁷⁰

Under the Practical Ability Standard, current employees sometimes have been found to have the practical ability to obtain documents in the possession of their employer, even where the employer is not a party to the case. For example, a defendant was ordered to produce his personnel file, which was in the possession of his current employer, and placed the burden on him to demonstrate that he had no control over the documents.⁷¹ The

68. *In re Flag Telecom Holding, Ltd. Sec. Litig.*, 236 F.R.D. 177 (S.D.N.Y. 2006).

69. *Cf. Diaz v. Washington State Migrant Council*, 165 Wash. App. 59, 265 P.3d 956 (2011) (reversing contempt finding and applying federal Practical Ability Test, court finds that corporate director had no duty to make personal records regarding immigration status available to the corporation he or she serves, and there had been no showing that defendant non-profit had practical ability to secure personal records belonging to its directors); *Piazza’s Seafood World, L.L.C. v. Odom*, No. CIV.A. 07-413-BAJ-CN, 2011 WL 3664437 (M.D. La. Aug. 19, 2011) (noting Practical Ability Standard, court found that as an ex-commissioner of a state agency, the defendant no longer had custody or control of the documents in the possession of the agency).

70. *Lopez v. Chertoff*, No. CV 07-1566-LEW, 2009 WL 1575214 (E.D. Cal. June 2, 2009) (under Legal Right analysis, former employee of public defender’s office did not have Rule 34 control over documents in possession of her former employer); *Lowe v. D.C.*, 250 F.R.D. 36, 38 (D.D.C. 2008) (court did not invoke either Practical Ability or Legal Right Standards but stated “[f]ormer employees of government agencies do not have ‘possession, custody, or control’ of documents held by their former employers”).

71. *In re Teligent, Inc.*, 358 B.R. 45 (Bankr. S.D.N.Y. 2006).

court reasoned that as a high-ranking officer and director, defendant failed to present evidence that he lacked the practical ability to produce documents in his own personnel file. Likewise, a defendant corrections officer was ordered to produce prior and subsequent excessive force complaints by prison inmates against the corrections officer contained in his employer's (the N.Y. Department of Correctional and Community Services, "DCCS") files, despite the fact that the defendant's lawyer "engaged, unsuccessfully, in extensive communications with DCCS concerning Plaintiff's requests to obtain the requested documents, and DCCS is unable to accommodate Plaintiff's requests."⁷² In reaching that result, the court canvassed other cases that had applied the Practical Ability Standard and noted those courts had looked at factors like:

- "a degree of close coordination";
 - "similar interests, missions or goals";
 - "interests are sufficiently aligned and closely interrelated"; and
 - a "sufficient nexus."⁷³
6. The Practical Ability Standard may Compel Service Providers to Produce Information Owned by Clients and Customers even if the Service Provider has no Legal Right to Demand or Obtain such Documents and ESI

Courts have applied the Practical Ability Standard to trump the absence of a party's legal right to control documents by imposing on parties who provide services a duty to preserve and produce documents stored on their client's servers. For example, in an employment matter, plaintiffs sued their employer,

72. Gross v. Lunduski, 304 F.R.D. 136 (W.D.N.Y. 2014).

73. *Id.*

Accenture, for age discrimination.⁷⁴ While employed by Accenture, plaintiffs performed Information Technology (IT) work for Accenture's client, Best Buy, and were provided bestbuy.com email accounts during the service period. Plaintiffs moved to compel discovery of emails sent by Accenture employees through Best Buy's email server with bestbuy.com email addresses. Accenture objected on the ground that the emails were stored on Best Buy's servers and were contractually owned by Best Buy—which was not a party in the case. The court found these facts irrelevant for purposes of applying the Practical Ability Test, reasoning: “[i]f an Accenture employee with a bestbuy.com email address can access information sent from or received by his or her bestbuy.com email address within his or her normal day-to-day work, then that information is within Accenture's control.”⁷⁵

74. *Hageman v. Accenture, LLP*, No. CIV. 10-1759 RHK/TNL, 2011 WL 8993423 (D. Minn. Oct. 19, 2011).

75. The *Hageman* court did issue one caveat, denying plaintiffs' motion with respect to information stored on Best Buy's server to the extent it was “inaccessible to Accenture employees within their normal day-to-day activity[],” explaining that:

[t]he fact that Accenture employees used bestbuy.com email addresses does not make information that is no longer accessible [to] [*sic*] those Accenture employees within Accenture's possession, custody, and control merely because the information may be stored or archived on the bestbuy.com server. The contract between Accenture and Best Buy does not state that Accenture can freely access the bestbuy.com server or has a contractual right to obtain information on the bestbuy.com server upon request. Rule 45 is the proper vehicle for Plaintiff to obtain information from the bestbuy.com server that cannot be accessed by an Accenture employee within his or her normal day-to-day activity.

Id. at *4.

Several other courts applying the Practical Ability Standard have found that similar obligations exist between service providers and their customers.⁷⁶ Courts have also used a “relationship” standard to determine Rule 34 “control” as between entities that conduct business with one another but otherwise have no corporate or legal relationship.⁷⁷ Yet, some courts applying the Practical Ability Standard have taken a more nuanced approach—again reinforcing the inconsistent application of this standard—moving away from outright sanctioning the producing parties even where the court found the party had “control.” In these cases, the courts have instead compelled the producing party to make efforts to obtain the requested documents from non-parties and to document their efforts to obtain the information with the court, or face the possibility of sanctions.⁷⁸ One court found the contractual relationship between

76. See *Chevron Corp. v. Salazar*, 275 F.R.D. 437, 451 (S.D.N.Y. 2011) (lead counsel had “practical ability” to obtain and produce email from other professionally affiliated law firms and individuals in response to subpoena); *Ice Corp. v. Hamilton Sundstrand Corp.*, 245 F.R.D. 513 (D. Kan. 2007), *objection overruled by, motion to strike denied by*, No. 05-4135-JAR, 2007 WL 3026641 (D. Kan. Oct. 12, 2007) (granting plaintiff’s motion to compel where court found that based on the master service agreement between defendants and contractors, defendants had sufficient control and practical ability to obtain the documents); *Chicago Ins. Co. v. Wiggins*, No. 02-73801, 2005 U.S. Dist. LEXIS 27159 (E.D. Mich. Aug. 12, 2005) (plaintiff had practical ability to demand materials that third parties used to train plaintiff’s employees).

77. See *R.F.M.A.S., Inc., v. So*, 271 F.R.D. 13, 24 (S.D.N.Y. 2010) (relationship between jewelry designer and her manufacturer sufficient to establish Rule 34 control, stating “[e]vidence in a party’s ‘control’ has been interpreted to mean evidence that the party has the legal right, authority or practical ability to obtain by virtue of its relationship with the party in possession of the evidence”).

78. *Sekisui Am. Corp. v. Hart*, No. 12 CIV. 3479 SAS FM, 2013 WL 2951924 (S.D.N.Y. June 10, 2013) (despite notifying Defendants of its intent to seek damages in October 2010, Plaintiff’s failure to implement litigation hold until January 2012 and failure to notify the outside vendor managing its

the defendant and its subcontractor satisfied “control” under Rule 34, but ruled that the defendant could either produce any responsive documents in the subcontractor’s possession or provide the requesting party with an affidavit detailing its efforts to obtain the documents.⁷⁹

Service provider cases in Legal Right Standard jurisdictions result in more consistent and arguably more equitable outcomes. In one case the court denied defendant’s motion to compel production of documents used by and in the possession of its independent claims adjuster.⁸⁰ The court reasoned that the

computer operations that it needed to preserve relevant electronically stored information until nearly three months after the suit was filed was held to constitute negligent spoliation).

79. *Sedona Corp. v. Open Sols., Inc.*, 249 F.R.D. 19 (D. Conn. 2008). *See also Cummings v. Moran Shipping Agencies, Inc.*, No. 3:09CV1393 RNC, 2012 WL 996883 (D. Conn. Mar. 23, 2012) (ordering plaintiff to make efforts to obtain the requested documents not in his possession and if unable to do so, to file an affidavit detailing his efforts); *In re Vitamin C Antitrust Litig.*, No. 06-MD-1738, 05-CV-0453, 2012 U.S. Dist. LEXIS 166720 (E.D.N.Y. Nov. 19, 2012) (plaintiff failed to meet burden to demonstrate practical ability to obtain documents where defendant denied possession, custody, or control and plaintiffs failed to show that, for example, defendant’s independent auditing firm would turn over the documents to defendant upon defendant’s request; but court directed defendant to make such a request and reminded plaintiffs that they should have sought the documents directly from the audit firm “years ago when discovery was ongoing”); *Fisher v. Fisher*, No. CIV. WDQ-11-1038, 2012 WL 2050785 (D. Md. June 5, 2012) (as bank account holder, defendant found to have practical ability to obtain bank records, but applying the Rule 26(b)(2)(C) proportionality test, court directed plaintiff to subpoena the financial institutions, except to the extent it would be less expensive for defendant to obtain and produce these documents).

80. *Bleecker v. Standard Fire Ins. Co.*, 130 F. Supp. 2d 726 (E.D.N.C. 2000).

appropriate vehicle to obtain these documents was via a Rule 45 subpoena.⁸¹

7. Effect of “Control” Issues on Third-Party Discovery

The application of the Practical Ability Standard may also unduly increase the burden of parties by requiring them to obtain documents from non-parties.⁸²

However, in *Lynn v. Monarch Recovery Management, Inc.*, the court recognized that even under a practical ability analysis, Rule (26)(b)(2)(C) considerations of proportionality, including burden, expense, and convenience made a Rule 45 subpoena the

81. See also, *Haskins v. First Am. Title Ins. Co.*, No. CIV. 10-5044 RMB/JS, 2012 WL 5183908 (D.N.J. Oct. 18, 2012) (in class action in Legal Right jurisdiction, defendant Title Insurance Company ordered to serve litigation hold notice on its third-party agents to preserve the third-party agents' closing files, where contracts between the Title Insurance Company and each of the third-party agents expressly required agent to maintain and preserve documents and make them available to defendant for inspection and copying on demand at any time; order carved out any agreements that did not contain similar language); *Inline Connection Corp. v. AOL Time Warner, Inc.*, No. C A 02-272-MPT, 2006 WL 2864586 (D. Del. Oct. 5, 2006) (finding no legal right of defendants to obtain documents in the possession of third-party telephone companies).

82. *Chevron Corp. v. Salazar*, 275 F.R.D. 437 (S.D.N.Y. 2011) (lead counsel waived privilege in related matter and was compelled to produce documents from co-counsel because it had the practical ability to obtain the documents); *S.E.C. v. Strauss*, No. 09 CIV. 4150 RMB/HBP, 2009 WL 3459204 (S.D.N.Y. Oct. 28, 2009) (discovery obligations trump “most other commitments”; practical ability means access); *Bleecker v. Standard Fire Ins. Co.*, 130 F. Supp. 2d 726 (E.D.N.C. 2000) (court rejected application of Practical Ability Test to compel party to produce documents in possession and custody of third party and explained that “ability to obtain” test would usurp principles of Federal Rules of Civil Procedure by permitting parties to obtain documents from non-parties who were not subject to the control of any party to the litigation).

appropriate vehicle through which a party should seek documents from a non-party when the producing party did not have possession or custody of billing information of its telephone provider.⁸³

83. *Lynn v. Monarch Recovery Management, Inc.*, 285 F.R.D. 350, 361 (D. Md. 2012):

Rule 34 requires a party to produce only those documents that are within the party's "possession, custody, or control." Fed. R. Civ. P. 34(a)(1). "Rule 34 'control' does not require a party to have legal ownership or actual physical possession of any [of the] documents at issue." *Goodman v. Praxair Servs., Inc.*, 632 F. Supp. 2d 494, 515 (D. Md. 2009) (citation omitted). Instead, "documents are considered to be under a party's control when that party has the right, authority, or practical ability to obtain the documents from a non-party." *Id.* (citation and internal quotation marks omitted); *Steele Software Sys., Corp. v. DataQuick Info. Sys., Inc.*, 237 F.R.D. 561, 563-65 (D. Md. 2006). Because Defendant has an account with the telephone carrier, Defendant likely has "the right, authority, or practical ability" to obtain an itemized telephone bill from the carrier, and may be compelled to do so. *See Goodman*, 632 F.Supp.2d at 515. However, Fed. R. Civ. P. 26(b)(2)(C) instructs the Court to "limit the frequency or extent of discovery otherwise allowed" if, *inter alia*, "the discovery sought . . . can be obtained from some other source that is more convenient, less burdensome, or less expensive." In light of the foregoing, the parties are DIRECTED as follows: If there are any additional documents not previously produced "identifying any calls to Plaintiff or 301-620-2250" in Defendant's actual possession or custody, Defendant must produce them, subject to the parties' stipulated confidentiality order, if Defendant contends that they contain confidential information. *See Fed. R. Civ. P. 34(a)(1)*. If documents responsive to this request are not in Defendant's possession or custody, but are in the physical custody of a non-party telephone carrier, Defendant will not be com-

Another recent case⁸⁴ also suggests that even though a party may have the “practical ability” to obtain documents from a non-party, a Rule 45 subpoena was the appropriate discovery device for collecting the documents since they were not under the producing party’s physical control.

In those cases, the court determined that proportionality of the costs and burdens associated with discovery were so great that a Rule 45 subpoena was the correct method of extracting such discovery. *Lynn* and *Fisher* thus indicate that physical control over documents should be the dispositive factor in determining the appropriate procedural discovery device.

D. How new Technologies may Influence the Rule 34 Possession, Custody, or Control Analysis

New technologies and organizational initiatives can further blur the lines of who actually “controls” Documents and ESI for purposes of preservation and production. They also complicate the practical problems associated with preserving and producing Documents and ESI that a party does not directly control.⁸⁵

pelled to produce them. *See* Fed. R. Civ. P. 26(b)(2)(C)(i). Rather, Plaintiff may obtain the documents by issuing a Fed. R. Civ. P. 45 subpoena to the telephone carrier.

84. *Fisher v. Fisher*, No. CIV. WDQ-11-1038, 2012 WL 2050785 (D. Md. June 5, 2012).

85. The drafters of the 2015 federal rule amendments specifically took note of how new technologies were impacting litigation:

Significant amounts of ESI will be created and stored not only by sophisticated entities with large IT departments, but also by unsophisticated persons whose lives are recorded on their phones, tablets, cars, social media pages, and tools not even presently foreseen. Most of this information will be stored somewhere on remote servers, often referred to as the “cloud,” complicating the preservation task.

1. Cloud Computing

For purposes of this Commentary, we will refer to “cloud computing” simply as the use of a remote device or network to store, manage, preserve, or backup any of a party’s rightfully owned data or software.⁸⁶ In this context, there are two major issues with cloud computing: (1) the location of the data, and (2) who is managing the data (be it one’s own company or a third party). The increasingly widespread use of cloud computing services to store information raises questions with respect to the ownership of the information, the right and ability to control the information, and the disposition of the information at the expiration of the cloud computing service contract. Frequently, businesses make decisions to use cloud computing resources on the basis of business judgments, in order to fulfill business needs, improve efficiencies, and reduce costs. However, when a contract is made with cloud providers, there is often little or no ability to effectively negotiate terms with the cloud provider because the provider only accepts standardized agreements.

Multi-tenancy issues: Cloud computing environments may use operating system tools to host the business applications

See Advisory Committee Report, *supra* note 5.

86. A more technical and thorough definition of Cloud Computing has been published by the National Institute of Standards and Technology:

Cloud computing is a model for enabling ubiquitous, convenient, on-demand network access to a shared pool of configurable computing resources (e.g., networks, servers, storage, applications, and services) that can be rapidly provisioned and released with minimal management effort or service provider interaction. This cloud model promotes availability and is composed of five essential characteristics, three service models, and four deployment models.

Peter Mell and Tim Grance, *The NIST Definition of Cloud Computing (Draft)* (Jan. 2011), http://docs.ismgcorp.com/files/external/Draft-SP-800-145_cloud-definition.pdf.

and data of more than one client in the same physical or logical computing environment, which is referred to as “Multi-tenancy” or “Split-tenancy.” Further, multi-tenant computing environments may also store together (“commingle”) the data of multiple clients in the same logical area of computer memory or on the same physical storage device.

Since this data is commingled, it is more difficult to show which data is owned by whom. Unlike a simple index used to track boxes stored in a warehouse, multi-tenancy computing environments may require an understanding of how a computing environment uses metadata to track, manage, and maintain logical distinctions among commingled data to comply with legal obligations to access, preserve, collect, and understand commingled data.

Location/Jurisdiction issues: Data stored “in the cloud” may also reside in more than one physical location which raises issues about the body of law applicable to such data, thereby posing additional preservation and collection challenges, especially since data sets may either be split into multiple locations or redundant storage locations.

Importantly, the third-party vendor’s data retention policies and data preservation protocols may differ from or conflict with those of the data owner. Third-party vendors may also be subject to different statutory obligations on the basis of the jurisdiction in which they operate. To the extent such inconsistencies arise, data owners may face additional compliance issues and litigation risk and expense when extracting data. They also may find that they have conflict of law issues when attempting to recover their own data.

Privacy and security issues: Data stored in the cloud may be accessible by a greater number of people, including the cloud vendor’s employees. Moreover, when data is held by a cloud provider, there is a risk that it can be sought directly from the

cloud provider—in some instances without notice to the customer.⁸⁷

The issues of who has possession, custody, or control in this age of electronic information is complicated by cost, burden, access, privacy, and contractual issues that simply did not exist in a world populated only by hardcopy documents. In short, unique issues of location, access, and multi-tenancy make cloud computing quite different than boxes of paper files stored in a depository.

2. Social Media

Social Media sites have complex possession, custody, and control issues because there is often a commingling of interests and sources as it pertains to speech and data communicated and collected on these sites. This information is generally in the custody of the third-party company which hosts the social media platform. But courts commonly require production of social media data and information from both individual⁸⁸ and corpo-

87. See Catherine Dunn, *Microsoft Reveals Law Enforcement Requests for Customer Data*, LAW TECHNOLOGY NEWS (March 26, 2013), <http://www.corpcounsel.com/id=1202593423164/Microsoft-Reveals-LawEnforcement-Requests-for-Customer-Data> (“In general, we believe that law enforcement requests for information from an enterprise customer are best directed to that customer rather than a tech company that happens to host that customer’s data,” [Microsoft General Counsel Brad] Smith said. “That way, the customer’s legal department can engage directly with law enforcement personnel to address the issue.”).

88. See, e.g., *Quagliarello v. Dewees*, No. CIV.A. 09-4870, 2011 WL 3438090 (E.D. Pa. Aug. 4, 2011) (plaintiff’s social media relevant to rebut emotional distress claims); *E.E.O.C. v. Simply Storage Mgmt, LLC*, 270 F.R.D. 430, 436 (S.D. Ind. 2010) (rejecting EEOC’s claim that producing social networking content would infringe on claimants’ privacy because merely locking a profile from public access does not prevent discovery and ordering EEOC to produce “any profiles, postings, or messages (including status updates, wall

rate sources. There is no question that individuals and corporations have control over the data which is created on these social media sites; however, they do not host this data and do not have physical possession of this data.

When information regarding a social media account is requested by a party in litigation or an investigation, it is the duty of the custodian to produce a valid copy of the data available. There are tools that can assist in the download of this data, but in many cases a complete set of data can only be recovered with the consent or cooperation of the “owner” of the data.

Corporations do not own or control their employees’ personal social media accounts. There have been instances where employees’ personal accounts contained information or speech relevant or desired as evidence by a corporation. While some have attempted to argue that under the Practical Ability Standard, corporations may have the “practical ability” to obtain data from social media sites they do not own or control merely by asking their employees to preserve/produce it, no court has specifically held this to be true. To the contrary, as noted above, an employer’s demand for this information from an employee may be viewed as improper or “coercive.”⁸⁹ Likewise, many states

comments, causes joined, groups joined, activity stream, blog entries),” third-party communications, photographs, and videos for the claimants that “reveal, refer, or relate to any emotion, feeling, or mental state, as well as communications that reveal, refer, or relate to events that could reasonably be expected to produce a significant emotion, feeling, or mental state”; and instructing that in accordance with the liberal discovery standard of Rule 26, in carrying out the court’s order “the EEOC should err in favor of production”); *Ledbetter v. Wal-Mart Stores, Inc.*, No. 06-CV-01958-WYDMJW, 2009 WL 1067018 (D. Colo. Apr. 21, 2009) (court ordered plaintiffs to produce email and other communications from Facebook, MySpace, and Meetup.com).

89. See, e.g., Debbie Kaminer, *Can Employers Ask Applicants for Social Media Login Information*, N.Y.L.J. (July 27, 2012), <http://www.newyork>

have enacted legislation that specifically prohibit an employer from seeking such information from an employee, and an employer's attempt to solicit an employee's usernames and passwords to facilitate a social media capture may violate those states' privacy statutes.⁹⁰

Employers also need to be aware of restrictions on policies they issue concerning employees' use of social media, as they may conflict with federal or state regulations.⁹¹

lawjournal.com/id=1202564023558/Can-Employers-Ask-Workers-Applicants-for-Social-Media-Login-Information?slreturn=20160428100635.

90. See, e.g.:

- Philip L. Gordon & Joon Hwang, *Making Sense of the Complex Patchwork Created by Nearly One Dozen New Social Media Password Protection Laws*, LITTLER (July 2, 2013), <http://www.littler.com/making-sense-complex-patchwork-created-nearly-one-dozen-new-social-media-password-protection-laws> ("In a single season, spring 2013, seven states enacted social media password protection legislation, bringing the total number of states to 11 since Maryland enacted the first such law in May 2012. Bills are pending in more than 20 other states. The current roster of states, dominated by the Rocky Mountain Region and the Far West, is as follows: Arkansas, California, Colorado, Illinois, Maryland, Michigan, Nevada, New Mexico, Oregon, Utah and Washington. New Jersey appears poised to join this group as the state's legislature amends a bill conditionally vetoed by Governor Christie in May."); and
- Philip Gordon & Joon Hwang, *New Jersey Becomes the Twelfth State to Enact Social Media Password Protection Legislation*, LITTLER (Sept. 1, 2012), <http://www.littler.com/new-jersey-becomes-twelfth-state-enact-social-media-password-protection-legislation-recent-amendment> ("On August 29, 2013, New Jersey became the twelfth state to enact social media password protection legislation, continuing the nationwide trend towards imposing some form of restriction on employer access to the restricted, personal social media content of applicants and employees. The new law becomes effective on December 1, 2013.").

91. See, e.g., *NLRB's Acting General Counsel Issues Third Guidance Document on Social Media and Approves One Policy*, LITTLER (June 5, 2012),

3. The “Bring your Own Device to Work” Movement⁹²

“BYOD,” or Bring Your Own Device is an increasingly popular corporate practice where employees purchase and own the physical hardware device (i.e., a smartphone or tablet) that then is connected to a corporate network system or otherwise used to conduct the company’s business. There are a myriad of issues that are created via BYOD initiatives.⁹³ As a general matter, an employer does not have “control” over or the right to access personal information and data stored on home or personal computers, personal email accounts, personal PDAs, etc., of its employees. Thus, if an adversary demands such information in discovery, an employer can legitimately object. Yet, if an employer has a BYOD program, and has the ability to access employees’ personal devices for work data, the lines concerning personal data and responsibility become blurred.

Likewise, the reality is that an employee may constructively and realistically have both custody and control over a BYOD device. Although the device may hold enterprise “owned” information, the employee both owns and accesses the

<http://www.littler.com/publication-press/publication/nlrbs-acting-general-counsel-issues-third-guidance-document-social-0> (noting that policy provisions that, among other things, required employees to protect confidentiality, prohibited inappropriate postings, encouraged employees to be respectful, fair, and courteous, and addressed the friending of co-workers, could potentially violate the National Labor Relations Act).

92. The Sedona Conference is preparing a more detailed commentary on BYOD issues that will be available on its website once it is released for public comment.

93. For a thorough discussion of BYOD issues, see *The “Bring Your Own Device” to Work Movement: Engineering Practical Employment and Labor Law Compliance Solutions*, THE LITTLER REPORT (May 2012), <http://www.littler.com/files/press/pdf/TheLittlerReport-TheBringYourOwnDeviceToWorkMovement.pdf>.

data. Without the employee's consent,⁹⁴ an employer is not likely to have the legal right to both secure control and custody of the device, much less preserve information on the same device.⁹⁵

4. Changing Locations/Jurisdictions

In the hard copy age, attorneys and clients could definitively determine the location of documents. In contrast, electronic documents may be physically stored in one jurisdiction, accessed and used for business purposes in a different (or multiple) jurisdiction(s), and stored for backup purposes in yet another jurisdiction. Electronic documents and data may also be stored on a variety of devices, including servers, hard drives, external media, handheld devices, backup tapes, portable hard drives, data archives, or employees' dual-use/BYOD personal devices.

As a result, lawyers and courts may struggle to determine the location of electronic documents as well as to identify the entity and/or individual properly charged with legal possession, custody, or control of electronic documents. Choice of law disputes may also arise over the body of law applicable to determine the privacy considerations that govern the preservation, access, collection, and production of electronic documents.

94. At least one court has held that an employer's ability to secure consent from its employees can only go so far. *See Stengart v. Loving Care Agency, Inc.*, 201 N.J. 300, 325, 990 A.2d 650, 665 (2010) (rejecting employer's claim to access employee's attorney-client communications "[b]ecause of the important public policy concerns underlying the attorney-client privilege").

95. *See, e.g., Matthew Enterprise, Inc. v. Chrysler Grp. LLC*, No. 13-cv-04236-BLF, 2015 WL 8482256 (N.D. Cal. Dec. 10, 2015) (employee's phone was not in Rule 34 possession, custody, or control of employer).

IV. THE SEDONA CONFERENCE PRINCIPLES ON POSSESSION, CUSTODY, OR CONTROL—WITH COMMENTARY

Principle 1: *A responding party will be deemed to be in Rule 34 or Rule 45 “possession, custody, or control” of Documents and ESI when that party has actual possession or the legal right to obtain and produce the Documents and ESI on demand.*

Comments:

A. Interpretation of Possession, Custody, or Control for Purposes of Rules 34 and 45 Should be Consistent across Federal Circuits

As noted above, the various federal circuits have defined Rule 34 or Rule 45 “possession, custody, or control” differently and inconsistently, leading to a lack of clarity for lawyers and organizations that must deal with information in multiple jurisdictions. The varying standards and often inconsistent application of the standards themselves have left parties without definitive guidance and a clear road map when attempting to make legal and defensible discovery decisions, and the courts without clear standards for adjudicating discovery issues. Further, the imprecision of the Practical Ability Test has resulted in inconsistent and, at times, inequitable results in many contexts.⁹⁶ The

96. For the most part, when addressing Documents held by third/non-parties the safe harbor contained in Rule 37(e) will not apply because a party will not have “control” over a non-party’s “electronic information systems” to determine their operations (routine, good faith, or otherwise). This further underscores the problems with the current framework, whereby on the one hand a party may have Rule 34 “possession, custody, or control” over third-party data, but on the other hand, the Safe Harbor in the current rules does not apply because the party does not “control” the data. For example, in *GenOn Mid-Atl v. Stone & Webster*, 282 F.R.D. 346, 354 (S.D.N.Y. 2012), the plaintiff was found to have control over documents in the possession of a third-party litigation consultant that was expected to provide expert testi-

problems with practical ability, and support for abandoning that standard are explored in more detail in Section III, *supra*.

B. A Framework for a More Objective Definition of “Control”

A more reliable, objective approach to fulfilling a party’s Rule 34 and Rule 45 obligations would be to base the interpretation of the language “possession, custody, or control” on the definition of “control” as the legal right to obtain and ability to produce Documents and ESI on demand. Courts in the Third, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, and Eleventh Circuits apply the Legal Right Standard set forth in Principle 1. That standard establishes that a party is deemed to have possession, custody, or control only if that party has: (1) actual possession of Documents and ESI; or (2) the legal right to obtain Documents and ESI. It is upon this well-established legal footing that this Commentary advocates that Rule 34 or Rule 45 “control” should be defined as the legal right to obtain Documents and ESI and ability to produce them on demand. This would also avoid the potentially unfair results from the application of the Practical Ability Standard, as detailed in Section III, *supra*.

mony at trial. The court held that “common sense” suggested that the plaintiff could have obtained the documents from the consultant merely by asking for them, and that the consultant would have honored a request by the plaintiff that the documents be preserved. The plaintiff failed to direct the consultant to preserve the documents, and they apparently were destroyed by the consultant in its normal course of business. Although the court found that the plaintiff had functional control over the documents, it declined to issue sanctions because the plaintiff sufficiently demonstrated that the defendant was not prejudiced.

1. Application of “Control” Under Relevant Legal Right Case Law

Illustrative of the definition of “control” in Principle 1 are recent cases decided by the Ninth Circuit where a contractual basis was lacking, such that “control” was found not to exist:

- *Ubiquiti Networks, Inc. v. Kozumi USA Corp.*⁹⁷ In *Ubiquiti*, the court denied a motion to compel defendants to obtain and produce documents from a consultant, a resident of Taiwan. Although the consultant had provided web design services to the defendant company, had an email account on the company’s system (which had not been preserved), and was the brother of an individual defendant, the court found no evidence of a contract or any other legal basis upon which the defendants could legally compel the consultant to produce documents. In denying the motion to compel, the court reasoned: “[a] party responding to a Rule 34 production request . . . is under an affirmative duty to seek that information reasonably available to [it] from [its] employees, agents, or others subject to [its] control.”⁹⁸
- *In re NCAA Student-Athlete Name & Likeness Litigation.*⁹⁹ In *In re NCAA*, the court held that “[n]either the NCAA Constitution nor the By-

97. No. 12-cv-2582 CW JSC, 2013 WL 1767960 (N.D. Cal. Apr. 15, 2013).

98. *Cf. Hageman v. Accenture, LLP*, No. CIV. 10-1759 RHK/TNL, 2011 WL 8993423 (D. Minn. Oct. 19, 2011) (*supra* note 7 and accompanying text).

99. No. 09-CV-01967 CW NC, 2012 WL 161240, at *3 (N.D. Cal. Jan. 17, 2012) (citing *In re Citric Acid Litig.*, 191 F.3d 1090, 1107 (9th Cir. 1999)).

laws grants the NCAA the right to take possession of its members' Documents and ESI," therefore, the NCAA had insufficient control over the documents to retrieve them from its member schools and produce them to the plaintiffs.¹⁰⁰

The Ninth Circuit has also held that a "relationship" between entities is insufficient to impose Rule 34 "control" over Documents and ESI held by a third party without telltale hallmarks of control founded in a legal right to obtain the Documents and ESI from the third party. The plaintiff in *In re Citric Acid Litigation* had subpoenaed Coopers & Lybrand in the U.S. to produce documents from both the U.S. firm as well as a Coopers firm located in Switzerland. The court held that the U.S. firm did not have control over the Swiss firm, because:

[a]lthough members use the 'Coopers & Lybrand' name, each firm is autonomous. Firms do not share profits or losses, nor do they have any management, authority, or control over other member firms. In addition, C&L-International does not exercise management, authority, or control over member firms. Of particular relevance to the case at hand, C&L-US does not have any economic or legal interest in C&L-Switzerland, and C&L-Switzerland has no such interest in C&L-US.¹⁰¹

Indeed, in holding that production would not be compelled pursuant to Rule 34, the court pointed out the impracticability of the Practical Ability Test:

100. *Id.* at *5.

101. *In re Citric Acid Litig.*, 191 F.3d at 1106.

Ordering a party to produce documents that it does not have the legal right to obtain will often-times be futile, precisely because the party has no certain way of getting those documents. . . . There is no mechanism for C&L-US to compel C&L-Switzerland to produce those documents, and it is not clear how [plaintiff] Varni wants C&L-US to go about getting the ECAMA documents, since C&L-Switzerland could legally—and without breaching any contract—continue to refuse to turn over such documents. Because C&L-US does not have legal control over C&L-Switzerland’s documents, Varni could not compel C&L-US to produce those documents.¹⁰²

Another application of the Legal Right Standard can be seen in the context of the obligation to preserve websites referenced by hyperlinks within a document. Under the Legal Right Standard, there is no such duty to preserve hyperlinks. As the websites referenced by those links are maintained by generally unrelated third parties, the producing party has no legal right to obtain the content of those sites.¹⁰³

102. *Id.* at 1108.

103. *See, e.g.,* Phillips v. Netblue, Inc., No. C-05-4401 SC, 2007 WL 174459, at *2–3 (N.D. Cal. Jan. 22, 2007) (content of reference website links not considered to be within a party’s possession, custody, or control); Ferron v. Echostar Satellite, Inc., 658 F. Supp. 2d 859, 864 (S.D. Ohio 2009) *aff’d*, 410 F. App’x 903 (6th Cir. 2010) (plaintiff failed to establish how defendant’s failure to maintain website links constituted “bad faith” under the court’s inherent sanction power); Philbrick v. eNom, Inc., 593 F. Supp. 2d 352, 372 n.23 (D.N.H. 2009) (court would not sanction defendant for failure to preserve website links where there was no evidence that defendant ever had such information, and plaintiff had also failed to preserve them). *But cf.* United States v. Cyberheat, Inc., No. CV-05-457-TUCDCB, 2007 WL 686678, at *8–9 (D. Ariz. Mar. 2, 2007) (FTC able to obtain images in emails from Hotmail

2. Application of “Control” Under Restatement Law

The definition of Rule 34 “control” proposed in this Commentary is also supported by other well-established legal authorities that specifically define control consistent with the Legal Right Standard, including the Restatements. To be clear, by describing these various tort-based principles below, it is not this Commentary’s intention to impose a tort-based test for Rule 34 possession, custody, or control. Rather, the reference is meant to be merely instructive.

a. Agency

The Restatement (Third) of Agency examines the issue of control from many perspectives as it pertains to the relationship of agency. In particular, § 1.01 cmt. f is instructive as it explains the concept of interim control:

(1). Principal’s power and right of interim control—in general. An essential element of agency is the principal’s right to control the agent’s actions. Control is a concept that embraces a wide spectrum of meanings, but within any relationship of agency the principal initially states what the agent shall and shall not do, in specific or general terms. Additionally, a principal has the right to give interim instructions or directions to the agent once their relationship is established.¹⁰⁴

This concept of control presupposes that a principal has the legal right to be able to demand actions from its agent, thereby controlling what the agent shall and shall not do. This

email “trap accounts” where Microsoft maintained web link information within emails and could capture the corresponding web page).

104. RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. f (2006).

is consistent with the Rule 34 Legal Right Standard, and the Rule 34 standard this Commentary is advocating.

b. Torts

The Restatement (Third) of Torts on Physical & Emotional Harm, § 56, provides that retained control for purposes of direct liability for negligence of an independent contractor can be established by a contractual right of control or by the hirer's actual exercise of control.¹⁰⁵

Additionally, several other sections of the Restatement (Second) of Torts address the concept of "control." For example, control-based liability regimes founded in tort doctrine assign liability where:

- parents fail to control their children to prevent intentional harm to others;¹⁰⁶
- actors fail to control third parties to prevent intentional harm where there is an ability to control third parties and the actor knows or should know of the need to control a third party;¹⁰⁷ and
- a lessor of land retains control of a portion with a dangerous condition the lessor could have discovered and prevented harm.¹⁰⁸

In contrast, when a party cedes control to another, the Restatement recognizes a halt to liability for the party who has relinquished control.¹⁰⁹ Similarly, § 414 assigns liability to an actor

105. See RESTATEMENT (THIRD) OF TORTS § 56 (2012).

106. RESTATEMENT (SECOND) OF TORTS § 316 (1979).

107. RESTATEMENT (SECOND) OF TORTS § 318 (1979).

108. RESTATEMENT (SECOND) OF TORTS § 360 (1979).

109. RESTATEMENT (SECOND) OF TORTS § 372 (1979).

for the torts of her independent contractor where the actor “retains the control of any part of the work.”¹¹⁰

All of these concepts from the Restatement are consistent with the Rule 34 Legal Right Standard, and the Rule 34 standard this Commentary is advocating.

c. Judgments

The Restatements (Second) of Judgments also addresses the concept of “control.”¹¹¹ Under principles of the law of judgments, a non-party to an action who controls or substantially participates in the control of the presentation on behalf of a party is bound by the determination of the issues decided.¹¹²

This too is consistent with the Rule 34 Legal Right Standard, and the Rule 34 standard this Commentary is advocating.

3. Examples of “Control” in the Agency Context

Under principles of agency law, a master’s control over her agent is the lynchpin of liability. Under § 219, a master will be liable for her servant’s torts when the servant’s conduct violated a non-delegable duty.¹¹³

Cases in the master-servant context are therefore instructive. For example, in *Schmidt v. Burlington Northern and Santa Fe Railway Co.*¹¹⁴ the court analyzed control on the basis of an employer’s right to control its employee’s conduct “on the job.” The court reasoned:

[f]or Schmidt to succeed under the sub-servant theory, he must show BNSF controlled or had the

110. RESTATEMENT (SECOND) OF TORTS § 414 (1970).

111. RESTATEMENT (SECOND) OF JUDGMENTS §§ 37 and 39 (1982).

112. RESTATEMENT (SECOND) OF JUDGMENTS § 39 (1982).

113. RESTATEMENT (SECOND) OF AGENCY § 219 (1958).

114. 605 F.3d 686 (9th Cir. 2010).

right to control his physical conduct on the job. It is not enough for him to merely show WFE was the railroad's agent, or that he was acting to fulfill the railroad's obligations; BNSF's generalized oversight of Schmidt, without physical control or the right to exercise physical control of his daily work is insufficient.¹¹⁵

Likewise, under the doctrine of respondeat superior, a principal is vicariously liable for his agent's negligent acts done in the scope of the agent's employment so long as the principal controls the means and method by which the agent performs his work.¹¹⁶ In the case of Rule 34 and Rule 45, it is equally well-reasoned to say that actual control over Documents and ESI is the lynchpin to any duty or obligation. Indeed, some courts have already looked to agency concepts when applying Rule 34.¹¹⁷

115. *See also* *Pinero v. Jackson Hewett Services, Inc.*, 638 F. Supp. 2d 632, 640 (E.D. La. 2009) (principal liable for actions of agent when the relationship of the parties includes the principal's right to control physical details of the actor as to the manner of his performance which is characteristic of the relation of master and servant); *Ramos v. Berkeley Cty.*, No. CIV. A. 2:11-3379-SB, 2012 WL 5292895 (D.S.C. Oct. 25, 2012) (granting defendant's motion for judgment on pleadings, dismissing claims because defendant employer was state entity and subject to control of county authorities).

116. *See* *Ramsey v. Gamber*, 469 F. App'x 737 (11th Cir. 2012) (citing *Martin v. Goodies Distribution*, 695 So.2d 1175, 1177 (Ala.1997)); *Ware v. Timmons*, 954 So.2d 545, 549-50 (Ala. 2006). *See also* *Universal Am-Can, Ltd. v. W.C.A.B. (Minteer)*, 563 Pa. 480, 490, 762 A.2d 328, 333 (2000) ("[C]ontrol over the work to be completed and the manner in which it is to be performed are the primary factors in determining [Rule 34 control] status."); *Meyer v. Holley*, 537 U.S. 280, 291, 123 S. Ct. 824, 154 L. Ed. 2d 753 (2003) (finding that courts have not imposed liability for failure to supervise in and of itself).

117. *See, e.g.*, *JPMorgan Chase Bank, N.A. v. KB Home*, No. 2:08-CV-1711-PMP-RJJ, 2010 WL 1994787 (D. Nev. May 18, 2010) (granting motion to

C. *The Legal Right Standard is a Better Test*

During the public comment period, the following comments were received:

- A comment was received from several judges that reside in a Circuit that applies the Practical Ability Standard indicating they do not agree with the Commentary's "adoption of the 'legal right standard' to the exclusion of the 'practical ability' standard," because:
 - "omitting the 'practical ability' test could lead to gamesmanship";¹¹⁸
 - the problem of document requests issued to a U.S. company in federal litigation to obtain information from a foreign affiliate, possibly in violation of foreign blocking statutes or data privacy laws, "is one of cross-border discovery generally, not of possession, custody or control in particular"; and
 - "[w]hile it may be useful to have a uniform standard in all federal circuits . . . this may

compel because agency relationship was sufficient to find control for purposes of Rule 34); *cf.* *Insignia Sys. v. Edelstein*, No. 09-4619, 2009 U.S. Dist. LEXIS 98399 (D.N.J. Oct. 20, 2009) (denying motion to compel local counsel to produce documents in possession and custody of lead counsel because no agency relationship existed among counsel).

118. The following example was given in the Comment:

A party may regularly obtain needed information from an affiliate, but when sued state that it has no legal right to obtain information. Or worse, that same defendant may obtain the "good" documents or ESI from its affiliate, while declining to obtain the bad, claiming it has no legal right to compel production.

be another area where lawyers are concerned about judicial discretion.”¹¹⁹

- A comment was received from an industry group that strongly supported the Commentary and in particular, Principle 1, for several reasons, including:
 - it would establish a common, national standard which is “an important discovery reform”;
 - courts that apply “the nebulous ‘practical ability standard’ engage in a highly subjective inquiry that downplays the importance of having any control over—or any legal right—to the information at issue,” resulting in a “checkerboard of widely divergent standards”;¹²⁰
 - the Practical Ability Standard leads to a “case-by-case” determination of matters

119. According to the Comment:

While there may be outlier judges, or some reported cases that were wrongly decided, that is no reason to advocate abandonment of the practical ability test and the judicial discretion accompanying it.

120. The following example was noted:

Compare In re Vivendi Univ., S.A., Sec. Litig., No. 02 CIV. 5571 RJH HBP, 2009 WL 8588405, at *3 (S.D.N.Y. July 10, 2009) (“[I]nterlocking officers or directors, without a showing of actual control, does not establish the practical ability of the parent to obtain the documents of the subsidiary.”), with *SRAM, LLC v. Hayes Bicycle Grp., Inc.*, No. 12 C 3629, 2013 WL 6490252, at *4 (N.D. Ill. Dec. 10, 2013) (finding “control” where “SRAM has provided undisputed evidence that the two companies share officers and directors and having interrelated corporate structures”).

vs. the Legal Right Standard which is “fairer and more predictable”;

- the practical ability framework encourages discovery of information over which no party to the action has “possession, custody or control” and Rule 45 is already in place for precisely this type of scenario;
- there is “an inherent unfairness in applying a court-ordered compulsion to require X to obtain documents from Y when X can apply no legal compulsion to force Y to turn over the documents,” and “parties should not be encouraged by courts to apply pressure without legal justification— simply by virtue of having, for example, the upper hand in a business relationship.” Moreover, “a requirement that one entity ‘voluntarily’ disclose information to another, without the protection of a court order but under threat of sanctions imposed upon the requesting party, runs directly against both the legal trend of increased protection of individuals’ information and the reality that more and more information about everyone is available somewhere, if only the right party is asked to produce it”;¹²¹ and

121. Examples noted in the comment included:

[A]n employer’s request to an employee to turn over highly personal information to which the employer is not entitled, no matter how the request is phrased, would run a significant risk of being deemed “coercive.”

[O]ne company’s request for information from an affiliate, in the absence of a legal right to obtain the information, puts

- o the approach suggested in the Commentary contains a mechanism to “weed out attempts to structure document maintenance to avoid discovery obligations.”¹²²

Taking all of those comments into consideration, Sedona believes the Legal Right Standard espoused in the Commentary is a better standard. The Practical Ability Standard:

unfair pressure on both the party asking for documents and the party which has to respond. The party making the request cannot “back up” its request with any legal authority, despite the fact that it might itself face sanctions if the other party says “no.” And the recipient of the request is forced to weigh the legal and non-legal risks of non-production against the potential risks of disclosing information—likely including financial and personal information in nearly any case, and sometimes also including health-related, educational, or other information subject to special protection—without even the “legal compulsion” which can sometimes justify such disclosure.

To the extent cross-border production is required, the potential application of non-U.S. law heightens the risk. But even within the U.S., a requirement that one entity “voluntarily” disclose information to another, without the protection of a court order but under threat of sanctions imposed upon the requesting party, runs directly against both the legal trend of increased protection of individuals’ information and the reality that more and more information about everyone is available somewhere, if only the right party is asked to produce it.

122. According to the Comment:

Under the suggested approach, if a party demonstrates that it does not possess and is without the legal right to obtain requested information, the requesting party can challenge the claim if the relevant facts . . . suggest that a party’s lack of control is not merely the by-product of its business decisions but rather an attempt to avoid having control over documents it would prefer not to produce.

- is inherently vague—it does not give parties notice of what factors will impact a court’s decision making;
- is unevenly applied, thus it leads (as noted in the industry group’s submission and throughout the Commentary)—and has the potential to lead—to disparate results;
- produces results that can vary case-by-case and judge-by-judge, leading to what can be perceived as random results, or at least the potential for different results before different judges and/or where a case lands;
- in the cross-border context, can be used to override foreign data protection laws that may legally restrict the ability to produce data outside of the country in which it resides;¹²³

123. Risk in this already uncertain area has escalated greatly since the Edward Snowden revelations concerning U.S. national security measures threw into question existing cross-border data transfer mechanisms, culminating in the EU/U.S. Safe Harbor agreement being struck down in October 2015 (*see* Schrems v. Data Protection Commissioner, Court of Justice of the European Union, Press Release No 117/15, The Court of Justice declares that the Commission’s US Safe Harbour Decision is invalid, 6 October 2015, http://curia.europa.eu/jcms/upload/docs/application/pdf/2015-10/cp150117_en.pdf (with link to underlying decision)) and sparking growing enforcement activity from European data protection authorities including in France and Germany. *See, e.g.,* David Meyer, *Here Comes the Post-Safe Harbor EU Privacy Crackdown*, FORTUNE (Feb. 25, 2016), <http://fortune.com/2016/02/25/safe-harbor-crackdown/>.

Moreover, the stakes are set to rise further as data protection law reforms in Europe exponentially increase fines for violations. When finalized, it is anticipated that fines under the General Data Protection Regulation (GDPR) may be up to 4% of a company’s total world annual gross revenue. *See* Committee on Civil Liberties, Justice and Home Affairs, Press Release, Data protection package: Parliament and Council now close to a deal, 15 December 2015, <http://www.europarl.europa.eu/news/en/news-room/20151>

- in the parent/subsidiary/affiliate context, does not appropriately consider corporate formalities that apply to legally distinct entities;
- can create the appearance of unfairness—because it is unbounded by any clear (or “nebulous” as characterized by the Comment from the industry group) factors,¹²⁴ there is a potential for cases to be decided differently based purely on “discretion” of different judges;¹²⁵ and
- could lead to “futile” and unfair results.¹²⁶

215IPR07597/Data-protection-package-Parliament-and-Council-now-close-to-a-deal.

Nor is this issue limited to Europe as countries around the globe develop tougher data protection regimens with higher fines.

124. Those may include amorphous concepts like the following over which there are no legal norms:

- “a degree of close coordination”;
- “similar interests, missions or goals”;
- “interests are sufficiently aligned and closely interrelated”; and
- a “sufficient nexus.”

See, e.g., Gross v. Lunduski, 304 F.R.D. 136 (W.D.N.Y. 2014).

125. That is not to say there is not a fundamental and important need for judicial discretion in the U.S. Judicial system. As an example, the analytical framework of the modified business judgment rule discussed in Principle 3 is an area where individual judges should apply their discretion to those factors based upon the specific factual circumstances of cases.

126. *Accord* Matthew Enter., Inc. v. Chrysler Grp. LLC, No. 13-cv-04236-BLF, 2015 WL 8482256 (N.D. Cal. Dec. 10, 2015) (“Even if the court were to order that Stevens Creek [car dealership] collect emails from its employees’ personal accounts, Chrysler has not identified any authority under which Stevens Creek could force employees to turn them over. The Ninth Circuit has recognized that “[o]rdering a party to produce documents that it does not have the legal right to obtain will oftentimes be futile, precisely because the party has no certain way of getting those documents.”).

This is not a sound basis for making legal decisions.

In contrast, the Legal Right Standard:

- is grounded in clear, well-established factors (as well as other well-established legal authorities that define control consistent with the Legal Right Standard, as detailed in this Commentary¹²⁷);
- provides notice to the parties of those standards;
- offers consistency in how it should be applied; thus, the result should not depend on where a case lands;
- appropriately considers competing legal interests that can impact “control,” including foreign data protection laws and corporate formalities that apply to legally distinct entities; and
- overall leads to fairer results (including with respect to the futility of complying with court orders).

As the new December 1, 2015 Amendments to the Rules of Civil Procedure expressly recognized, consistency across circuits through uniform, national standards is a laudable goal.¹²⁸ Parties’ legal obligations should not depend on where a case is filed. The approach espoused in this Commentary achieves this

127. There are no such parallels for the Practical Ability Standard.

128. One of the primary drivers of the 2015 amendments to Rule 37(e) was to “provide a uniform standard in federal courts.” See FED. R. CIV. P. 37(e)(2), Committee Note (Dec. 15, 2015). See also, Advisory Committee Report, *supra* note 5, at B-14, B-17 (“Resolving the circuit split with a more uniform approach . . . has been recognized by the Committee as a worthwhile goal. . . . [The] primary purpose of [amended Rule 37(e)] is to eliminate the circuit split on [a key aspect of the rules].”).

important objective. Helping resolve the disparity among Circuits to bring a uniform, national standard to this important area of the law is also consistent with Sedona's mission of moving the law forward in a just and reasoned way.

Just as important, the Legal Right Standard provides clear guidance resulting in its consistent application, which also furthers Fed. R. Civ. P. 1's goal of "just, speedy and inexpensive determination of every action and proceeding."

Moreover, if a requesting party truly needs information that a responding party can demonstrate it does not have the legal right to obtain, the requesting party is not left without recourse—it can subpoena the Documents and ESI from the non-party that legally controls them via Rule 45, which squarely addresses the discovery of such non-party information. Stated another way, the approach espoused by this Commentary as a whole (including incorporation of the "Legal Right Plus Notification Standard" in Principle 5) fairly puts the onus on the party that claims it needs the information (via its request in the first instance) to obtain it via Rule 45.

A final note: one court has already favorably cited the public comment version of this Commentary before this final version was released, for the proposition that the majority of circuits already follow the Legal Right Standard:

What does it mean for a party to have control over data like the data disputed here? "Control is defined as the legal right to obtain documents upon demand." Like the majority of circuits, the Ninth Circuit has explicitly rejected an invitation "to define 'control' in a manner that focuses on the

party's practical ability to obtain the requested documents."¹²⁹

D. Illustrations of what Should and Should Not Constitute Rule 34 "Control" Under a Consistent Standard

The following is a non-exclusive list of illustrative examples where "control" for purposes of disputes under Rules 34 and 45 will or will not exist under the proposed, uniform standard espoused by Principle 1 and this Commentary.

- Illustrative situations/examples where Rule 34 "control" exists:
 - actual possession of data
 - clear contractual right to access or obtain the data
 - deliberate decision to outsource critical business data
 - deliberate decision to move data to foreign jurisdiction for litigation advantage
 - individual obtaining information from their own ISP account (email, Facebook, etc.)
 - separate sister/parent-subsidiary corporation has a legal right to obtain Documents and ESI from its sister corporation
- Illustrative situations/examples where Rule 34 "control" does not exist:
 - customer relationships where there is no legal right to demand data from a customer

129. *Matthew Enterprise, Inc. v. Chrysler Grp. LLC*, No. 13-cv-04236-BLF, 2015 WL 8482256, at *3 n.37 (N.D. Cal. Dec. 10, 2015).

- informal business relationships, i.e., the ability to “ask” for Documents or ESI
- employer/employee relationships, e.g., employer does not have the legal right to obtain personal Documents and ESI from a director, officer, or employee’s personal cell phone, personal email account, or personal social networking sites; employee does not have the legal right to demand or remove data from his/her employer
- former directors, officers, and employee relationships where no legal right to demand data exists
- separate sister/parent-subsidary corporation does not have a legal right to obtain Documents and ESI from its sister corporation
- partial ownership, minority control situations where no legal right to demand data exists
- international affiliate subject to data privacy or blocking statutes (e.g., company compelled to collect and produce Documents and ESI or data from a country where doing so would be impermissible and perhaps a crime)

Principle 2: *The party opposing the preservation or production of specifically requested Documents and ESI claimed to be outside its control, generally bears the burden of proving that it does not have actual possession or the legal right to obtain the requested Documents and ESI.*

Comment:

Whether “Control” Exists must be Answered, in the First Instance, by the Responding Party

Principle 2 is born out of the wellspring of common sense, but grounded in well-established principles of jurisprudence pursuant to the Federal Rules of Civil Procedure. For example, it is a logical presumption that the responding party would have access to the facts necessary to determine control, e.g., to cite one of the examples listed in the comments to Principle 1, *supra* Section IV(D), whether a contractual relationship exists between a consultant and the organization such that access to the data exists.¹³⁰

More particularly, the justification for placing the burden of demonstrating lack of control can be found in a similar provision of Fed. R. Civ. P. 26(b)(2)(B) which states: “[a] party need not provide discovery of electronically stored information from sources that the party identifies as not reasonably accessible because of undue burden or cost. On motion to compel discovery or for a protective order, *the party from whom discovery is sought must show* that the information is not reasonably accessible because of undue burden or cost.” (emphasis added)

Further, under Fed. R. Civ. P. 34, the party objecting to a discovery request has the obligation to state a reason for such

130. See *Ubiquiti Networks, Inc v. Kozumi USA Corp*, No. 12-cv-2582 CW (JSC), 2013 WL 1767960 (N.D. Cal. Apr. 15, 2013).

objection, i.e., a lack of control over Documents and ESI requested.

However, this Principle generally applies when the responding party has greater knowledge of or access to the information that bears upon the inquiry. Where the requesting party has equal or superior access to the facts about whether the responding party has actual possession or the legal right to obtain the requested Documents and ESI, the burden should be applied accordingly.¹³¹ Likewise, Principle 2 would not preclude a requesting party from demonstrating that the responding party indeed has control in the appropriate case.

This Principle is also not intended to imply a general duty for a responding party to identify Documents and ESI that might be relevant in a case that are not within a party's "possession, custody, or control." Instead, it only applies to Documents and ESI that are "specifically requested," in accordance with the general mandates of Rule 34.¹³² Stated another way, this Principle does not apply unless and until the requesting party has met

131. See, e.g., *Enviropak Corp. v. Zenfinity Capital, LLC*, No. 4:14CV00754 ERW, 2014 WL 5425541, at *7 (E.D. Mo. Oct. 22, 2014) (denying plaintiff's motion to compel production of documents after defendant properly objected to the request as seeking information equally available in public records, because defendant did not control the documents requested and they were in the public domain); *Sec. & Exch. Comm'n v. Samuel H. Sloan & Co.*, 369 F. Supp. 994, 995 (S.D.N.Y. 1973) (denying motion for production of transcript of administrative hearing because "[i]t is well established that discovery need not be required of documents of public record which are equally accessible to all parties").

132. See, e.g., FED. R. CIV. P. 34(b)(1)(A) ("Contents of the Request. The request must describe with *reasonable particularity* each item or category of items to be inspected.") (emphasis added); *Mancia v. Mayflower Textile Servs. Co.*, 253 F.R.D. 354, 357–58 (D. Md. 2008):

[Rule 26(g)] provides a *deterrent* to both *excessive discovery* and *evasion* by imposing a certification requirement that obligates each attorney to *stop and think about the legitimacy of a*

its burden to be as specific as possible when requesting information in discovery or making pre-litigation preservation demands.

During the public comment period, a very short comment was received stating that in the commenter's view, Principle 2 "shifts the burden of proof improperly." While we agree this Principle shifts the burden of proof to the responding party,¹³³ we believe this is a fair compromise and the correct result for several reasons:

discovery request. . . . [T]he rule aspires to eliminate one of the most prevalent of all discovery abuses: kneejerk discovery requests served without consideration of cost or burden to the responding party. Despite the requirements of the rule, however, the reality appears to be that with respect to certain discovery, principally interrogatories and document production requests, lawyers customarily serve requests that are far broader, more redundant and burdensome than necessary to obtain sufficient facts to enable them to resolve the case through motion, settlement or trial.

(emphasis in original); *Frey v. Gainey Transp. Servs.*, No. CIVA 1:05CV1493 JOF, 2006 WL 2443787, at *9 (N.D. Ga. Aug. 22, 2006) (Courts frown on overly broad preservation/"spoliation" letters/demands that "lend itself to an effort on any plaintiff's part to sandbag a defendant in the event that any of those materials were not preserved."); *Accord* FED. R. CIV. P. 34(b) Committee Note (Dec. 15, 2015) (Although objections to Rule 34 requests must be stated with specificity under the amended Rule, "[a]n objection may state that a request is overbroad.").

133. See, e.g., *Matthew Enterprise, Inc. v. Chrysler Grp. LLC*, No. 13-cv-04236, 2015 WL 8482256 (N.D. Cal. Dec. 10, 2015) ("The party seeking production of the documents . . . bears the burden of proving that the opposing party has such control."); *Alexander Interactive, Inc. v. Adorama, Inc.*, No. 12 CIV. 6608 PKC JCF, 2014 WL 61472, at *3 (S.D.N.Y. Jan. 6, 2014) ("Where control is contested, the party seeking production of documents bears the burden of establishing the opposing party's control over those documents."); *St. Jude Med. S.C., Inc. v. Jassen-Counotte*, 104 F. Supp. 3d 1150, 1159 (D. Ore. 2015) ("The burden is on the party seeking the production of documents to

- First, the burden is not a high one. If a party does not have actual possession or custody of Documents and ESI that are “specifically requested” under a proper Rule 34 request,¹³⁴ or the legal right to obtain such Documents and/or Data, a simple representation (via a meet-and-confer letter, declaration, discovery response, or deposition testimony) so stating this meets the burden. The burden would then switch to the requesting party to demonstrate that the responding party indeed has the legal right to obtain the specific Documents and ESI they want, if they believe that is the case.
- As noted above, the burden of proof is intended to be fluid; if the requesting party has equal or superior access to information about the responding party’s legal right to obtain the requested Documents and ESI, then the burden should shift to the requesting party. In short, the parties and the court have a collective responsibility to address these issues, which follows how responsibilities are allocated when addressing similar proof issues under the Federal Rules.¹³⁵

prove that the opposing or subpoenaed party has the requisite control.”). *Accord In re Porsche Cars N. Am., Inc.*, No. 2:11-MD-2233, 2012 WL 4361430, at *4 (S.D. Ohio Sept. 25, 2012) (“Speculation that one company has legal control over the documents of another company simply because they are related corporate entities is insufficient to establish control and compel discovery.”).

134. See FED. R. CIV. P. 34 (b)(1)(A) (“Contents of the Request. The request must describe with reasonable particularity each item or category of items to be inspected.”).

135. See, e.g., FED. R. CIV. P. 26(b), Committee Note (Dec. 15, 2015) (emphasis added):

- Finally, Sedona wants to ultimately have a balanced approach to these issues and believes this is a fair trade-off for achieving a national standard. While responding parties will no longer be unfairly burdened with having to preserve, search, review, and produce Documents and ESI they have no legal right to obtain, there is now a small burden placed on them to demonstrate they do not have the legal right to do so when faced with a specifically tailored request for such Documents and ESI.

Restoring the proportionality calculation to Rule 26(b)(1) does not change the existing responsibilities of the court and the parties to consider proportionality, and the change does not place on the party seeking discovery the burden of addressing all proportionality considerations.

Nor is the change intended to permit the opposing party to refuse discovery simply by making a boilerplate objection that it is not proportional. *The parties and the court have a collective responsibility to consider the proportionality of all discovery and consider it in resolving discovery disputes.*

Principle 3(a): *When a challenge is raised about whether a responding party has Rule 34 or Rule 45 “possession, custody, or control” over Documents and ESI, the Court should apply modified “business judgment rule” factors that, if met, would allow certain, rebuttable presumptions in favor of the responding party.*

Principle 3(b): *In order to overcome the presumptions of the modified business judgment rule, the requesting party bears the burden to show that the responding party’s decisions concerning the location, format, media, hosting, and access to Documents and ESI lacked a good faith basis and were not reasonably related to the responding party’s legitimate business interests.*

Comments:

A. Rule 34 Application of the Business Judgment Rule

The business judgment rule is an acknowledgment of the managerial prerogatives of [] directors [of a corporation] under [a state statute]. It is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Absent an abuse of discretion, that judgment will be respected by the courts. The burden is on the party challenging the decision to establish facts rebutting the presumption.¹³⁶

As applied in the context of possession, custody, or control of Documents and ESI, the business judgment rule would acknowledge the managerial prerogatives of an enterprise in

136. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000) (internal citations omitted).

managing its Documents and ESI if it acts on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the organization. Once this showing is made, absent demonstrable proof that decisions concerning the management of Documents and ESI lacked a good faith business basis, those decisions will be respected by the courts.¹³⁷ The burden is on the party challenging the decision to establish facts rebutting the presumption.¹³⁸ Cases that apply the business judgment rule identify foundational principles that courts may apply, in a slightly modified manner, to adjudicate disputes concerning Rule 34 possession, custody, or control of Documents and ESI, including:

137. In the context of motion practice concerning electronic discovery disputes, pre-litigation decisions by an organization concerning the treatment of Documents and ESI may be documented and supported by sworn affidavits of fact submitted by an affiant who is competent and authorized to make such affidavits.

138. The business judgment rule arises and is typically applied in the context of corporate transactions. This Commentary seeks to translate the deference that courts grant to a corporate board's business decisions into deference that courts should grant to an entity's pre-litigation decisions concerning IT systems and information management in the context of electronic discovery. The authors note that in contrast to board decisions concerning corporate transactions, lower-level personnel within an organization typically make pre-litigation IT and information management decisions. For this reason, this Commentary does not advocate a literal application of each aspect of the business judgment rule to an entity's or organization's pre-litigation decisions.

For a thorough discussion of information management in the context of eDiscovery, see The Sedona Conference, *Commentary on Information Governance*, 15 SEDONA CONF. J. 125 (2014), available at <https://thesedonaconference.org/publication/The%20Sedona%20Conference%C2%AE%20Commentary%20on%20Information%20Governance>.

- a rebuttable presumption that good faith decisions concerning the management of Documents and ESI are not subject to discovery;¹³⁹
- absent a colorable rebuttal of the presumption, courts will not substitute their judgment for that of the responding party if the decision can be attributed to a rational business purpose;¹⁴⁰
- the presumption shields good faith business decisions that are reasonably prudent and believed to be in the entity's best interest at the time they are made;¹⁴¹
- courts will not overturn decisions concerning the management of Documents and ESI unless the decisions lack any rational business purpose;¹⁴² and
- the rebuttable presumption shields entities from allegations of spoliation arising from

139. *See, e.g.,* Seidman v. Clifton Sav. Bank, S.L.A., 205 N.J. 150, 166, 14 A.3d 36, 45 (2011):

Under the business judgment rule, there is a rebuttable presumption that good faith decisions based on reasonable business knowledge by a board of directors are not actionable by those who have an interest in the business entity. The rule protects a board of directors from being questioned or second-guessed on conduct of corporate affairs, except in instances of fraud, self-dealing, or unconscionable conduct; it exists to promote and protect the full and free exercise of the power of management given to the directors. Stated differently, bad judgment, without bad faith, does not ordinarily make officers individually liable.

140. *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 928 (Del. 2003).

141. *Oberbillig v. W. Grand Towers Condo. Ass'n*, 807 N.W.2d 143, 154 (Iowa 2011).

142. *Laborers' Local v. Intersil*, 868 F. Supp. 2d 838, 846 (N.D. Cal. 2012).

good faith business decisions made in an informed and deliberate manner. However, entities may be susceptible to a spoliation finding where their decisions demonstrate bad faith.¹⁴³

The type of deference afforded by a modified business judgment rule analysis is already enshrined in electronic discovery case law.¹⁴⁴ In the eDiscovery context, courts have already recognized the type of presumptions that are allowed by the business judgment rule, by similarly deferring to an entity's data management decisions.¹⁴⁵ This type of deference to good faith business decisions also acknowledges that the management of ESI, including in the context of preservation and spoliation, "cannot be analyzed in the same way as similar claims

143. *TSG Water Res., Inc. v. D'Alba & Donovan Certified Pub. Accountants, P.C.*, 260 F. App'x 191, 197 (11th Cir. 2007).

144. "[Because] there are many ways to manage electronic data, litigants are free to choose how this task [preservation] is accomplished" and responding parties are "best situated" to evaluate the detailed procedures, methodologies, and technologies "appropriate for preserving and producing their own electronic data and documents." The Sedona Conference, *Commentary on Preservation, Management and Identification of Sources of Information that are Not Reasonably Accessible*, 10 SEDONA CONF. J. 281, 284 (2008) (citing *Zubulake v. UBS Warburg LLC* ("Zubulake IV"), 220 F.R.D. 212, 218 (S.D.N.Y. 2003) and Principle 6 of The Sedona Conference, *The Sedona Principles: Best Practices Recommendations & Principles for Addressing Electronic Document Production*, THE SEDONA CONFERENCE (2nd ed. 2007), available at <https://thesedonaconference.org/publication/The%20Sedona%20Principles>).

145. See *E.I. du Pont de Nemours and Co. v. Kolon Indus., Inc.*, No. 3:09CV58, 2011 WL 1597528 (E.D. Va. Apr. 27, 2011) (deferring to producing party's decision after the onset of litigation to shorten retention period of email in view of evidence that party's preservation process was reasonable and undertaken in good faith).

involving static information.”¹⁴⁶ Rule 37(e) further buttresses the exercise of deference because it shields entities from spoliation liability when the routine, good faith operation of electronic information systems causes the loss of information after the onset of a duty to preserve.

Further, the Federal Rules’ meet and confer obligations, particularly with respect to scope of discovery, issues about disclosure of Documents and ESI, protective orders, and motions to compel¹⁴⁷ should obviate the need for formal discovery into pre-litigation business decisions about the management of Documents and ESI for purposes of applying the presumptions of the business judgment rule. In situations where the modified business judgment presumptions are being invoked, those rules should encourage parties to informally exchange general information about the circumstances under which the pre-litigation decision(s) concerning management of the Documents and ESI at issue were made. *However, it is important to note that those considerations only apply if a responding party is relying upon the modified business judgment rule presumptions.* Stated another way, this Principle is not intended to create a general right to inquire about or conduct discovery into pre-litigation business decisions about a party’s management of Documents and ESI; it is only if the modified business judgment rule is being asserted that such disclosures may be required to capitalize on the presumptions. Likewise, litigants and the courts can use Rule 26(b)(2)(C)(iii) as a proxy for one of the main tenets of the busi-

146. The Sedona Conference, *Commentary on Preservation, Management and Identification of Sources of Information that are Not Reasonably Accessible*, *supra* note 144, at 285 (quoting Lee H. Rosenthal, *A Few Thoughts on Electronic Discovery After December 1, 2006*, 116 YALE L. J. POCKET PART 167 (2006), <http://yalelawjournal.org/forum/an-overview-of-the-e-discovery-rules-amendments>).

147. See FED. R. CIV. P. 26(c) and (f) and FED. R. CIV. P. 37(d)(1)(B).

ness judgment rule, namely the application of a rebuttable presumption that good faith decisions concerning the management of Documents and ESI are not subject to discovery.¹⁴⁸

To summarize, the presumption that an entity made good faith pre-litigation business decisions concerning the management of its Documents and ESI shall apply when: (1) after

148. The Sedona Conference, *Commentary on Proportionality in Electronic Discovery*, 11 SEDONA CONF. J. 289, 294 (2010), available at <https://thesedonaconference.org/publication/The%20Sedona%20Conference%20Commentary%20on%20Proportionality>. See also *Wood v. Capital One Servs., LLC*, No. 09-CV-1445 NPM/DEP, 2011 WL 2154279, at *5, 7 (N.D.N.Y. Apr. 15, 2011) (noting that “the scope of discovery is defined in the first instance by relevance to the claims and defenses in a case” and, applying proportionality principles, denying plaintiff’s motion to compel production of emails and other ESI where “the relevance of the specific discovery sought is marginal, and the information sought is not likely to play an important role in resolving the material issues in the case”); *Tamburo v. Dworkin*, No. 04 C 3317, 2010 WL 4867346, at *3 (N.D. Ill. Nov. 17, 2010) (ordering a phased discovery schedule “to ensure that discovery is proportional to the specific circumstances of this case, and to secure the just, speedy, and inexpensive determination of this action”); *E.I. du Pont de Nemours and Co. v. Kolon Industries, Inc.*, No. 3:09CV58, 2011 WL 1597528, at *10 (E.D. Va. Apr. 27, 2011) (citing *Victor Stanley’s, infra* following case citation, discussion of proportionate preservation conduct and denying motion for spoliation sanctions where responding party took reasonable measures to preserve information and could not have reasonably known that certain custodians’ emails would be relevant to the other side’s defenses); *Victor Stanley, Inc. v. Creative Pipe, Inc.*, 269 F.R.D. 497, 522–23 (D. Md. 2010):

[W]hether preservation or discovery conduct is acceptable in a case depends on what is reasonable, and that in turn depends on whether what was done—or not done—was proportional to that case and consistent with clearly established applicable standards. . . . [A]ssessment of reasonableness and proportionality should be at the forefront of all inquiries into whether a party has fulfilled its duty to preserve relevant evidence.

(internal citation and quotation omitted).

asserting an intention to rely upon the modified business judgment rule presumption, the entity meets its obligation to make good faith Rule 26 disclosures concerning pre-litigation decisions that were made about Documents and ESI and (2) absent indicia of bad faith. Once that showing is made, if the requesting party wants to challenge the presumption, it bears the burden to demonstrate that the producing party's pre-litigation decisions about Documents and ESI were made in bad faith, i.e., the entity did not act on an informed basis, or in good faith, and in the honest belief that the action taken was in the best interests of the organization, by adducing actual evidence (not mere speculation)¹⁴⁹ in support of such a claim in accordance with the mandates of Rules 26(g) and 11.¹⁵⁰ Facts supporting an "improper purpose" attack against the presumption could include

149. See, e.g., *In re Ford Motor Co.*, 345 F.3d 1315, 1317 (11th Cir. 2003) (vacating order allowing discovery of certain databases where there was no factual finding of "some non-compliance with discovery rules by Ford"); *Scotts Co., LLC v. Liberty Mut. Ins. Co.*, No. CIV. A. 2:06-CV-899, 2007 WL 1723509 (S.D. Ohio June 12, 2007) (mere suspicion that defendant was withholding ESI is an insufficient basis to permit discovery on discovery, including forensic searches of defendant's computer systems, network servers, and databases); *Hubbard v. Potter*, 247 F.R.D. 27 (D.D.C. 2008) (rejecting a request for additional discovery because speculation that other electronic documents existed does not overcome a Rule 26(g) certification); *Beverly Hills Unified Sch. Dist. v. Fed. Transit Admin.*, No. CV 12-9861-GW SXX, 2013 WL 6154168 (C.D. Cal. Nov. 7, 2013) (belief that destroyed emails would demonstrate failure to comply with federal law too speculative to justify additional discovery); *Rusk v. New York State Thruway Auth.*, No. 10-CV-0544A SR, 2011 WL 6936344, at *2 (W.D.N.Y. Dec. 29, 2011) (denying plaintiff's motion to compel as "[p]laintiff's speculation that additional e-mails exist is insufficient to overcome counsel's declaration that a search for responsive documents has been conducted and that responsive documents have been disclosed").

150. The Advisory Committee's Notes to Rule 26(g) explain that the rule "parallels the amendments to Rule 11" and "requires that the attorney make a reasonable inquiry into the factual basis of his response, request, or objection." FED. R. CIV. P. 26(g) Advisory Committee Notes (1983). Further,

business decisions that render the information more difficult or expensive to access for litigation without offering a corresponding business advantage, or downgrading the “usability” of electronic information without a corresponding business reason for doing so.

B. Appropriate Modifications of the Business Judgment Rule for Rule 34 and Rule 45 Analysis of Possession, Custody, or Control

To be fairly applied in the Rule 34 and Rule 45 “possession, custody, or control” context, some adjustments need to be made to the traditional business judgment rule factors. These include the following:

- First, the business judgment rule’s traditional “abuse of discretion” standard should be eliminated in this context, in favor of the “control” paradigm advanced earlier in this Commentary.¹⁵¹
- Second, the traditional form of the business judgment rule requires courts to honor the or-

“[t]he duty to make a ‘reasonable inquiry’ is satisfied if the investigation undertaken by the attorney and the conclusions drawn therefrom are reasonable under the circumstances. It is an objective standard similar to the one imposed by Rule 11.” *Id.*

151. Further, when a court attempts to adjudicate motive, it is difficult to apply the business judgment rule’s “abuse of discretion” test because it distracts from the analysis of the entity’s underlying good or bad faith. Under a modified business judgment rule adapted to provide an analytical framework to adjudicate disputes concerning the possession, custody, or control of Documents and ESI, the entity and its personnel would enjoy a presumption that business decisions taken within the scope of their duties were made in the good faith and honest belief that the action taken was in the best interests of the company. Determination of the entity’s intent (i.e., their “good faith” or not) take a back seat to determining whether the entity made a legitimate business decision, regardless of intent.

ganization's directors' business judgment absent an abuse of their discretion. In the context of Rule 34 possession, custody, or control, however, IT executives and other personnel with decision-making authority are not directly analogous to members of boards of directors, who are company executives of the highest level. In contrast, personnel charged with decision making regarding the management of electronic information typically occupy a lower rung in corporate managerial hierarchies.

- Third, the traditional factors that courts have examined to determine whether a company properly exercised its business judgment¹⁵² should be adjusted as follows for the Rule 34 context:

152. See, e.g., *In re Abbott Laboratories Derivative Shareholders Litig.*, 325 F.3d 795, 806 (7th Cir. 2003); *Ocilla Indus., Inc. v. Katz*, 677 F. Supp. 1291, 1298 (E.D.N.Y. 1987); *Herald Co. v. Seawell*, 472 F.2d 1081, 1101 (10th Cir. 1972); *In re Gulf Fleet Holdings, Inc.*, 491 B.R. 747, 770 (Bankr. W.D. La. 2013); *In re PSE & G S'holder Litig.*, 173 N.J. 258, 296, 801 A.2d 295, 319 (2002).

TRADITIONAL BUSINESS JUDGMENT RULE	RULE 34 POSSESSION, CUSTODY, OR CONTROL BUSINESS JUDGMENT RULE
Pre-decision conduct	Same
The decision-making method	Same
The decision-makers themselves	Same
Formality of the decision	Business basis of the decision
Impact of the decision on the directors, the company, and the shareholders	Impact of the decision on the possession, custody, or control of Documents and ESI

In particular, set forth below is a table that in the left column recites *non-exclusive*¹⁵³ factors cited by courts applying the business judgment rule to adjudicate business disputes,¹⁵⁴ and in the right column contains suggestions for how the business judgment rule factors should be applied in the Rule 34 context.

153. The table is not intended to serve as an exhaustive, exclusive, or mandatory ‘checklist’ of requirements or analytical factors.

154. See *Baldwin v. Bader*, 585 F.3d 18, 22 (1st Cir. 2009); *Cia Naviera Financiera Aries, S.A. v. 50 Sutton Place South Owners, Inc.*, 510 F. App’x 60, 63 (2d Cir. 2013); *Halebian v. Berv*, 644 F.3d 122, 131 (2d Cir. 2011); *In re Lemington Home for Aged*, 659 F.3d 282, 292 (3d Cir. 2011), *as amended* (Oct. 20, 2011), *subsequent mandamus proceeding sub nom. In re Baldwin*, 700 F.3d 122 (3d Cir. 2012); *Dellastatious v. Williams*, 242 F.3d 191, 194 (4th Cir. 2001); *Bolton v. Tesoro Petroleum Corp.*, 871 F.2d 1266, 1274 (5th Cir. 1989); *Priddy v. Edelman*, 883 F.2d 438, 443 (6th Cir. 1989); *In re Abbott Laboratories Derivative Shareholders Litig.*, 325 F.3d 795, 807 (7th Cir. 2003); *Potter v. Hughes*, 546 F.3d 1051, 1059 (9th Cir. 2008); *Hoye v. Meek*, 795 F.2d 893, 896 (10th Cir. 1986); *TSG Water Resources, Inc. v. D’Alba & Donovan Certified Public Accountants, P.C.*, 260 F. App’x 191, 198 (11th Cir. 2007); *Pirelli Armstrong Tire Corp. v. Retiree Med. Benefits Trust*, 534 F.3d 779, 791 (D.C. Cir. 2008).

<p>TRADITIONAL BUSINESS JUDGMENT RULE FACTOR</p>	<p>RULE 34 POSSESSION, CUSTODY, OR CONTROL BUSINESS JUDGMENT RULE FACTOR</p>
<p>Whether the decision was made with requisite care and diligence</p>	<p>Adopt as is</p>
<p>Whether the decision was an exercise in arbitrariness, favoritism, discrimination, or malice</p>	<p>Adopt as is</p>
<p>Whether the decision was made after reasonable inquiry</p>	<p>Adopt as is</p>
<p>Whether the decision was made after reasonable investigation and in a cool, dispassionate, and thorough fashion</p>	<p>Adopt as is</p>
<p>Whether the methods and procedures followed in gathering and analyzing information prior to making a decision were restricted in scope, shallow in execution, a mere pretext, half-hearted, or a sham</p>	<p>Adopt as is</p>
<p>Whether the decision was made independently</p>	<p>Adopt as is</p>
<p>Whether the decision-maker was assisted by counsel or other “reputable outside advisors”</p>	<p>Whether the decision-maker was assisted by “reputable advisors”¹⁵⁵</p>
<p>Whether the decision was made in reliance on advice of experienced and knowledgeable counsel</p>	<p>Whether the decision was made in reliance on advice of experienced and knowledgeable personnel¹⁵⁶</p>
<p>Whether the decision was delegated to a person who was not properly supervised</p>	<p>Adopt as is</p>

155. Reputable advisors include internal or outside advisors.

156. Experienced and knowledgeable personnel include internal or outside resources.

TRADITIONAL BUSINESS JUDGMENT RULE FACTOR	RULE 34 POSSESSION, CUSTODY, OR CONTROL BUSINESS JUDGMENT RULE FACTOR
Whether the decision-makers complied with any applicable legal duties	Adopt as is
Whether the decision was documented	Adopt as is
The speed with which the decision was made	Adopt as is
Whether the decision was the result of collusion between a director and an outsider	Whether the decision was demonstrably the result of an improper attempt to render information less useable or accessible to achieve tactical advantage in litigation
Whether the decision was made with a “we don’t care about the risks” attitude	Adopt as is
Whether the decision promoted directors’ personal interests	Not applicable
Whether benefits accruing to the directors from the decision were made available to other shareholders on equal terms	Not applicable
Whether the decision was fair	Not applicable

Importantly, it is recognized that the business judgment rule was created to protect members of the Boards of Directors, not rank-and-file executives, managers, or other decision-makers. Courts should translate the rule to fit the circumstances of electronic discovery when applying it to pre-litigation decisions made by an entity’s personnel below the board of director level concerning the management of electronic information. When a corporate document/data storage or retention decision is made by a person whose legal duties arise from the employment relationship instead of membership on the board, examination of the decision should legitimately include inquiry into why the

decision-maker was authorized to make the decision. The question of “why” reflects directly on the issue of whether the company acted “in good faith.”

Finally, like other areas of electronic discovery, the business judgment rule provides courts with an analytical framework to conduct case and fact specific inquiries¹⁵⁷ to resolve parties’ Rule 34 and Rule 45 disputes over possession, custody, or control.¹⁵⁸

C. *The (Re)Emergence of Information Governance*

During the past several years, there has been a renewed recognition that one of the most effective ways to streamline

157. Determining when the duty to preserve is triggered is always a fact-specific analysis that depends on the unique circumstances of each case. *See generally* Rimkus Consulting Grp., Inc. v. Cammarata, 688 F. Supp. 2d 598, 613 (S.D. Tex. 2010) (The “analysis [of when the duty to preserve arises] depends heavily on the facts and circumstances of each case and cannot be reduced to a generalized checklist of what is acceptable or unacceptable.”) (citing Pension Comm. of Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC, 685 F. Supp. 2d 456, 464–65 (S.D.N.Y. 2010), *abrogated by* Chin v. Port Auth. of New York & New Jersey, 685 F.3d 135 (2d Cir. 2012)); Victor Stanley, Inc. v. Creative Pipe, Inc., 269 F.R.D. 497, 522 (D. Md. 2010) (“[T]he duty to preserve evidence should not be analyzed in absolute terms; it requires nuance, because the duty ‘cannot be defined with precision.’”) (internal quotation omitted); Cache La Poudre Feeds, LLC v. Land O’ Lakes, Inc., 244 F.R.D. 614, 621 (D. Colo. 2007) (When deciding when the duty to preserve evidence arises, “[u]ltimately, the court’s decision must be guided by the facts of each case.”). *Cf. also* The Sedona Conference, *Commentary on Legal Holds: The Trigger & The Process*, 11 SEDONA CONF. J. 265, 268 (2010), available at <https://thesedonaconference.org/publication/The%20Sedona%20Conference%20Commentary%20on%20Legal%20Holds> (“The basic principle that an organization has a duty to preserve relevant information in anticipation of litigation is easy to articulate. However, the precise application of that duty can be elusive.”).

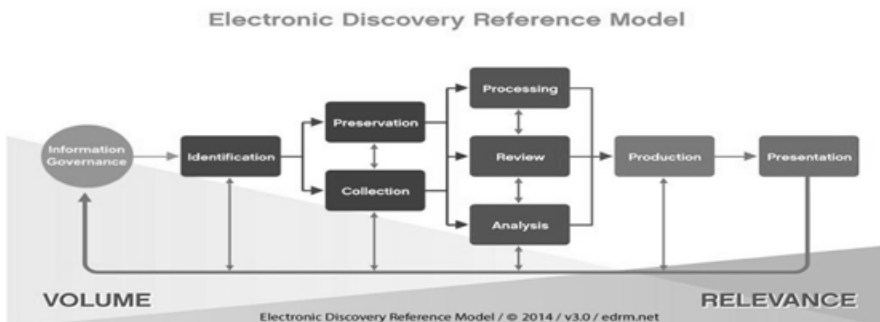
158. This is an area where individual judges can apply their discretion in applying the business judgment factors.

eDiscovery in litigation, including the associated costs, is to better organize massive volumes of data in the first instance, or what is sometimes referred to as a focus on the left-hand side of the EDRM (Electronic Discovery Reference Model).¹⁵⁹

The Sedona Conference has specifically published a Commentary on those issues.¹⁶⁰ The *Commentary on Information Governance* notes that the benefits of establishing an information governance program include: “enhanced compliance with legal obligations for records retention, privacy and data security, and e-discovery, as information policies and processes are rationalized, integrated, and aligned in accord with the organization’s information governance strategy.”¹⁶¹

Applying the modified business judgment factors in the context of Rule 34 and 45 possession, custody, or control decisions will further the goal of encouraging the expansion of information governance programs to help reduce eDiscovery costs in litigation, which is again consistent with the mandates of Fed. R. Civ. P. 1.

159.



160. See The Sedona Conference, *Commentary on Information Governance*, 15 SEDONA CONF. J. 125, 134 (2014), available at <https://thesedonaconference.org/publication/The%20Sedona%20Conference%20Commentary%20on%20Information%20Governance>.

161. *Id.* at 134.

Principle 4: *Rule 34 and Rule 45 notions of “possession, custody, or control” should never be construed to override conflicting state or federal privacy or other statutory obligations, including foreign data protection laws.*

Comments:

The mere fact that a party may be deemed to have possession, custody, or control over certain Documents or ESI is not necessarily dispositive of whether the Documents and ESI ultimately can or should be produced. State and federal statutory limitations, privacy laws, or international laws may preclude or limit disclosure of the kind of Documents or ESI sought. Thus, the possession, custody, or control analysis should also factor in federal and state statutory non-disclosure obligations, along with foreign data protection laws, to ensure that discovery obligations are not inconsistent and do not force non-compliance. This is particularly true when the scope of discovery implicates disclosure of information involving consumers’ rights and privacy considerations.

A. Examples of Overriding Statutory Restrictions

For example, the Financial Services Modernization Act of 1999, also known as the Gramm-Leach-Bliley Act (GLBA), precludes financial institutions from “disclos[ing] to a nonaffiliated third party any nonpublic personal information, unless such financial institutions provide or have provided to the consumer a notice that complies with section 6803 of this title.”¹⁶² The statute by its terms supersedes “any [s]tate statute, regulation, order, or interpretation” to the extent that they are inconsistent with state law.¹⁶³ A number of courts have interpreted this language to hold that GLBA preempts any inconsistent or contrary state law,

162. 15 U.S.C.A. § 6802(a) (1999).

163. 15 U.S.C.A. § 6807(a) (1999).

rule, ordinance, or court order.¹⁶⁴ Additionally, at least one court has extended GLBA non-disclosure requirements to third parties with whom the financial institution does business.¹⁶⁵

Similarly, the Health Insurance Portability and Accountability Act of 1996 (HIPAA) and its implementing regulations restrict the release of individually identifiable “protected health information” by health care providers to litigants and may be in conflict with discovery obligations.¹⁶⁶ Among other things, HIPAA precludes health care providers from responding to “a subpoena, discovery request, or other lawful process that is not accompanied by an order of court or administrative tribunal” unless the health care provider “receives satisfactory assurance . . . from the party seeking the information” of “reasonable efforts” to (i) provide appropriate notice to the affected patient or (ii) secure a qualified protective order.¹⁶⁷ However, HIPAA by its terms establishes a floor, not a ceiling, thus more restrictive state statutes (meaning those under which the patient is afforded greater protection from disclosure) are not preempted.¹⁶⁸

Other federal statutes such as the Genetic Information Nondiscrimination Act of 2008 (GINA),¹⁶⁹ Computer Fraud &

164. See *Bowler v. Hawke*, 320 F.3d 59 (1st Cir. 2003) (GLBA preempts state statutes regulating insurance); *Cline v. Hawke*, 51 F. App'x 392 (4th Cir. 2002) (GLBA preempted certain West Virginia insurance regulations); *Gen. Motors Corp. v. Kilgore*, 853 So. 2d 171 (Ala. 2002) (GLBA preempts Alabama law permitting discovery of certain information).

165. *Union Planters Bank v. Gavel*, No. CIV. A. 02-1224, 2002 WL 975675 (E.D. La. May 9, 2002), *vacated on other grounds*, 369 F.3d 457 (5th Cir. 2004) (holding that GLBA precludes a third party from complying with a subpoena absent consent of the defendant's customers where the third party's business was financial in nature).

166. 45 C.F.R. § 164.512(e) (2016).

167. *Id.*

168. 45 C.F.R. § 160.203 (2016).

169. Pub. L. No. 110-233, 122 Stat. 881 (May 21, 2008).

Abuse Act (CFAA),¹⁷⁰ and Stored Communications Act (SCA),¹⁷¹ and their state equivalents, likewise impose strict limitations on disclosure of data and further limit the manner in which such data may be obtained, which may be in conflict with discovery obligations. For example, under Fed. R. Civ. P. 34, a court may find that an employer has sufficient control over corporate data on dual-use devices (devices used by an employee for both business and personal purposes, also known as “bring your own device” (BYOD)) and is obligated to preserve and produce such relevant information. However, under some circumstances, employers may risk liability for reviewing certain information stored on an employee’s dual-use device regardless of the employer’s policy or of the employee’s purported “consent,” leaving employers in an unwinnable discovery catch-22.¹⁷²

Likewise, employers who access information stored on a dual-use device, even with the employee’s authorization, could still be exposed to liability for statutory breaches under certain circumstances due to the nature of the data stored on the device, for example, if the employer accessed information protected by GINA or the American’s With Disabilities Act (ADA).¹⁷³ In addition, many states have enacted some type of social media password protection laws, which prohibit employers from requiring employees to disclose user names and passwords for

170. 18 U.S.C. § 1030.

171. 18 U.S.C. §§ 2701–2712.

172. *See, e.g.*, Computer Fraud and Abuse Act, 18 U.S.C. § 1030 (2008); computer trespass laws that have been enacted by all 50 states; *Pure Boot Camp, Inc. v. Warrior Fitness Boot Camp, LLC*, 587 F. Supp. 2d 548 (S.D.N.Y. 2008); *Pietrylo v. Hillstone Restaurant Grp.*, No. CIV.06-5754(FSH), 2009 WL 3128420 (D.N.J. Sept. 25, 2009).

173. 42 U.S.C. § 12112 *et seq.* (1995).

personal social networking accounts like Facebook, Twitter, and LinkedIn.¹⁷⁴

Thus, while a responding party may have control over certain Documents or ESI based on the manner and location in which they are stored, production of such information in the course of litigation must be reconciled with overarching privacy considerations by which a responding party is statutorily bound. Accordingly, courts evaluating whether a responding party has possession, custody, or control should give deference to state and federal statutes limiting or precluding disclosure, and litigants should not be punished in discovery disputes for complying with such laws.

174. See Philip L. Gordon & Joon Hwang, *Making Sense of the Complex Patchwork of State Social Media Password Protection Laws Creates Challenges for Employers*, LITTLER (May 13, 2013), <http://www.littler.com/making-sense-complex-patchwork-created-nearly-one-dozen-new-social-media-password-protection-laws> (“In a single season, spring 2013, seven states enacted social media password protection legislation, bringing the total number of states to 11 since Maryland enacted the first such law in May 2012. Bills are pending in more than 20 other states. The current roster of states, dominated by the Rocky Mountain Region and the Far West, is as follows: Arkansas, California, Colorado, Illinois, Maryland, Michigan, Nevada, New Mexico, Oregon, Utah and Washington. New Jersey appears poised to join this group as the state’s legislature amends a bill conditionally vetoed by Governor Christie in May.”); Brent Johnson, *Christie signs bill banning N.J. companies from forcing workers to hand over social media passwords*, THE STAR LEDGER (August 29, 2013), http://www.nj.com/politics/index.ssf/2013/08/christie_signs_bill_banning_nj_companies_from_forcing_workers_to_hand_over_social_media_passwords.html (“Gov. Christie signed a bill today that will ban New Jersey companies from forcing workers to hand over user names or passwords to their social media accounts. Under [the legislation], companies will be fined \$1,000 if they request or demand access to workers’ or potential employees’ accounts on websites like Facebook, Twitter, LinkedIn and Pinterest.”).

B. *International Law must also be Considered*

The same analysis is necessary when parties seek foreign data that may be subject to data privacy and blocking statutes that operate to legally preclude discovery and/or movement of private data across the border into the United States.¹⁷⁵ At least 58 countries have been identified as having some form of autonomous data protection laws.¹⁷⁶ The consequences for violating international laws can be severe.¹⁷⁷ Moreover, a party may believe it owns ESI under United States law, but in fact may not own it under the laws of various foreign jurisdictions. As such, where international law is implicated, the question is not limited to whether a party simply has custody, but also whether the party actually has ownership over the Documents and ESI sought.¹⁷⁸ As a result, the relatively broad discovery permitted by United States federal courts is in direct conflict with international restrictions on data movement.¹⁷⁹

175. See 45 C.F.R. § 164.512(e); The Sedona Conference, *Framework for Analysis of Cross-Border Discovery Conflicts: A Practical Guide to Navigating the Competing Currents of International Data Privacy and e-Discovery*, *supra* note 48; see also Moze Cowper and Amor Esteban, *E-Discovery, Privacy, and the Transfer of Data Across Borders: Proposed Solutions for Cutting the Gordian Knot*, 10 SEDONA CONF. J. 263 (2009).

176. See The Sedona Conference, *International Overview of Discovery, Data Privacy & Disclosure Requirements*, THE SEDONA CONFERENCE (Sept. 2009), <https://thesedonaconference.org/publication/International%20Overview%20of%20Discovery%20Data%20Privacy%20and%20Disclosure%20Requirements>.

177. See The Sedona Conference, *Framework for Analysis of Cross-Border Discovery Conflicts: A Practical Guide to Navigating the Competing Currents of International Data Privacy and e-Discovery*, *supra* note 48.

178. See *Data Protection Laws of the World Handbook* (Cameron Craig, Paul McCormack, Jim Halpert, Kate Lucente, and Arthur Cheuk of DLA Piper, eds., 2012), <http://www.edrm.net/resources/data-privacy-protection/data-protection-laws>.

179. *Id.* at 23–26.

Indeed, foreign data laws such as the European Union's (EU) Data Protection Directive, directly conflict with ESI disclosure obligations that are otherwise required pursuant to the Fed. R. Civ. P.¹⁸⁰ Under some circumstances, the failure to adhere to foreign data laws could lead to criminal prosecution. For example, a violation of the German Federal Data Protection Act (BDSG), drafted to comply with the EU's Data Protection directive, makes disclosure of information protected by the German BDSG a criminal offense carrying substantial fines and/or jail terms.¹⁸¹

As discussed above, a responding party can find itself in a Catch-22 where it must collect and produce Documents and ESI pursuant to United States law but doing so would be impermissible and perhaps a crime in foreign jurisdictions. For this reason, courts evaluating possession, custody, and control in cases involving cross-border corporate families or in which Documents and ESI are otherwise protected by international laws should defer to international data privacy and blocking statutes by which a litigant may also be bound.

180. See Council Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the Protection of Individuals with Regard to the Processing of Personal Data and on the Free Movement of Such Data, 1995 O.J. (L 281) 31 (EC); http://ec.europa.eu/justice/policies/privacy/docs/95-46-ce/dir1995-46_part1_en.pdf.

181. See, e.g., *In re Vitamins Antitrust Litig.*, No. 99-197TFH, 2001 WL 1049433 (D.D.C. June 20, 2001).

Principle 5: *If a party responding to a specifically tailored request for Documents or ESI (either prior to or during litigation), does not have actual possession or the legal right to obtain the Documents or ESI that are specifically requested by their adversary because they are in the “possession, custody, or control” of a third party, it should, in a reasonably timely manner, so notify the requesting party to enable the requesting party to obtain the Documents or ESI from the third party. If the responding party so notifies the requesting party, absent extraordinary circumstances, the responding party should not be sanctioned or otherwise held liable for the third party’s failure to preserve the Documents or ESI.*

Comment:

As discussed throughout this Commentary, there are various situations in which a responding party does not own or “control” the Documents or ESI that have been requested, and instead is claiming that such Documents and ESI are in the hands of a third party.

For example, an employer may become aware that a custodian used a dual-use/BYOD personal device, personal web-mail, or a personal social media account to communicate about the facts underlying the lawsuit and those sources may contain relevant information. The employer, however, does not have Rule 34 “control” as espoused by this Commentary. In accordance with the Legal Right Plus Notification Standard, a responding party claiming it does not own or “control” relevant Documents and ESI is required to timely notify the requesting party,¹⁸² which allows the requesting party the opportunity to obtain those Documents and ESI from the third party.

182. Charter Oak Fire Insurance Co. v. Marlow Liquors, 908 F. Supp. 2d 673, 679 (D. Md. 2012) (citing *Silvestri v. Gen. Motors Corp.*, 271 F.3d 583, 591 (4th Cir. 2001)).

From a practical standpoint, this approach enables the requesting party, who has the greatest need and incentive to preserve the information, to learn about the existence of the data at around the same time as the responding party, and to have the same ability as the responding party to take steps to attempt to preserve or obtain access to the Documents or ESI from third parties through subpoenas or other mechanisms. If a responding party complies with its notice obligations, it should not be sanctioned if third parties do not cooperate with preservation or production efforts.

The concept of this Principle applies to pre-litigation demands for preservation as well, thus the language “either prior to or during litigation.”

Moreover, similar to the discussion in the comment to Principle 2, this Principle is also not intended to imply a general duty for a responding party to identify Documents and ESI that might be relevant in a case that are not within a party’s possession, custody, or control. Instead, it only applies to Documents and ESI that are “specifically requested,” in accordance with the general mandates of Rule 34.¹⁸³ Stated another way, this Principle does not apply unless and until the requesting party has met its burden to be as specific as possible when requesting information in discovery or making pre-litigation preservation demands.

183. See *supra* note 133.

THE POTENTIAL IMPACT OF ARTICLE 48 OF THE GENERAL DATA PROTECTION REGULATION ON CROSS BORDER DISCOVERY FROM THE UNITED STATES

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It is well understood that there is significant tension between the discovery process in the United States (U.S.) and the European Union Data Protection Laws based on the Directive 95/46/EC (the “Directive”) as implemented in the member states.¹ Substantially, much less perfectly, complying with the

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1. Presuming that a U.S. court has jurisdiction over a party, discovery is not limited to documents and electronically stored information (ESI) that are located within the U.S. so long as they are relevant, proportional, and within the party’s possession, custody, or control. Thus, the mere fact that a party has stored relevant ESI in another country does not exclude it from discovery (*e.g.*, at an offshore facility or second home). Likewise, if relevant

laws of all international jurisdictions is a difficult, if not impossible, task for multinational companies doing business in the U.S. and the European Union (EU).

On May 25, 2018, the General Data Protection Regulation (GDPR) will become the law in all the member states and replace laws implementing the Directive. In many respects, the GDPR is similar to the Directive, but certain aspects of the regulation are different and may also impact U.S. discovery and parties' ability to produce responsive information containing personal data of EU data subjects to opposing parties and U.S. courts. This paper focuses on the impact of the newly introduced provision, Article 48 ("Art. 48" or "the Article"):

Any judgment of a court or tribunal and any decision of an administrative authority of a third country requiring a controller or processor to transfer or disclose personal data may only be recognised or enforceable in any manner if based on an international agreement, such as a mutual legal assistance treaty, in force between the requesting

ESI is stored with a third party outside the U.S., a party to U.S. litigation can still be forced to produce the ESI if the party retains control of the data. *See, e.g., U.S. v. Vetco, Inc.*, 691 F.2d 1281 (9th Cir. 1981) (holding that U.S. parent corporations must produce documents located abroad in the possession of foreign subsidiaries).

Thus, ESI sitting in the EU can become subject to both U.S. discovery (because it is relevant, proportional, and within the possession, custody, or control of a U.S. litigant) and the data protection laws applicable in the affected member state (because it contains personal data of an EU data subject and is within the control of an EU data controller). This creates a dilemma as the broad scope of the discovery conflicts with the procedural concepts of most of the member states of the EU (which do not know discovery) and, consequently, with the data protection principles in the EU limiting the transfer of personal data outside the European Economic Area (EEA). Moze Cowper & Amor Esteban, *eDiscovery, Privacy & the Transfer of Data Across Borders: Proposed Solutions for Cutting the Gordian Knot*, 10 SEDONA CONF. J. 263 (2009).

third country and the Union or a Member State, without prejudice to other grounds for transfer pursuant to this Chapter.²

There is no analogous provision under the Directive. To understand whether or not Art. 48 will complicate discovery requires not only understanding how the EU will interpret and apply this provision and its requirements, but also how courts in the U.S. (and, by extension, U.S. regulators) will interpret the Article. This paper attempts to provide a first analysis of Art. 48 from both perspectives.

I. SUBJECT AND CONTENT OF ARTICLE 48 OF THE GDPR

As explained, the legislative bodies have ultimately decided to include Art. 48 in order to specifically regulate requests from a court, tribunal, or administrative authority which is based in a third country (i.e., a country outside of the European Economic Area).

Since such provision cannot be found in the Directive 95/46/EC, as the current data protection regime in the EU which national laws are based on, it is questionable how the new Art. 48 will be interpreted and if and how it will ultimately change the legal requirements when it comes to dealing with discovery requests from third countries.

A. Current Legal Situation in the EU Regarding U.S. Discovery Requests

When currently dealing with discovery requests from U.S. courts or administrative authorities, companies, which themselves or whose subsidiaries or affiliates are based in the

2. Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation).

EU, are faced with significant legal hurdles when trying to comply with such requests regarding production of personal data of EU data subjects.

1. Requests by U.S. Courts Through the Hague Evidence Convention

In theory, it is possible for a U.S. court to make its discovery request through the Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters (“Hague Convention”) which is an international treaty allowing for legal assistance between different countries. This means that the request would be handled by a public authority in the country in which it is directed to.³ However, in practice, pursuing discovery through the Hague Convention is not a viable path in most cases involving EU countries because several EU member states have not become a party to the Hague Convention and some other major EU member countries that adopted the Hague Convention, such as Germany, have chosen to opt out of having to comply with discovery requests from third countries.⁴

2. Requests by U.S. Courts and Administrative Authorities Outside of International Treaties

Therefore, the more relevant cases are those where U.S. courts and administrative authorities are requesting personal data from EU-based companies, subsidiaries, or affiliates di-

3. Article 29 Data Protection Working Party, Working Paper (WP) 158, *Working Document 1/2009 on Pre-trial Discovery for Cross Border Civil Litigation* (Feb. 11, 2009), http://ec.europa.eu/justice/policies/privacy/docs/wpdocs/2009/wp158_en.pdf (hereinafter WP 158).

4. *Id.*; German Implementation Act of the Hague Convention § 14, ¶ 1 (1977).

rectly and without the use of international treaties for legal assistance.⁵ The strict requirements of EU data protection laws can make it very difficult to comply with such requests. Under EU data protection law, there are several legal requirements which have to be complied with and considered when dealing with discovery requests.

i. Collection and Transfer of Personal Data

The first major issue to analyze under the GDPR is that the collection and transfer of personal data has to be justified under a legal ground of EU data protection law.

a) Obtaining Consent of the Data Subjects

The most imminent and appealing legal ground under EU data protection laws is obtaining consent from the affected data subjects in the EU. However, EU data protection authorities (“DPAs”) are reluctant to accept consent of employees in many cases since, due to their obligations they owe to their employers, the DPAs question whether such consent would be based on the employees’ free will as required by EU data protection law.⁶ Additionally, employees could refuse to give their consent or withdraw it at a later stage, which is undesirable, because it might lead to the respective collection or transfer of data becoming legally impossible. Therefore, obtaining consent is not a viable option in many cases.

5. As discussed in detail below, under U.S. law, parties are not required to use the Hague Convention to obtain discovery of responsive materials in the possession, custody, or control of parties in U.S. litigation even if such material is stored outside the U.S.

6. WP 158, *supra* note 3.

b) Relying on a Provision of EU Data Protection Law

Since obligations under foreign law are generally not considered to be proper legal obligations under EU data protection law, the central provision which can allow a data transfer to the U.S. because of a discovery request requires such transfer to be in the legitimate interest of the transferring company with no existing overriding interest of the data subject.⁷

Based on this provision, DPAs in the EU generally allow documents to be transferred to the U.S. if personal data, which is not necessarily relevant for the discovery proceedings in the U.S., is redacted (i.e., anonymized).⁸

In addition, opposing counsel requesting discovery and U.S. courts ordering such production usually have to agree for the un-redacted personal data not to be publicized and only to be seen by the parties involved in the discovery proceedings. Furthermore, one has to generally put in place reasonable technical and organizational measures to ensure the security of the handling and especially the transfer of the affected data.⁹

Data protection law in the EU also requires for the affected data subjects to be informed of a transfer to the U.S.,¹⁰ while some European jurisdictions also obligate companies to potentially include a works council when dealing with personal data of employees.

One must keep in mind that EU data protection law considers certain categories of personal data, such as data relating to racial or ethnic origin and religious beliefs, to be especially

7. *Id.* at 9.

8. *Id.*

9. *Id.* at 12.

10. *Id.* at 11.

sensitive, and handling this type of data is even more restricted and requires further safeguards for the data subjects.¹¹

ii. Data Export of Personal Data to the U.S.

Data protection laws in the EU also require specific justification for the data export to a third country, such as the U.S., since they are generally not seen as providing an adequate level of protection from a data privacy standpoint.

Data protection laws also allow for personal data to be transferred for the defense of legal claims. However, the DPAs in the EU for the most part do not consider discovery proceedings as covered by said allowance since, in their opinion, they are just a precursor of the trial itself.¹²

Since its invalidation in October 2015 by a judgment of the Court of Justice of the European Union (CJEU),¹³ the Safe Harbor Decision, as the previously preferred solution, cannot be relied on for data exports to the U.S. any longer. The EU Commission is currently working with the U.S. to reach an agreement on a successor to the Safe Harbor Decision or the so called Privacy Shield.¹⁴ Since the CJEU judgment has set a very high bar for a successive agreement, it remains to be seen whether

11. *Id.* at 10.

12. *Id.* at 13.

13. Case C-362/14, Schrems v. Data Protection Comm'r, 2015 E.C.R. 650 (Oct. 6, 2015), http://curia.europa.eu/juris/document/document_print.jsf?doclang=EN&text=&pageIndex=0&part=1&mode=lst&docid=169195&occ=first&dir=&cid=441512; see also Press Release No. 117/15, *The Court of Justice declares that the Commission's US Safe Harbour Decision is invalid*, Court of Justice of the European Union (Oct. 6, 2015), <http://curia.europa.eu/jcms/upload/docs/application/pdf/2015-10/cp150117en.pdf>.

14. European Commission Press Release IP/16/216, EU Commission and United States Agree on New Framework for Transatlantic Data Flows: EU-US Privacy Shield (Feb. 2, 2016), available at http://europa.eu/rapid/press-release_IP-16-216_en.htm.

and when such solution can be put in place. Consent of the data subjects can generally also legitimize data exports. However, it should not be predominantly relied upon as a viable solution for the reasons stated previously.

Therefore, companies are left with two possible options which lead to additional problems. One of these options is Standard Contractual Clauses (“SCCs”) issued by the EU Commission which have to be signed by the data exporter in the EU and the data importer in the U.S. However, it is very unlikely that opposing counsel and U.S. courts can and will enter into respective transfer contracts with SCCs.¹⁵

The second option would be consideration of Binding Corporate Rules (“BCRs”), i.e., agreements between several entities of a multinational corporate group which allow for the sharing of personal data between them. However, similar to SCCs, onward transfers of data from the U.S. entity of a corporate group to opposing counsel and U.S. courts can generally not be legitimized through BCRs.

B. Legal Situation in the EU Regarding U.S. Discovery Requests Under the GDPR

In light of the legal situation under the current EU data protection regime, the question arises as to whether the newly introduced GDPR, especially its Art. 48, will materially change the rules in the EU when dealing with U.S. discovery requests.

1. Legislative History of Article 48

To better understand the impact of Art. 48, it is important to review its specific history based on the legislative process of the GDPR.

15. See generally Ralf Deutmoser & Alexander Filip, *European Data Privacy versus U.S.(e-) Discovery Obligations—A Practical Guide for Enterprises*, *Zeitschrift für Datenschutz* (6/2012).

The first draft of the GDPR was presented by the EU Commission on January 25, 2012. However, Art. 48 or a similar provision was not included at that time. Only at a later stage of the legislative process, a provision similar to Art. 48 was introduced in the March 12, 2014, draft of the European Parliament under Art. 43a:¹⁶

Transfers or disclosures not authorised by Union law

1. No judgment of a court or tribunal and no decision of an administrative authority of a third country requiring a controller or processor to disclose personal data shall be recognised or be enforceable in any manner, without prejudice to a mutual legal assistance treaty or an international agreement in force between the requesting third country and the Union or a Member State.
2. Where a judgment of a court or tribunal or a decision of an administrative authority of a third country requests a controller or processor to disclose personal data, the controller or processor and, if any, the controller's representative, shall notify the supervisory authority of the request without undue delay and must obtain prior authorisation for the transfer or disclosure by the supervisory authority.
3. The supervisory authority shall assess the compliance of the requested disclosure with this Regulation and in particular whether the disclosure is necessary and legally required in

16. European Parliament Draft of the General Data Protection Regulation (Mar. 12, 2014), <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2014-0212+0+DOC+XML+V0//EN>.

accordance with points (d) and (e) of Article 44(1) and Article 44(5). Where data subjects from other Member States are affected, the supervisory authority shall apply the consistency mechanism referred to in Article 57.

4. The supervisory authority shall inform the competent national authority of the request. Without prejudice to Article 21, the controller or processor shall also inform the data subjects of the request and of the authorisation by the supervisory authority and, where applicable, inform the data subject whether personal data were provided to public authorities during the last consecutive 12-month period, pursuant to point (ha) of Article 14(1).

Article 43a had a broader scope including an obligation to notify the relevant DPA as well as to “obtain prior authorization for the transfer or disclosure” by the relevant DPA¹⁷ which cannot be found in the final version of the provision. The implementation of such provision would have had a profound impact on how European companies dealing with U.S. discovery, while also complying with these provisions, would have been significantly more cumbersome.

The introduction of the provision was a reaction to the Snowden revelations in June 2013 about the National Security Administration’s (NSA) PRISM program and its worldwide mass surveillance.¹⁸ The purpose of its introduction was to avoid mass surveillance and other overly broad monitoring by

17. *Id.*

18. David Meyer, *Industry Issues Plea Over Data Reform*, POLITICO.COM (Aug. 27, 2015), <http://www.politico.eu/Art./industry-plea-data-reform-protection-privacy/>.

third countries, e.g., the NSA or the Foreign Intelligence Surveillance Court were able to request personal data from EU companies without arguably going through the proper legal channels under international laws.¹⁹

However, the subsequently released draft of the Council of the European Union dated June 11, 2015, did not contain a provision such as Article 43a.²⁰ This omission seems to show that there was disagreement between the legislative bodies in the EU on whether to even include a provision such as Article 43a in the GDPR.

Ultimately, and despite a lot of criticism from the U.S. as well as European businesses, it might be difficult if not impossible in some cases to comply with such provision while also complying with U.S. laws.²¹ Nevertheless, the EU kept the provision in the final version of the GDPR. However, only the first part of Article 43a within the draft of the European Parliament was retained while the rest of the proposed wording was removed.²² Furthermore, the clause “without prejudice to other grounds for transfer pursuant to this Chapter” was added as the last part of the provision. Especially the removal of the most restrictive parts of Article 43a shows that the final version of the GDPR does not intend to restrict dealing with discovery requests in the way which might have initially been intended by the draft of the European Parliament.

19. *Id.*

20. Council of the European Union Draft of the General Data Protection Regulation (June 11, 2015), <http://data.consilium.europa.eu/doc/document/ST-9565-2015-INIT/en/pdf>.

21. Meyer, *supra* note 18.

22. European Parliament Draft of the General Data Protection Regulation, *supra* note 16.

2. Meaning of Article 48

It is imperative to analyze the meaning of Art. 48. As is generally the case with EU legislation, the GDPR also provides an explanation under Recital 115 as to how Art. 48 is supposed to be interpreted:

Some third countries adopt laws, regulations and other legal acts which purport to directly regulate the processing activities of natural and legal persons under the jurisdiction of the Member States. This may include judgments of courts or tribunals or decisions of administrative authorities in third countries requiring a controller or processor to transfer or disclose personal data, and which are not based on an international agreement, such as a mutual legal assistance treaty, in force between the requesting third country and the Union or a Member State. The extraterritorial application of those laws, regulations and other legal acts may be in breach of international law and may impede the attainment of the protection of natural persons ensured in the Union by this Regulation. Transfers should only be allowed where the conditions of this Regulation for a transfer to third countries are met. This may be the case, *inter alia*, where disclosure is necessary for an important ground of public interest recognised in Union or Member State law to which the controller is subject.²³

While the Recital gives an indication as to the interpretation of Art. 48, a thorough analysis is still necessary.

23. Recital 115, General Data Protection Regulation, *supra* note 2.

- i. “Any judgment of a court or tribunal and any decision of an administrative authority”

Art. 48 appears to only apply to “[a]ny judgement of a court or tribunal and any decision of an administrative authority requiring a controller or processor to transfer or disclose personal data.” It is clear that Art. 48 applies to any disclosure mandated by any order from a third country (read U.S.) court or regulator. Also, it seems equally clear that Art. 48 would not apply to voluntary disclosures or government authorities like those contemplated by the U.S. Department of Justice’s new Foreign Corrupt Practices Act (FCPA) Pilot Program. Nor would data controllers’ internal investigations be affected by Art. 48. Finally, it appears that voluntary disclosures of personal data made to third parties to resolve disputes outside of discovery would not be impacted by Art. 48 because no court, tribunal, or administrative agency is involved.

An open question is whether disclosures to opponents in response to U.S. civil discovery requests technically fall under Art. 48. Under U.S. federal and state civil procedure, discovery is self-executing and not executed through court order, though the failure to reasonably comply with discovery requests is sanctionable.²⁴ Ideally, discovery between two parties in civil litigation in the U.S. is meant to be undertaken with little or no court involvement. If a court does not order a party to produce documents or if the party is responding to a document request requiring disclosure of personal data because of “[a]ny judgement of a court,” then it should be noted that the language of Art. 48 is narrower than the French blocking statute which uses the phrase “with a view to foreign administrative or judicial proceedings or as part of such proceedings.”²⁵ Arguably, the

24. FED. R. CIV. P. 37.

25. French law No. 68-678 of 26 July 1968.

French blocking statute does not require a court order and simply disclosing the information with “a view” that it will be used in third country proceedings violates the statute. However, it appears that Art. 48 requires an operative order that requires the disclosure of personal data. Of course, the court’s scheduling order that opens discovery and applies the rules of discovery that allow for production of data from non-U.S. countries could be considered the operative order.

At present, this remains a highly technical interpretation. Parties may need guidance from the Article 29 Working Party and DPAs, but the safer course of action at the moment is to assume that responding to discovery requests will be considered to be covered by Art. 48.

ii. International Agreements

First, a party must determine what kind of “international agreements” are included within the meaning of Art. 48. One could assume that the reference to “a mutual legal assistance treaty” is just meant as one example for applicable international agreements while the legislative bodies of the EU might want to include all sorts of international agreements. However, even though it seems to be the case that “mutual legal assistance treaties” do not solely account for the scope of application of the provision, Art. 48, nevertheless, clearly seems to aim for international conventions which allow for courts or public authorities of one country to officially request assistance (i.e., in this case, information) from another country. In the present context, the provision seems to be tailored towards the Hague Convention which becomes even clearer when analyzing the other parts of Art. 48.

iii. “Without prejudice to other grounds for transfer pursuant to this Chapter”

Because the Hague Convention is not a viable path in many cases involving EU countries, it is more important to understand whether Art. 48 is supposed to limit or prohibit direct information requests from U.S. courts and administrative authorities to EU companies without the use of international treaties for legal assistance.

Especially when reading the first part of Art. 48 which states “may only be recognised or enforceable in any manner if based on an international agreement,” one could very well reason that Art. 48 is supposed to limit or even prohibit any response to discovery requests which occur outside of such agreements. This is supported by the title of the provision referring to “Transfers or disclosures not authorized by Union law.”

However, the last part of Art. 48 and Recital 115 clearly contradict such a restrictive interpretation of Art. 48. “Without prejudice to other grounds for transfer pursuant to this Chapter” most likely is a clarification which states that Art. 48 does not intend to prohibit data transfers which are legally possible through other provisions of the GDPR, although the GDPR is Union law as mentioned in the title of the provision. It, therefore, means that a company might legally be able to comply with an information request by a foreign court if such request falls, e.g. under Article 49, paragraph 1(e), even if it is not based on an international agreement. This analysis corresponds with Recital 115 which explicitly states that “[t]ransfers should only be allowed where the conditions of this Regulation for a transfer to third countries are met.”

In conjunction with the last sentence of Recital 115, which refers to Article 49, paragraph 1(d), of the GDPR as one of the cases where disclosures are supposed to be permitted, one has to conclude that Art. 48 is not supposed to be the only provision

allowing data transfers in response to discovery requests from courts or administrative authorities in third countries. As opposed to that, the explicit mentioning of “other grounds for transfer pursuant to this Chapter” in the wording of Art. 48 has to be understood as a referral to other provisions within the GDPR which also allow for data transfers to third countries. Therefore, the GDPR does not intend to prohibit any data transfer outside of international treaties for legal assistance.

It seems to be surprising that the effect of the newly introduced Art. 48 could be limited. However, the legislative process of the GDPR indicates that there was a disagreement between the legislative bodies on whether a provision such as Art. 48 should even be part of the GDPR. As could be seen during the fallout of the NSA revelations, the European Parliament seemed to have taken a restrictive position on this topic. As opposed to that, the final version of Art. 48 appears to be a compromise between the legislative bodies while its primary purpose probably lies in the clarification that foreign courts and administrative bodies shall not circumvent the data export obligations set out in the GDPR.

This clarification looks like what the legislative bodies were ultimately able to agree on while they did not seem to be able to find an agreement on the more restrictive suggestions of the European Parliament. This is supported by Recital 115 of the GDPR, “[t]ransfers should only be allowed where the conditions of this Regulation for a transfer to third countries are met,” which states the obvious. Furthermore, and in light of the effect that the reason for its introduction was the NSA revelations,²⁶ it is not very likely that Art. 48 will severely limit the ability of European entities to comply with requests based on discovery proceedings in civil litigations outside of the EU.

26. Meyer, *supra* note 18.

On the other hand, and in light of the judgment by the CJEU on the Safe Harbor Decision,²⁷ one cannot rule out that a European court might still have a different view about Art. 48. Based on the unusual wording of Art. 48—which seems to be a result of the legislative process involving different drafts from several legislative bodies—as well as its headline, the provision is open for different interpretations of its meaning and effect.

3. Effect of Article 48 and the GDPR on the Legal Situation in the EU

Based on the above as well as an analysis of the GDPR as a whole, the legal situation when it comes to dealing with U.S. discovery requests under the obligations of EU data protection law will most likely not materially change in many cases compared to the legal situation under the current legal regime in the EU.

i. Requests by U.S. Courts and Administrative Authorities Outside International Treaties

In light of the fact that the wording of the majority of the respective legal provisions within the GDPR have not materially changed compared to the current law, it is not likely that the previously expressed guidance by European DPAs will change significantly. This conclusion is also based on the fact that the most relevant authority when it comes to interpreting the GDPR will still be the DPAs of the EU member states. The DPAs will cooperate in the European Data Protection Board (Article 68 of the GDPR), which despite the different name is quite similar to the current Article 29 Working Party (Article 29 Directive) in many regards.

27. *Supra* note 13.

Therefore, companies will most probably face the same issues when trying to rely on consent of data subjects.

When it comes to relying on a provision of the law, a data transfer to the U.S. because of a discovery request will also in the future require such transfer to be in the legitimate interest of the transferring company while no overriding interest of the data subjects exists. In many cases, this leads to the applicability of the already outlined approach which to a certain extent requires the redaction of personal data while similar additional requirements would also apply under the GDPR. Furthermore, the GDPR also considers similar categories of personal data like the current Directive 95/46/EC to be especially sensitive and includes additional restrictions for them as well.

Finally, the legal grounds for allowing data exports to the U.S. apart from the introduction of Art. 48 are also similar to the ones outlined above regarding the current legal situation. However, apart from already outlined and still applicable data export options under the GDPR, note that Article 49, paragraph 1, sentence 2 of the GDPR may also allow for data exports:

if the transfer is not repetitive, concerns only a limited number of data subjects, is necessary for the purposes of compelling legitimate interests pursued by the controller which are not overridden by the interests or rights and freedoms of the data subject, and the controller has assessed all the circumstances surrounding the data transfer and has on the basis of that assessment provided suitable safeguards with regard to the protection of personal data.

As stated by Recital 113 of the GDPR, one can only rely on this provision “where none of the other grounds for transfer are applicable.” Since the invalidation of the Safe Harbor Deci-

sion in October 2015, data exports under the remaining legal options provided by European data protection law can be very difficult. One might be able to argue in favor of the applicability of Art. 49, paragraph 1, sentence 2 of the GDPR in discovery cases which is also supported by the fact that data exports for the purpose of complying with discovery requests are generally non-repetitive while concerning only a limited number of data subjects. In particular, this derogation may be ideal for those cases where personal data needs to be provided to U.S. courts or regulators who cannot sign SCC as these disclosures are almost always miniscule when compared to discovery generally and certainly non-repetitive.

Relying on this data export option could also be compelling for affected companies since they will want to rely on their legitimate interest under European data protection law when collecting and transferring the data while having to implement suitable safeguards in many cases anyway. However, it should be taken into account that Article 49 at paragraphs 1, 3, and 4, includes an obligation to inform the competent DPA as well as additional notification obligations regarding the affected data subject.

ii. Significant Increase of Possible Fines under the GDPR

Even though it seems that the legal requirements and issues which companies are facing when it comes to dealing with U.S. discovery requests will not materially change under the regime of the GDPR, the most important change is the very significant increase regarding possible fines for non-compliance with EU data protection law.

Article 79 of the GDPR allows DPAs to impose fines of up to 4% of a company's entire worldwide turnover for the previous financial year for any violations. While it still remains to

be seen whether and to what extent DPAs will in practice impose such fines, this could become a game changer since some companies in the past would rather choose to accept non-compliance regarding their EU data protection obligation and potential fines in order to avoid significantly higher financial losses for not complying with U.S. discovery obligations. As the delta between the threatening penalties is reduced, this decision will become a tougher one.

C. Opt-Out Option Via the United Kingdom

The Treaty on the Functioning of the European Union (TFEU) is amended by several protocols, which contain specific regulations for individual EU member states. Protocol 21 to the TFEU, for example, relates to the position of the United Kingdom (UK) and Ireland with respect to the areas of freedom, security, and justice. Article 3 of Protocol 21 to the TFEU provides that:

the United Kingdom or Ireland may notify the President of the Council in writing, within three months after a proposal or initiative has been presented to the Council pursuant to Title V of Part Three of the Treaty on the Functioning of the European Union, that it wishes to take part in the adoption and application of any such proposed measure, whereupon that State shall be entitled to do so.

With respect to Article 43(a) of the GDPR (now Art. 48), the UK already decided and announced not to opt-in to the parts of Art. 48 which trigger the Protocol 21.²⁸ Hence, if this action

28. Baroness Neville-Rolfe, General Data Protection Regulation: Written Statement, HLWS500 (Feb. 4, 2016), <http://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Lords/2016-02-04/HLWS500/>.

would be lawful, Art. 48 would not have any effects in relation to the UK. While other countries, for example Germany, do not have a similar option, one could consider if a transfer of data via the UK would allow circumventing the limitations of Art. 48.

However, it is already disputed whether the UK can in fact rely on Protocol 21.²⁹ Furthermore, even a centralization of data storage and processing within the UK would not allow data controllers within another EU country to ignore Art. 48 as the GDPR is applicable for controllers and processors with an establishment in the EU irrespective of whether the processing takes place in the Union or not (Article 3, paragraph 1 of the GDPR).

II. HOW U.S. COURTS WILL INTERPRET ARTICLE 48

If Art. 48 simply requires data controllers to establish their legitimate interest in processing personal data to comply with U.S. discovery requests and to be more transparent and more proportional in their processing, then not much will change for U.S. courts, and they will not necessarily need to consider Art. 48. However, if a party refuses because of Art. 48 to produce responsive documents from the EU because they contain personal data of EU data subjects, then U.S. courts will need to apply their own lens to the issue. The question is whether U.S. courts will excuse a failure to produce if it is because of Art. 48 of the GDPR.

A. *Where the Tension with EU Data Protection Starts*

As mentioned, the conflict between the discovery obligations in U.S. court proceedings and the EU data protection laws

29. See, e.g., Deutscher Bundestag, "Ausschuss Digitale Agenda" Voßhoff, Ausschussdrucksache 18(24)93 (Feb. 24, 2016) <https://www.bundestag.de/blob/409392/af981344cf08d553d52c36030bc1fb2/a-drs-18-24-93-data.pdf>.

is not new. In 1987, the U.S. Supreme Court in *Societe Nationale Industrielle Aerospatiale v. U.S. District Court for the Southern District of Iowa*³⁰ attempted to resolve the dilemma for U.S. litigants seated within the EU. The Supreme Court held that a requesting party was not *required* to use the Hague Convention.³¹ The defendants in *Aerospatiale* were aircraft manufacturers that were owned by the Republic of France and sued in federal court in the U.S. In response to discovery requests, the defendants moved for a protective order asserting that the Hague Convention was the exclusive source for obtaining foreign discovery.

The Supreme Court disagreed. The Supreme Court held that the Hague Convention does not provide exclusive or mandatory means for litigants in the U.S. to obtain information located in a foreign country. The Supreme Court further concluded that international comity does not require litigants to first resort to the Hague Convention before pursuing discovery under the Federal Rules of Civil Procedure. It also held that the French penal statute, known as a "*blocking statute*," did not deprive an American court of the power to order a party subject to its jurisdiction to produce evidence. Thus, the Supreme Court has already decided that from the U.S. perspective, courts and requesting parties are not obligated to do what Art. 48 arguably requires.

The Supreme Court did not completely disregard the tension it was creating. Understanding that U.S. discovery was broad and on occasion could be intrusive, the court instructed district courts to be careful when weighing the needs of the requesting party and the impact of U.S. discovery in foreign countries:

30. 482 U.S. 522 (1987).

31. *Id.* at 534.

American courts, in supervising pretrial proceedings, should exercise special vigilance to protect foreign litigants from the danger that unnecessary, or unduly burdensome, discovery may place them in a disadvantageous position. Judicial supervision of discovery should always seek to minimize its costs and inconvenience and to prevent improper uses of discovery requests. When it is necessary to seek evidence abroad, however, the district court must supervise pretrial proceedings particularly closely to prevent discovery abuses. For example, the additional cost of transportation of documents or witnesses to or from foreign locations may increase the danger that discovery may be sought for the improper purpose of motivating settlement, rather than finding relevant and probative evidence. Objections to “abusive” discovery that foreign litigants advance should therefore receive the most careful consideration. In addition, we have long recognized the demands of comity in suits involving foreign states, either as parties or as sovereigns with a coordinate interest in the litigation. American courts should therefore take care to demonstrate due respect for any special problem confronted by the foreign litigant on account of its nationality or the location of its operations, and for any sovereign interest expressed by a foreign state.³²

To help courts provide “due respect for any special problem confronted by the foreign litigant,” the Supreme Court refrained to create a specific line, but rather held that comity “requires in this context a more particularized analysis of the

32. *Id.* at 546 (emphasis supplied) (internal citations omitted).

respective interests of the foreign nation and the requesting nation.”³³ The Supreme Court did not lay out specific rules to help guide resolution of problems arising in the international discovery context. Instead, it commented that “[t]he nature of the concerns that guide a comity analysis is suggested by the Restatement of Foreign Relations Law of the United States (Revised) § 437(1)(c) (Tent. Draft No. 7, 1986) (approved May 14, 1986) (Restatement),”³⁴ which lists the following factors as determinative of whether “to order foreign discovery in the face of objections by foreign” litigants:

- 1) “the importance to the . . . litigation of the documents or other information requested;”³⁵
- 2) “the degree of specificity of the request;”³⁶

33. *Id.* at 524.

34. *Id.* at 544 n.28.

35. Under this factor, a court may analyze the importance of discovery that is being requested. Some courts have found that the information that is requested must meet a high level of importance in order for the factor to weigh in favor of proceeding with foreign discovery. *See, e.g., In re Activision Blizzard, Inc. Stockholder Litigation*, 86 A.3d 531, 544 (Del. Ch. 2014) (“This factor calls on the court to consider the degree to which the information sought is more than merely relevant under the broad test generally for evaluating discovery requests.”); *Strauss v. Credit Lyonnais, S.A.*, 249 F.R.D. 429, 400 (E.D.N.Y. 2008) (“Because the scope of civil discovery in the US is broader than that of many foreign jurisdictions, some courts have applied a more stringent test of relevancy when applying the Federal Rules to foreign discovery.”). Other courts have only required relevance as a basis for determining that this factor weighs in favor of proceeding with international discovery under the Rules. *Richmark Corp. v. Timber Falling Consultants*, 959 F.2d 1468, 1475 (9th Cir. 1992).

36. The *Aerospatiale* Court emphasized “exercise [of] special vigilance” to ensure that foreign discovery is not abused and that foreign parties are not placed “in a disadvantageous position” by “unnecessary, or unduly burdensome discovery.” 482 U.S. at 546. Courts often analyze to which degree international discovery requests are appropriately “tailored” to the claims and defenses of the litigation. *See, e.g., In re Cathode Ray Tube (CRT) Antitrust*

- 3) “whether the information originated in the United States;”³⁷
- 4) “the availability of alternative means of securing the information;”³⁸ and
- 5) “the extent to which noncompliance with the request would undermine important interests of the

Litig., 2014 U.S. Dist. LEXIS 41275, at *70 (N.D. Cal. Mar. 26, 2014) (“courts are less inclined to ignore a foreign state’s concerns” about the conflicts in discovery where discovery seeks cumulative evidence); *In re Vitamins Antitrust Litig.*, 120 F. Supp. 2d 45, 54 (D.D.C. 2000) (“Since plaintiffs have alleged a prima facie basis for jurisdiction and their revised requests are narrowly tailored and are not the type of blind fishing expeditions of concern to these signatory nations, the Court finds that the signatory defendants’ sovereign interests will not be unduly hampered by proceeding with jurisdictional discovery under the Federal Rules.”).

37. If the requested information and people involved are in a foreign country, this factor often weighs against conducting foreign discovery under the Federal Rules, particularly where there is evidence that the foreign laws in the country have provisions prohibiting disclosure of information. *Richmark*, 959 F.2d at 1475 (“The fact that all the information to be disclosed (and the people who will be deposed or who will produce the documents) are located in a foreign country weighs against disclosure, since those people and documents are subject to the law of that country in the ordinary course of business.”).

38. If the information sought from a foreign country can easily be obtained elsewhere, then courts find that there is “little or no reason to require a party to violate foreign law.” *Richmark*, 959 F.2d at 1475. However, courts have found this factor weighing in favor of discovery under the Federal Rules where the requested information is in the complete control of the foreign party resisting discovery and where the party requesting the information cannot obtain it elsewhere. The effectiveness of the Hague Convention is often a consideration, and courts generally find that the Hague Convention is not an available and alternate means for obtaining foreign discovery. *In re Automotive Refinishing Paint.*, 358 F.3d 288, 300 (3d Cir. 2004) (“*Aerospatiale* notes that in many situations, the Convention procedures would be unduly time-consuming and expensive, and less likely to produce needed evidence than direct use of the Federal Rules of Evidence.”).

United States, or compliance with the request would undermine important interest of the state where the information is located.”

Although courts apply and analyze all these factors when determining how to proceed with international discovery, it is the fifth factor that is the most important and “is a balancing of competing interests, taking into account the extent to which the discovery sought serves important interests of the forum state versus the degree to which providing the discovery would undermine important interests of the foreign state.”³⁹ It is also this factor that plays a greater role in getting a better understanding of how courts in the U.S. will react to Art. 48 as the others are dependent on the facts of the case. The fifth factor is the only one that weighs the importance of the EU’s interest in Art. 48.

B. How U.S. Courts Have Analyzed the Fifth Factor

Applying the fifth factor, most courts have concluded that discovery should proceed under the Federal Rules as opposed to the Hague Convention. For example, in *Wultz v. Bank of China*,⁴⁰ plaintiffs were victims of a suicide bombing and brought suit against defendant for providing material support and resources to the alleged terrorist organization. To prove their claims, plaintiffs sought various documents from the defendant located in China. The court ordered defendant to produce the documents after evaluating the *Aerospatiale* factors. Under the fifth factor, the court considered the extent to which the

39. *In re Activision Blizzard*, 86 A.3d at 547; see also *Motorola Credit Corp. v. Kemal Uzan*, 73 F. Supp. 3d 397, 402 (S.D.N.Y. 2014) (“[I]t must not be forgotten that what we are concerned with here is a comity analysis, and from that standpoint the most important factor is the fifth factor.”).

40. 942 F. Supp. 2d 452 (S.D.N.Y. 2013).

defendant's compliance to discovery would undermine important Chinese interests. The Chinese laws are concerned with "depriving international terrorist and other criminal organizations of funding," and the court recognized that there is a risk that ordering production of documents could have a chilling effect on future communications by Chinese banks, leading suspicious transactions to go unreported.⁴¹ Nevertheless, the court gave greater weight to U.S. interests. The court considered that if the defendant was liable and did not produce the requested materials, this would allow a bank that recklessly or knowingly funded terrorists who murdered an American citizen to operate with impunity in the U.S.

A similar outcome resulted in *Strauss v. Credit Lyonnais, S.A.*,⁴² where plaintiffs were victims of a terrorist attack and sued Credit Lyonnais, a French bank. The court decided in that case that

[the fifth] factor weighs strongly in favor of plaintiffs. The interests of the United States and France in combating terrorist financing, as evidenced by the legislative history of the ATA, codified at 18 USC § 2331 et seq., Presidential Executive Orders, and both countries' participation in international treaties and task forces aimed at disrupting terrorist financing, outweigh the French interest, if any, in precluding Credit Lyonnais responding to plaintiffs' discovery requests.⁴³

The defendant argued that "France has an obvious and undeniable national interest in protecting bank customer privacy and enforcing its internal banking, money laundering and

41. *Id.* at 467.

42. 242 F.R.D. 199 (E.D.N.Y. 2007).

43. *Id.* at 213.

terrorism laws, as well as its laws regarding criminal investigation.”⁴⁴ However, the U.S.’s interest in protecting against terrorism outweighed these interests.

In the antitrust context, U.S. interests have also been upheld and discovery has been compelled. In *In re Air Cargo Shipping Servs. Antitrust Litig.*,⁴⁵ plaintiffs involved in an international antitrust litigation moved to compel defendant French air service to produce documents that defendant had withheld on the ground that the production was prohibited by the French blocking statute. The court granted the motion to compel, finding that “this is a case involving violations of antitrust laws whose enforcement is essential to the country’s interests in a competitive economy,” “enforcement through private civil actions such as this one is a critical tool for encouraging compliance with the country’s antitrust laws,” and “the interest in prohibiting price-fixing of the type alleged here is shared by France.”⁴⁶ By way of contrast, “the only French interest is a sovereign interest in controlling access to information within its borders, fueled at least in part by a desire to afford its citizens protections against discovery in foreign litigation.”⁴⁷

On the other hand, though very infrequently, courts have found under the fifth *Aerospatiale* factor that discovery must proceed under the Hague Convention or should be blocked. In *In re Payment Card Interchange Fee and Merch. Disc. Antitrust Litigation*,⁴⁸ plaintiffs sought information from an investigation conducted by the EU Commission. The court emphasized the

44. *Id.* at 219.

45. 278 F.R.D. 51 (E.D.N.Y. 2010).

46. *Id.* at 61–62.

47. *Id.* at 61.

48. No. 05-MD-1720, 2010 U.S. Dist. LEXIS 89275, at *27 (E.D.N.Y. Aug. 27, 2010).

fifth *Aerospatiale* factor. The court noted that the EU Commission has “strong and legitimate reasons to protect the confidentiality” of the investigation which outweighed the “plaintiffs’ interest in discovery of the European litigation documents.” The confidentiality of the EU Commission was found to be important in encouraging voluntary cooperation by third parties, and the court determined that the EU Commission’s interests would be significantly undermined if its confidentiality rules were disregarded by American courts.⁴⁹

In *In re Perrier Bottled Water Litigation*,⁵⁰ the court also ordered discovery through the Hague Convention. The plaintiff citizens sought to compel discovery of documents by the defendant water producer. One of the producers sought a protective order requiring that any discovery requests be made through the Hague Convention. The federal district court held that the Hague Convention applied because the discovery requests were intrusive and not narrowly tailored and that application of the federal rules would breach French sovereignty. The court noted that France in particular has been “emphatic” about expressing disfavor towards private litigants’ use of the Federal Rules for discovery. The court gave importance to the fact that “France has even amended its civil and penal codes to incorporate the Hague Evidence Convention,” which weighs heavily in favor of the use of those procedures.⁵¹

C. U.S. Courts’ Reactions to Other Rules that Impact International Discovery

The thread that emerges from *Aerospatiale* and the cases that have followed that have earnestly examined the interests of

49. *Id.* at *29.

50. 138 F.R.D. 348 (D. Conn. 1991).

51. *Id.* at 355.

the foreign jurisdiction is that while courts in the U.S. are loathe to excuse a failure to produce, they do make exceptions.

1. Blocking Statutes

Foreign data protection laws that appear designed simply to thwart U.S. jurisdiction and discovery and provide no real substantive rights to their citizens are not given credit by courts in the U.S. Essentially, most courts simply quote *Aerospatiale*: “[i]t is clear that American courts are not required to adhere blindly to the directives of such a statute. Indeed, the language of the statute, if taken literally, would appear to represent an extraordinary exercise of legislative jurisdiction by the Republic of France over a United States district judge.”⁵²

Thus, blocking statutes, like French law discussed in *Aerospatiale* and *Strauss*, are unlikely to be seen as a good excuse to not produce responsive, relevant, proportional documents in the possession, custody, or control of a party before a court in the U.S. Generally speaking, courts do not believe that thwarting U.S. discovery is a legitimate interest of foreign governments.⁵³ The Supreme Court has stated that noncompliance with a discovery order for fear of foreign prosecution still constitutes nonproduction and can subject a person to discovery sanctions; however, dismissal is an inappropriate sanction “when it has

52. 482 U.S. 522, 544 n.29 (1987).

53. *Rich v. KIS California, Inc.*, 121 F.R.D. 254, 258 (M.D.N.C. 1988) (stating that the French blocking statute is “overly broad and vague and need not be given the same deference as a substantive rule of law”); *Compagnie Francaise D’Assurance Pour Le Commerce Exterieur v. Phillips Petroleum Co.*, 105 F.R.D. 16, 30 (S.D.N.Y. 1984) (declining to apply the French blocking statute and noting that “the legislative history of the statute gives strong indications that it was never expected to nor intended to be enforced against French subjects but was intended rather to provide them with tactical weapons and bargaining chips in foreign courts”) (internal citations omitted).

been established that failure to comply has been due to inability, and not to willfulness, bad faith, or any fault of [the party].”⁵⁴

Although courts recognize that forcing a party to produce documents in violation of the French blocking statute may result in criminal sanctions, including imprisonment and payment of sizeable monetary fines, “there is little evidence that the statute has been or will be enforced.”⁵⁵ Moreover, where the plaintiffs are the party being compelled to make a production, the plaintiffs have a choice: “[t]hey can withdraw the complaint voluntarily at any time or produce the requested documents and risk prosecution under French law.”⁵⁶

i. Banking and Other Secrecy Laws

Banking and state secrecy laws have also been analyzed by courts in the U.S. and sometimes guide a court’s decision on whether to allow foreign discovery.⁵⁷

In *Reinsurance Co. of Am. Inc. v. Administratia Asigurarilor de Stat*,⁵⁸ for example, the court determined that Romania’s interest in its national secrecy laws outweighed American interests in enforcing judicial decisions. Unlike the French blocking

54. *Societe Internationale v. Rogers pour Participations Industrielles et Commerciales, S.A.*, 357 U.S. 197, 212 (1958).

55. *Phillips Petroleum*, 105 F.R.D. at 31; *see also* *Bodner v. Banque Paribas*, 202 F.R.D. 370, 375 (E.D.N.Y. 2000) (“As held by numerous courts, the French Blocking Statute does not subject defendants to a realistic risk of prosecution, and cannot be construed as a law intended to universally govern the conduct of litigation within the jurisdiction of a US court.”).

56. *Phillips Petroleum*, 105 F.R.D. at 31.

57. *Rogers*, 357 U.S. at 203 (dismissal of the case was not justified where the plaintiff Swiss bank failed to comply with pretrial production, in that its failure was “not due to inability fostered by its own conduct or by circumstances within its control but because production of documents might violate Swiss laws” that included criminal penalties).

58. 902 F.2d 1275 (7th Cir. 1990).

statute, the court stated that “Romania’s law appears to be directed at domestic affairs rather than merely protecting Romanian corporations from foreign discovery requests.”⁵⁹ In *Minpeco, S.A. v. ContiCommodity Servs.*,⁶⁰ the court examined the Swiss national interest in bank secrecy statutes, which imposed penal sanctions on agents of a bank who disclosed a customer’s identity or any other information about a customer. The court determined that the “Swiss interest in bank secrecy [was] ‘substantial’ because the prohibition on disclosure of customer information was expressed in criminal statute and the secrecy laws had the legitimate purpose of protecting commercial privacy inside and outside Switzerland.”⁶¹

These decisions may be a minority because, most frequently, courts in the U.S. do not use banking laws or other similar secrecy laws to block discovery.⁶² In *Strauss*, the court stated that “courts in this Circuit have already examined the French bank secrecy law . . . and denied [it’s] applicability to preclude

59. *Id.* at 1280.

60. 116 F.R.D. 517 (S.D.N.Y. 1987).

61. *Id.* at 524–525.

62. *See, e.g., In re Am. Int’l Group, Inc.*, 2008 Secs. Litig., No. 08-cv-4772, 2010 U.S. Dist. LEXIS 127660, at *8 (S.D.N.Y. Dec. 1, 2010) (“Under the circumstances of this case, this due process interest outweighs the French interest in protecting the secrecy of banking records, given that all of the records in question have already been disclosed to governmental agencies without redaction and much of the information contained in those records has already been disclosed to the public.”); *Richmark Corp. v. Timber Falling Consultants*, 959 F.2d 1468, 1476 (9th Cir. 1992) (declining arguments related to Chinese secrecy laws because the interest in confidentiality was not raised prior to the litigation and because “Beijing routinely disclosed information regarding its assets, inventory, bank accounts, and corporate structure to the general public, for example through a trade brochure, and to companies with whom it did business”).

discovery,” because the bank secrecy law is not intended to apply to litigation in which the bank is a party.⁶³ In *Linde v. Arab Bank*,⁶⁴ the court concluded that the U.S.’s interests in combating terrorism trumped the foreign state’s interest in bank secrecy. Plaintiffs moved for an order compelling discovery and sanctioning defendant bank for nonproduction. Defendant declined to comply with the request because doing so would violate the bank secrecy laws in Jordan, Lebanon, and Palestine, violation of which involved criminal fines and incarceration. Although the court acknowledged that maintaining bank secrecy is an important interest, it held that this interest must yield to the interests of fighting terrorism and compensating victims. The court directed defendant to secure permission from foreign authorities to provide the discovery and deferred further action pending outcome of this process.

Similarly, in *In re Air Crash at Taipei*,⁶⁵ the court found defendant’s implication of Taiwan secrecy laws unpersuasive. The plaintiffs moved to compel discovery that defendants argued it could not produce because Taiwan prohibited release of all accident investigation documents. The court held that although countries generally have a strong interest in enforcing their secrecy laws, there was no evidence that Taiwan’s interest would be implicated or infringed. Defendant offered a letter arguing that foreign law prohibited disclosure, but failed to address the specific document requests at issue. In addition, defendant failed to provide “persuasive proof” that defendant or its officers would be criminally prosecuted for complying with an order of the court, or evidence regarding the manner and extent to which Taiwan enforces its secrecy laws.

63. *Strauss v. Credit Lyonnais, S.A.*, 242 F.R.D. 199, 220 (E.D.N.Y. 2007).

64. 463 F. Supp. 2d 310 (2006).

65. 211 F.R.D. 374, 379 (D. Cal. 2002).

ii. Substantive Data Protection Laws

Where courts in the U.S. are most likely to excuse, or limit, discovery under the Federal Rules, is where they believe that discovery is infringing on substantive rights of foreign governments or citizens, particularly non-parties.

For example, in *Cascade Yarns, Inc. v. Knitting Fever, Inc.*,⁶⁶ the court granted a motion for issuance of letters rogatory finding that the “[u]se of Hague Convention procedures is particularly relevant where, as here, discovery is sought from a non-party in a foreign jurisdiction.” Similarly, the court in *Tulip Computers Int’l B.V. v. Dell Computer Corp.*⁶⁷ stated that “[r]esort to the Hague Evidence Convention in this instance is appropriate since both Mr. Duynisveld and Mr. Dietz are not parties to the lawsuit, have not voluntarily subjected themselves to discovery, are citizens of the Netherlands, and are not otherwise subject to the jurisdiction of the Court.” Courts routinely find that “[w]hen discovery is sought from a non-party in a foreign jurisdiction, application of the Hague [Evidence] Convention, which encompasses principles of international comity, is virtually compulsory.”⁶⁸

The question remains whether courts in the U.S. will view Art. 48 more as a “blocking statute” or the articulation of a substantive right of an EU data subject. This is not an easy question to address because the answer may be both.

66. No. C10-861, 2014 US Dist. LEXIS 8285, at *6 (W.D. Wash. Jan. 17, 2014).

67. 254 F. Supp. 2d 469, 474 (D. Del. 2003).

68. See *Orlich v. Helm Brothers, Inc.*, 160 A.D.2d 135, 143 (N.Y.S.2d 1990).

D. Predicting U.S. Courts' Reaction to Article 48

The problem with trying to predict how much respect courts in the U.S. will give Art. 48 is that it is inexorably intertwined within the larger GDPR. On its own (and excluding its final clause), it reads very much like a blocking statute attempting to force international courts to use treaties like the Hague Convention to conduct discovery. As such, one would quickly predict that courts in the U.S. will immediately dismiss Art. 48 and not accept it as a valid excuse to not produce responsive documents, in particular if the affected member state of the EU is not a party to or does not comply with discovery request under the Hague Convention at all (like, for example, Germany). However, this superficial analysis ignores what role Art. 48 plays in the GDPR.

It is inarguable that the GDPR is a substantive piece of legislation that clearly establishes the EU's interest in protecting the data of its subjects. While the interests at issue—and the great weight the EU member states put on them—may be foreign to American courts and lawyers (pun intended), Art. 48 is an express statement by the EU about how it values data protection and data privacy and how it prioritizes these issues above other national and commercial concerns. Moreover, the enactment of the GDPR not only significantly increases the potential penalties for non-compliance (both civil and criminal), but EU data protection authorities are expected to increase enforcement.

Thus, on the whole, the GDPR is a weighty substantive data protection law that expresses an “important state interest” of the EU and its member states and that, in the words of the *Aerospatiale* Court, “American courts should . . . take care to demonstrate due respect.” Therefore, the GDPR would appear

to be in that rare class of laws that American courts would seriously consider accepting as a legitimate excuse for non-production (or limited production).

Arguably, Art. 48 is only an extension of the larger GDPR purpose. It could be read to protect data subjects (namely employees and individual third parties) whose personal data may be exported out of the EU by data controllers who will likely judge their interests in resolving foreign litigations and investigations higher than the rights of data subjects. On the other hand, Art. 48 appears aimed completely outside the jurisdiction to limit U.S. style discovery and, perhaps most importantly, does not provide a solution for transferring relevant personal data in cases where treaties either do not exist (or are not applied with regard to discovery request as the Hague Convention in Germany) or are impractical (in internal investigations and voluntary disclosures).

At the end of the day, one would expect that U.S. courts following *Aerospatiale* would provide due respect to the GDPR and under the principles of proportionality, comity, and possession, custody, or control limit and narrow discovery in the EU. U.S. courts should place greater emphasis on protecting the personal data of EU data subjects that are drawn into U.S. litigations and investigations through protective orders, redactions, and sealing orders that will allow parties to resolve their disputes using necessary information, but provide confidence that personal data will not be misused or unnecessarily disclosed.

However, it is also likely that most U.S. courts will view Art. 48 more as a blocking statute and less a substantive rule of data protection and, as such, are unlikely to regularly excuse production or require requesting parties to use the Hague Convention or other treaties to obtain documents from the EU. This is especially true if a party claims that it could produce the personal data but for Art. 48 (and not other provisions of the

GDPR). Therefore, it will be incumbent upon responding parties to develop discovery processes that comply (or at least substantially comply) with “other grounds for transfer pursuant to this Chapter” if they do not want to be stuck between the rock of complying with U.S. discovery obligations and the hard place of complying with the GDPR.

III. A NEW APPROACH TO DISCOVERY UNDER THE GDPR?

In summary, it appears that the introduction of Art. 48 may not result in major changes to the way data transfers between the EU and the U.S. in the course of discovery proceedings can be justified. Rather, Art. 48 seems to codify and confirm the legal situation as it existed prior to the adoption of the GDPR. This is because (1) the Hague Evidence Convention has not been applicable with respect to international legal assistance in terms of discovery proceedings for some of the key countries in the EU already before the implementation of Art. 48 and (2) the provision explicitly leaves room for alternative solutions as developed under the previous legal regime. Hence, Art. 48 should not exclude or limit the legitimate transfer practices as conducted and accepted by the authorities in the EU under the current legal regime. This is supported by the fact that the European Data Protection Board, which will be the primary authority providing guidance as to the interpretation of the GDPR, is structured in a similar way to the Article 29 Working Party. However, it will be up to the courts, and ultimately the CJEU, to decide on the interpretation of the relevant provisions of the GDPR. In any case, due compliance with the GDPR when fulfilling discovery requests will be of high importance considering the increased risk of violation following from the new penalty scheme.

LIMITS ON LIMITING INHERENT AUTHORITY: RULE 37(E) AND THE POWER TO SANCTION

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I. INTRODUCTION

This article examines the interplay between inherent judicial authority and Rule 37(e) of the Federal Rules of Civil Pro-

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cedure, which governs remedies for the spoliation of electronically stored information. Part II provides a brief outline of the genesis and current status of Rule 37(e). Part III explores the doctrine of inherent authority generally, with particular attention to the historical and constitutional bases for a federal court's exercise of its inherent authority in light of the tradition of congressional control over the distribution of the judicial power and the doctrine of separation of powers. Part IV discusses the extent to which a federal court retains inherent authority to impose sanctions or order remedies in light of amended Rule 37(e). Finally, Part V summarizes our conclusions.

II. THE BIRTH OF A NEW RULE OF SANCTIONS

In December 2015, a package of amendments to the Civil Rules went into effect. No amendment was more sweeping than the rewriting of Rule 37(e). Previously, it had consisted of a "safe harbor," which provided in its entirety that "[a]bsent exceptional circumstances, a court may not impose sanctions under these rules on a party for failing to provide electronically stored information lost as the result of the routine, good faith operation of an electronic information system."¹ The protection provided to parties under an obligation to preserve electronically stored information was narrow. By its terms, the safe harbor applied only where the loss of data was attributable to automatic features of a computer system, such as the auto-delete function, and even then the protection could be lost if the preserving party failed to implement an adequate litigation hold.²

1. This section was originally adopted as Rule 37(f), but was redesignated as 37(e) as part of the restyling of the Rules in 2007. For purposes of clarity, we will refer to all iterations of the Rule as "37(e)" in this article.

2. According to the Advisory Committee on the Federal Rules of Civil Procedure [hereinafter *Advisory Committee*]:

Furthermore, the Rule precluded only sanctions imposed “under these rules.” Accordingly, even when the loss of information occurred as the result of routine, good faith computer operation, a court was still theoretically free to impose sanctions under its inherent authority. Both before and after introduction of the Rule in 2006, it was criticized as overly limited and ultimately ineffectual.³

Rule [37(e)] applies only to information lost due to the “routine operation of an electronic information system”—the ways in which such systems are generally designed, programmed, and implemented to meet the party’s technical and business needs. The “routine operation” of computer systems includes the alteration and overwriting of information, often without the operator’s specific direction or awareness, a feature with no direct counterpart in hard-copy documents. Such features are essential to the operation of electronic information systems.

The good faith requirement of Rule [37(e)] means that a party is not permitted to exploit the routine operation of an information system to thwart discovery obligations by allowing that operation to continue in order to destroy specific stored information that it is required to preserve. When a party is under a duty to preserve information because of a pending or reasonably anticipated litigation, intervention in the routine operation of an information system is one aspect of what is often called a “litigation hold.”

FED. R. CIV. P. 37 advisory committee’s note to 2006 amendment.

3. See, e.g., Alexander Nourse Gross, *A Safe Harbor From Spoliation Sanctions: Can An Amended Federal Rule of Civil Procedure 37(e) Protect Producing Parties?*, 2015 COL. BUS. L. REV. 705, 717–24 (2015) [hereinafter Gross]; Nicole D. Wright, *Federal Rule of Civil Procedure 37(e): Spoiling the Spoliation Doctrine*, 38 HOFSTRA L. REV. 793, 812–14 (2009); Gal Davidovitch, *Why Rule 37(e) Does Not Create a New Safe Harbor for Electronic Evidence Spoliation*, 38 SETON HALL L. REV. 1131, 1136–40 (2008); Daniel Renwick Hodgman, *A Port in the Storm?: The Problematic and Shallow Safe Harbor for Electronic Discovery*, 101 NW. U. L. REV. 259, 285 (2007) (“[E]ven if one concedes the existence of the

In drafting the next major set of amendments, the Advisory Committee on the Federal Rules of Civil Procedure attempted to address some of the perceived flaws in the safe harbor provision of Rule 37(e). The Advisory Committee released a package of amendments for public comment in August 2013, including a substantially revised Rule 37(e).⁴ That iteration of the amended Rule received substantial feedback during the comment period.⁵ In response, the Discovery Subcommittee drafted an entirely new version of the Rule, literally overnight, which was adopted by the Advisory Committee and forwarded to the Standing Committee on Rules of Practice and Procedure without again being circulated for public comment.⁶ This is the permutation that ultimately became effective in December 2015.

(e) Failure to Preserve Electronically Stored Information.

If electronically stored information that should have been preserved in anticipation or conduct of litigation is lost because a party failed to take rea-

‘electronic discovery problem,’ the proposed Safe Harbor in Rule 37(f) provides little, if any, protection outside of the common law spoliation doctrine. Because no court has ever sanctioned a party for the routine operation of its electronic information system, litigants gain no protection under the “shallow” Safe Harbor the Committee has created.”); Mark R. Nelson & Mark H. Rosenberg, *A Duty Everlasting: The Perils of Applying Traditional Doctrines of Spoliation to Electronic Discovery*, 12 RICH. J. L & TECH. 14, 47–51 (2006).

4. Gross, *supra* note 3, at 729.

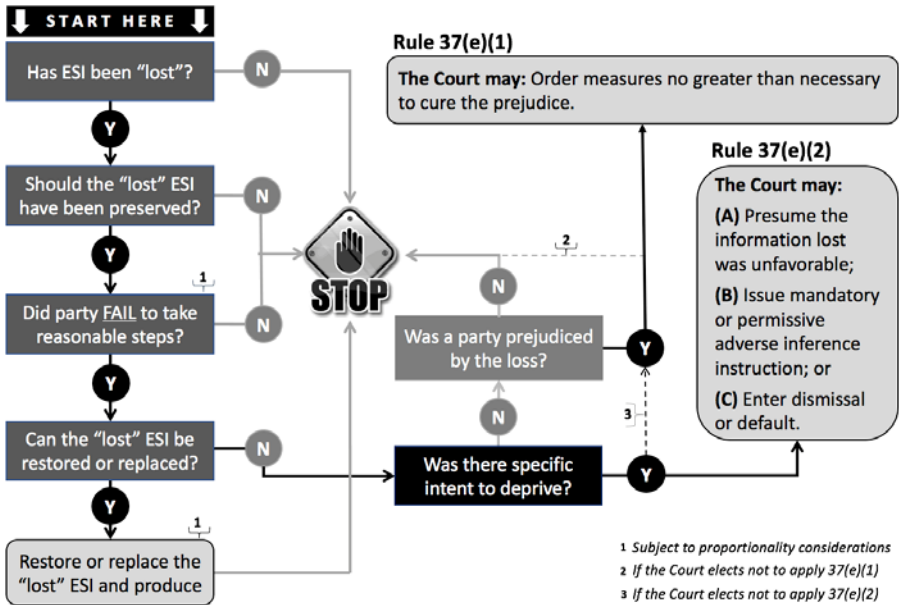
5. Out of a total of 2,343 written comments received by the Advisory Committee, 287 specifically addressed the proposed amendment to Rule 37(e). Gross, *supra* note 3, at 729.

6. Michele Lange, *FRCP Amendments: The Long and Winding Road*, THE EDISCOVERY BLOG (April 21, 2014), <http://www.theediscoveryblog.com/2014/04/21/frcp-amendments-long-winding-road/>.

sonable steps to preserve it, and it cannot be restored or replaced through additional discovery, the court:

- (1) upon finding prejudice to another party from the loss of the information, may order measures no greater than necessary to cure the prejudice; or
- (2) only upon finding that the party acted with intent to deprive another party of the information's use in the litigation, may:
 - (A) presume that the lost information was unfavorable to the party;
 - (B) instruct the jury that it may or must presume the information was unfavorable to the party; or
 - (C) dismiss the action or enter a default judgment.

The amended Rule thus creates a series of gateways or decision points that will determine whether a remedial measure may be ordered in the event of spoliation and what form it may take. The following chart provides a graphic representation of the resulting decision-making process:



To analyze whether courts retain inherent power to issue spoliation sanctions following the adoption of this scheme, it is first necessary to understand the origin and contours of inherent authority.

III. THE DOCTRINE OF INHERENT JUDICIAL AUTHORITY

Both the academic literature and case law reflect highly divergent views of the appropriate scope of inherent authority. As the Third Circuit noted in 1985, “[d]espite historical reliance on inherent powers, including Supreme Court jurisprudence

dating back to 1812, the notion of inherent power has been described as nebulous, and its bounds as ‘shadowy.’”⁷ The court recognized several factors that give rise to this lack of clarity, including: (1) the paucity of published decisions;⁸ (2) the inconsistent use of generic terms to describe “several distinguishable court powers;”⁹ and (3) reliance on precedent underlying one form of inherent power to support the use of a different power.¹⁰

One commentator summarized the doctrinal uncertainty in this area as arising from two sources. The first is the lack of clear standards establishing when courts may invoke their inherent authority absent express statutory authorization, a situation resulting in the Supreme Court jurisprudence appearing “schizophrenic.”¹¹ The second source of confusion is a lack of consensus over the constitutional authority of Congress to abrogate common-law rules governing the use of inherent authority.¹² As the Third Circuit has observed, the Supreme Court has failed to provide clarity with respect to “the conceptual and definitional problems regarding inherent power that have bedeviled commentators for years.”¹³ The confusion is reflected, and perhaps exacerbated, by regular use of the term “inherent

7. *Eash v. Riggins Trucking, Inc.*, 757 F.2d 557, 561 (3d Cir. 1985) (en banc) (citing Maurice Rosenberg, *Sanctions to Effectuate Pretrial Discovery*, 58 COLUM. L. REV. 480, 485 (1958); Stephen B. Burbank, *Sanctions in the Proposed Amendments to the Federal Rules of Civil Procedure: Some Questions About Power*, 11 HOFSTRA L. REV. 997, 1004 (1983); R. Rodes, K. Ripple & C. Mooney, *Sanctions Imposable for Violations of the Federal Rules of Civil Procedure* 179 n.466 (Federal Judicial Center 1981)).

8. *See id.*

9. *Id.* (citations omitted).

10. *See id.*

11. Joseph J. Anclien, *Broader is Better: The Inherent Powers of Federal Courts*, 64 N.Y.U. ANN. SURV. AM. L. 37, *41–42 (2008) [hereinafter Anclien].

12. *Id.*

13. *Eash*, 757 F.2d at 561.

power” that conflates “certain implied powers” purportedly arising from the structure of the Constitution itself, with “inherent authority” which refers to powers originating outside of the Constitution. Notwithstanding the semantic distinction,¹⁴ the Supreme Court and the lower courts have repeatedly used the terms “implied power” and “inherent power” interchangeably. This article will therefore treat these terms as synonymous unless otherwise indicated.

In part III.A, below, we examine what might be termed the “narrow” view of inherent authority, which is characterized by a correspondingly broad view of the power of Congress to limit judicial authority. Next, in part III.B, we discuss the “expansive” view, where the balance of power tips in favor of the judicial branch. Then, in part III.C, we consider the somewhat tortured path that inherent authority has taken in Supreme Court jurisprudence and address the current status of the doctrine.

A. *The Narrow View of Inherent Authority*

Several scholars have concluded that Congress has virtually unlimited authority over the exercise of judicial power. A principal proponent of this position is Professor Robert J. Pushaw, Jr., who summarizes this view as follows:

Any judicial invocation of inherent power [] seems to clash with three principles of constitutional structure that the Court has long endorsed. First, the American government is founded upon a written Constitution that enumerates and limits

14. Compare Anclien, *supra* note 11, at n.10 (“neither the caselaw nor the underlying concepts admit such a sharp distinction”), with Scott C. Idleman, *The Emergence of Jurisdictional Resequencing in the Federal Courts*, 87 CORNELL L. REV. 1, 43, 45–52 (2001) (proposing a fundamental distinction between “implied” and “inherent” powers).

the powers of each department, with particularly stringent restrictions placed on the judiciary. Second, the Court's claim that federal judges may act without statutory authorization appears to conflict with its longstanding position that the Constitution vests Congress with full power over the judiciary's structure, jurisdiction, and operations. Third, the Court's development of rules to govern the exercise of inherent powers cannot be squared with its axiom that Congress makes federal law, both substantive and procedural, which judges merely interpret and apply.¹⁵

In general, these scholars extrapolate from Congress' long-standing exercise of control over the judiciary, and they infer that the drafters of the Constitution intended to vest in the legislative branch the authority to establish not only substantive law, but also procedural and operational rules for the judiciary pursuant to the "necessary and proper" clause or the "tribunals" clause of Article I, Section 8. The former provides that "Congress shall have power . . . [t]o make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this Constitution in the government of the United States, or in any department or officer

15. Robert J. Pushaw, Jr., *The Inherent Powers of Federal Courts and the Structural Constitution*, 86 IOWA L. REV. 735 (2001) [hereinafter Pushaw]; see also Benjamin H. Barton, *An Article I Theory of the Inherent Powers of the Federal Courts*, 61 CATH. U. L. REV. 1 (2011) [hereinafter Barton] ("An examination of the Constitution's history and text, the ratification debates, and early case law establishes that Article I's Necessary and Proper Clause—not Article III's usage of the words 'judicial power' and 'courts'—controls any inherent judicial authority. Thus, . . . Congress has near plenary authority over the structure and procedure of the federal courts.").

thereof.”¹⁶ The latter states, “The Congress shall have power . . . [t]o constitute tribunals inferior to the Supreme Court.”¹⁷ The inference that these scholars draw from the “tribunals” clause is that Congress, having been assigned the authority to constitute the inferior courts of the United States, can, by “necessary implication,” limit those courts and control all aspects of their exercise of the judicial power.¹⁸

In this view, inherent authority is limited to powers that are necessary to preserve very narrowly defined judicial functions:

By vesting ‘judicial power’ in independent ‘courts,’ Article III incorporated the English understanding that judges were to administer justice impartially by applying pre-existing law to the facts in a particular case, then rendering a final and binding judgment that the political branches

16. U.S. CONST. art. I, § 8, cl. 18 (“The Congress shall have power . . . To make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this Constitution in the government of the United States, or in any department or officer thereof.”).

17. U.S. CONST. art. I, § 8, cl. 9 (“The Congress shall have power . . . To constitute tribunals inferior to the Supreme Court.”). The asserted inference stemming from the “tribunals” clause is that Congress, having been assigned the authority to constitute the inferior courts of the United States, can by “necessary implication” destroy those courts, and control all aspects of their exercise of the judicial power while in existence.

18. See Pushaw, *supra* note 15, at 832 (arguing from statements made during the ratification debates, as reported in *The Debates in the Several State Conventions on the Adoption of the Federal Constitution* (Jonathan Elliot, 1827): “Most significantly, the Constitution’s ratifiers often asserted that Congress had authority over rules of judicial procedure and evidence, derived by necessary implication from both general democratic principles and Congress’s specific power to establish inferior federal courts and to regulate the Supreme Court’s appellate jurisdiction.”).

could not alter. The Court has always adhered to this sound interpretation of Article III, which assumes that the constitutional provisions concerning congressional regulation of the judiciary do not pertain to the courts' exercise of their essential function of adjudication.¹⁹

Proponents of the narrow view draw support from what Congress has actually done in defining the limits of judicial authority and prescribing procedural rules. In its first session, Congress passed the Judiciary Act of 1789 to establish the courts of the United States pursuant to Article III.²⁰ The Act defined the roles of the Supreme Court, the circuit courts, and the district courts, including their respective jurisdictions.²¹ Additionally, Section 17 of the Act expressly granted the judiciary the power to "impose and administer all necessary oaths or affirmations, and to punish by fine or imprisonment, at the discretion of said courts, all contempts of authority in any cause or hearing before the same; and to make and establish all necessary rules for the orderly conducting business in the said courts, provided such rules are not repugnant to the laws of the United States."²²

B. The Expansive View of Inherent Authority

The arguments favoring a more expansive view of inherent judicial authority are partly historical, partly structural, and partly based on an analysis of the intent of the Founders.

19. Pushaw, *supra* note 15, at 741.

20. *See* 1 Stat. 73.

21. *See id.* §§ 1–16.

22. *Id.* § 17. The fact that Congress included the power to punish contempt in the Judiciary Act of 1789 could be taken as implying that Congress did not believe that the courts possessed such power as a matter of inherent authority.

1. Historical Underpinnings

Well prior to the American Revolution, English courts had relied on their inherent authority—as opposed to a grant of authority from the crown or parliament—to assert control over proceedings and the conduct of parties and counsel on a wide variety of matters, including the dismissal of cases for vexatiousness or failure to prosecute.²³ Thus, for example, the implied power to fine or imprison a contemnor existed in the English courts of common law and chancery long before the ratification of the U.S. Constitution.²⁴ As Professor Benjamin H. Barton notes, “Courts in 1787 would have been at a loss without the power to act in the absence of legislative authority.”²⁵ The argument, then, is that the use of inherent authority by courts to regulate themselves was well-established in the colonies prior to the Revolution, and was inherited by the Judiciary of the United States upon the ratification of the Constitution in 1789.²⁶

23. See Daniel J. Meador, *Inherent Judicial Authority in the Conduct of Civil Litigation*, 73 TEX. L. REV. 1805, *1806 (1994) [hereinafter Meador] (“American concepts of judicial functions and the nature of judicial power are rooted in English common law and chancery practice. Long before the American Revolution, English courts assumed the authority to prevent abuses of their processes and procedures and to control the conduct of persons appearing before them or interfering with their business.”).

24. *Id.* at *1806–07.

25. Barton, *supra* note 15, referencing Pushaw, *supra* note 15, at 817–18 (noting the uniqueness of the Virginia Assembly’s decision to enact a code of judicial procedure, given that most courts addressed such issues as they arose).

26. See Barton, *supra* note 15; Pushaw, *supra* note 15; Meador, *supra* note 23.

2. Separation of Powers

The broad view of judicial authority also rests on a separation-of-powers argument,²⁷ which emphasizes the co-equal roles of the legislative and judicial branches. Congress is vested with the constitutional authority to utilize the legislative power of the United States within the scope of Article I, including establishing substantive rights and obligations. Article III vests the judicial power of the United States “in one Supreme Court, and in such inferior courts as the Congress may from time to time ordain and establish.”²⁸ Once Congress acts, these lower

27. See generally Linda S. Mullenix, *Unconstitutional Rulemaking: The Civil Justice Reform Act and Separation of Powers*, 77 MINN. L. REV. 1284 (1993). The uninitiated may be forgiven for wondering why separation of powers doctrine is implicated by the relationship between decisions by courts created under Article III of the Constitution and rules promulgated by committees composed largely of Article III judges. The answer lies in the Rules Enabling Act, 28 U.S.C. §§ 2071–2077. That statute constitutes the delegation by Congress of its power to enact rules governing the conduct of proceedings in the federal courts. The proposed rules must be laid before Congress for a prescribed period giving Congress the opportunity to modify or reject them before they become effective. 28 U.S.C. § 2074(a). See *Hanna v. Plumer*, 380 U.S. 460, 472 (1965) (“[T]he constitutional provision for a federal court system (augmented by the Necessary and Proper Clause) carries with it congressional power to make rules governing the practice and pleadings in those courts, which in turn includes a power to regulate matters which, though falling within the uncertain area between substance and procedure, are rationally capable of classification as either.”); *Sibbach v. Wilson & Co.*, 312 U.S. 1, 9–10 (1941) (“Congress has undoubted power to regulate the practice and procedure of federal courts, and may exercise that power by delegating to this or other federal courts authority to make rules not inconsistent with the statutes or constitution of the United States”); Mullenix, *supra*, at 1323–31. Thus, in a sense, judges act as agents of Congress when they amend the Federal Rules, a structure that some commentators consider a violation of separation of powers when those rules are procedural. Mullenix, *supra*, at 1331.

28. U.S. CONST., art. III, § 1. The Constitution is silent as to the meaning of “judicial power.” However, Article III, Section 2 states, “The judicial

federal courts are expressly vested with judicial power of the United States, which historically has included the authority to, among other things, (1) establish procedural rules for litigation and (2) regulate and enforce standards of conduct for those appearing before the court. According to this argument, when Congress creates non-substantive rules for the federal courts, it usurps the judicial power vested exclusively in the judiciary under Article III.

3. Original Intent

Adherents to the expansive view buttress this structural argument with an analysis of original intent. One aspect of this analysis is an examination of the legislative history of what ultimately became Article III. According to the records of the Constitutional Convention, on Monday, August 6, 1787, the Committee of Detail delivered to the Committee of the Whole a proposed draft of the Constitution for consideration.²⁹ Article XI of the August 6 draft was dedicated to the national judiciary,³⁰ and is reproduced in Appendix A. On August 27, 1787, the Committee of the Whole took up the proposed Article XI, and,

power shall extend to all cases, in law and equity, arising under this Constitution, the laws of the United States, and treaties made, or which shall be made, under their authority;—to all cases affecting ambassadors, other public ministers and consuls;—to all cases of admiralty and maritime jurisdiction;—to controversies to which the United States shall be a party;—to controversies between two or more states;—between a state and citizens of another state;—between citizens of different states;—between citizens of the same state claiming lands under grants of different states, and between a state, or the citizens thereof, and foreign states, citizens or subjects.” U.S. CONST., art. III, § 2, cl. 1.

29. *THE RECORDS OF THE FEDERAL CONVENTION OF 1787*, vol. 2, 176 (Max Farrand, ed. 1911) [hereinafter Farrand].

30. 2 Farrand, *supra* note 29, at 186–187.

toward the end of that day, two motions were made and considered to amend Section 3, the provision that would establish the subject matter jurisdiction of the federal courts.³¹

The first motion, no. 383, was to append a sentence to the end of Section 3 that would read: "In all the other cases before mentioned the Judicial power shall be exercised in such manner as the Legislature shall direct."³² Motion 383 was rejected by a vote of 2 states in favor and 6 states in opposition.³³

The second motion, no. 384, sought to strike the last sentence in Section 3—as proposed by the Committee of Detail—which read: "The Legislature may assign any part of the jurisdiction above mentioned (except the trial of the President of the United States) in the manner and under the limitations which it shall think proper, to such inferior courts as it shall constitute from time to time."³⁴ Motion no. 384 to strike this sentence was passed unanimously.³⁵

Thus, it can be maintained that the delegates to the Constitutional Convention rejected the proposition that Congress should have the constitutional authority to direct the federal court's exercise of the judicial power by statute, or to otherwise

31. *Id.*; see also Appendix A, *infra* (Much of the approved text from the August 6, 1787, draft of Article XI, § 3 was subsequently moved by the Committee on Style into Article III, § 2 of the Constitution.).

32. 2 Farrand 425, 426 (motion 383), 431.

33. *Id.* (Delaware and Virginia voted in "aye," while New Hampshire, Connecticut, Pennsylvania, Maryland, South Carolina, and Georgia voted "no." Massachusetts, New York, New Jersey, North Carolina, and Rhode Island were not present.).

34. 2 Farrand 425, 426 (motion 384), 431.

35. *Id.* (New Hampshire, Connecticut, Pennsylvania, Maryland, South Carolina, Georgia, Delaware, and Virginia voted "aye." Massachusetts, New York, New Jersey, North Carolina, and Rhode Island were not present.).

limit or control the distribution of the jurisdiction except as otherwise expressly granted in Article III, Section 2.³⁶

This view is supported by the writings of James Madison, both before and after the ratification of the Constitution. In *The Federalist* No. 51, Madison is credited with explaining that the constitutional partition of the legislative, executive, and judicial powers into three distinct branches was designed to ensure that the constituent parts of the federal government would each be kept “in their proper places” and that the danger that arises from encroachment by one branch would be counteracted by another branch.³⁷

36. Of course, caution must be exercised in drawing inferences from the rejection of proposed language by the delegates to the Constitutional Convention, just as courts are careful about divining congressional intent from inaction. See *United States v. Craft*, 535 U.S. 274, 287 (2002) (“[C]ongressional inaction lacks persuasive significance because several equally tenable inferences may be drawn from such inaction, including the inference that the existing legislation already incorporated the offered change.”) (internal punctuation and alterations omitted); *Federal Election Commission v. Arlen Specter* ‘96, 150 F. Supp. 2d 797, 815 (E.D. Pa. 2001) (“[W]e are skeptical about the amount of weight that can be properly given to a failed amendment that died in committee.”).

37. THE FEDERALIST NO. 51 (James Madison) (“[T]he great security against a gradual concentration of the several powers in the same department, consists in giving to those who administer each department the necessary constitutional means and personal motives to resist encroachments of the others. The provision for defense must in this, as in all other cases, be made commensurate to the danger of attack. Ambition must be made to counteract ambition. The interest of the man must be connected with the constitutional rights of the place. It may be a reflection on human nature, that such devices should be necessary to control the abuses of government. But what is government itself, but the greatest of all reflections on human nature? If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to

Madison further reflected on his views of the separation of powers during the 1789 House debate on the Executive branch power to remove the principal officers of the United States who were appointed by the President with the advice and consent of the Senate.³⁸ The Constitution is silent as to whether these principal officers are to serve at the pleasure of the President, or may only be removed from office by Congress through its impeachment power. Speaking from the floor of the House of Representatives, Madison explained how the separation-of-powers doctrine should be applied in the absence of direct instruction in the Constitution on whether the power of removal should rest in the hands of the President or the hands of Congress:

There is another maxim which ought to direct us in expounding the constitution, and is of great importance. It is laid down, in most of the constitutions or bills of rights in the republics of America; it is to be found in the political writings of the most celebrated civilians, and is everywhere held as essential to the preservation of liberty, that the three great departments of Government be kept separate and distinct; and if in any case they are

control the governed; and in the next place oblige it to control itself. A dependence on the people is, no doubt, the primary control on the government; but experience has taught mankind the necessity of auxiliary precautions. This policy of supplying, by opposite and rival interests, the defect of better motives, might be traced through the whole system of human affairs, private as well as public.”).

38. Under the proposed Act to create the Executive department of Foreign Affairs, the President was given the authority to remove the principal officer (Secretary) of the department. U.S. CONST. Art. II, § 2, Cl. 2 provides that the President “shall nominate, and by and with the advice and consent of the Senate, shall appoint . . . all other officers of the United States.”

blended, it is in order to admit a partial qualification, in order more effectually to guard against an entire consolidation. I think, therefore, when we review the several parts of this constitution, when it says that the legislative powers shall be vested in a Congress of the United States under certain exceptions, and the executive power vested in the President with certain exceptions, we must suppose they were intended to be kept separate in all cases in which they are not blended, and ought, consequently, to expound the constitution so as to blend them as little as possible.³⁹

Thus, according to Madison, the Constitution should be interpreted so as to permit the intrusion of one branch on another “as little as possible.”⁴⁰ During this same debate,⁴¹ Madison expressed his strong conviction about the separation of powers between the judicial and the legislative branches:

The judicial power is vested in a Supreme Court; but will gentlemen say the judicial power can be placed elsewhere, unless the constitution has made an exception? The constitution justifies the Senate in exercising a judiciary power in determining on impeachments; but can the judicial power be further blended with the powers of that body? They cannot.⁴²

39. 1 ANNALS OF CONG. 518–519 (June 17, 1789).

40. *Id.*

41. This debate occurred five weeks before the House received the Judiciary Act from the Senate.

42. 1 ANNALS OF CONG. 482 (June 16, 1789). In the continuing debate the following day, Madison examined and rejected the argument often asserted by those who believe that under the “tribunals” clause the power of

Thus, to the extent that the views of Madison carry special weight, they support the broad view of inherent judicial authority.

C. *The Course of Inherent Authority in the Supreme Court*

As noted above, Supreme Court opinions reflect a less than consistent approach to inherent authority. One of the first cases to address the reach of a federal court's power in the absence of a statutory grant of authority was *Turner v. Bank of North America*, decided in 1799.⁴³ There, the Supreme Court was

Congress to create the inferior courts implies the power to control all aspects of those courts:

The gentleman from Connecticut (Mr. Sherman) has advanced a doctrine which was not touched upon before. He seems to think (if I understood him rightly) that the power of displacing from office is subject to legislative discretion; because it having a right to create, it may limit or modify as it thinks proper. I shall not say but at first review this doctrine may seem to have some plausibility. But when I consider, that the constitution clearly intended to maintain a marked distinction between the legislative, executive, and judicial powers of Government; and when I consider, that if the Legislature has a power, such as contended for, they may subject and transfer at discretion powers from one department of our Government to another; they may, on that principle, exclude the President altogether from exercising any authority in the removal of officers; they may give it to the Senate alone, or the President and Senate combined; they may vest it in the whole Congress; or they may reserve it to be exercised by this House. When I consider the consequences of this doctrine, and compare them with the true principles of the constitution, I own that I cannot subscribe to it.

Id. at 515 (June 17, 1789).

43. *Turner v. Bank of North America*, 4 U.S. (4 Dall.) 8 (1799).

faced with the argument that, because the Constitution authorized suits between citizens of different states, a federal court had jurisdiction to hear such a case even though Congress had not enacted a parallel jurisdictional provision. The Court rejected this contention, and its reasoning is captured in an exchange between two of the justices, contained in a footnote to the opinion:

ELLSWORTH, Chief Justice. — How far is it meant to carry this argument? Will it be affirmed, that in every case, to which the judicial power of the United States extends, the federal courts may exercise a jurisdiction, without the intervention of the legislature, to distribute and regulate the power?

CHASE, Justice. — The notion has frequently been entertained, that the federal courts derive their judicial power immediately from the constitution; but the political truth is that the disposal of the judicial power (except in a few specified instances) belongs to congress. If congress has given the power to this court, we possess it, not otherwise: and if congress has not given the power to us, or to any other court, it still remains at the legislative disposal. Besides, congress is not bound, and it would, perhaps, be inexpedient, to enlarge the jurisdiction of the federal courts, to every subject, in every form, which the constitution might warrant.⁴⁴

In *United States v. Hudson & Goodwin* in 1812, the Supreme Court took a different view with respect to powers other than those defining the jurisdiction of the federal courts, and it held that the federal judiciary has “certain implied powers” and

44. *Id.* at 9, n. “a.”

“inherent authority” independent of any statutory grant from Congress.⁴⁵ In *Hudson*, the Court distinguished between the existence of inherent powers, specifically the power “[t]o fine for contempt—imprison for contumacy—inforce the observance of order, &c.” that “cannot be dispensed with in a Court,” and the exclusive role of Congress under the Constitution to establish the subject matter jurisdiction of the inferior courts of the United States.⁴⁶ To be sure, the Court offered these pronouncements only after Section 17 of the Judiciary Act of 1789 had expressly granted authority to the courts to “punish by fine or imprisonment, at the discretion of said courts, all contempts of authority in any cause or hearing before the same.”⁴⁷

In 1821 in *Anderson v. Dunn*,⁴⁸ the Supreme Court examined the power of Congress to issue its own warrant to have the Sergeant-at-Arms arrest and imprison the plaintiff, a member of Congress, for contempt committed in the presence of the House. The plaintiff asserted that the authority to charge contempt was within the judicial power solely granted under the Constitution

45. *United States v. Hudson & Goodwin*, 11 U.S. (7 Cranch) 32, 34 (1812) [hereinafter *Hudson*].

46. *Id.* (“The legislative authority of the Union must first make an act a crime, affix a punishment to it, and declare the Court that shall have jurisdiction of the offence. Certain implied powers must necessarily result to our Courts of justice from the nature of their institution. But jurisdiction of crimes against the state is not among those powers. To fine for contempt—imprison for contumacy—inforce the observance of order, &c. are powers which cannot be dispensed with in a Court, because they are necessary to the exercise of all others: and so far our Courts no doubt possess powers not immediately derived from statute; but all exercise of criminal jurisdiction in common law cases we are of opinion is not within their implied powers.”).

47. 1 Stat. 87, § 17.

48. *Anderson v. Dunn*, 19 U.S. (6 Wheat.) 204 (1821).

to the judiciary of the United States, and thus could not be exercised by Congress.⁴⁹ In rejecting the plaintiff's assertion and holding in favor of Congress, the Court noted that to deny Congress the implied power to guard itself from contempt would "leave it exposed to every indignity and interruption that rudeness, caprice, or even conspiracy, may meditate against it."⁵⁰ The Court likened this congressional power to the inherent authority vested in the courts, stating that "[c]ourts of justice are universally acknowledged to be vested, by their very creation, with power to impose silence, respect, and decorum, in their presence, and submission to their lawful mandates."⁵¹ The Court then noted that while the Judiciary Act of 1789 provided for the courts to fine or imprison for contempt, this did no more than endorse the inherent authority already existing in the

49. *Id.* at 224 ("The power of issuing warrants is manifestly *judicial*. This may be assumed as an axiom. The Constitution ordains, that the judicial power (which is equivalent to all the judicial power) shall be vested in one Supreme Court, and other inferior Courts (art. 3. sec. 1.) Thus, the right of the *Courts* to exercise such a power, is *exclusive*, and an assumption of it by any other department, is an usurpation . . . Courts enforce the laws; they must, therefore, be clothed with authority to compel obedience to them: whereas, the Legislature is merely deliberative.").

50. *Id.* at 228–29 ("This result is fraught with too much absurdity not to bring into doubt the soundness of any argument from which it is derived. That a deliberate assembly [sic], clothed with the majesty of the people, and charged with the care of all that is dear to them; composed of the most distinguished citizens, selected and drawn together from every quarter of a great nation; whose deliberations are required by public opinion to be conducted under the eye of the public, and whose decisions must be clothed with all that sanctity which unlimited confidence in their wisdom and purity can inspire; that such an assembly should not possess the power to suppress rudeness, or repel insult, is a supposition too wild to be suggested.").

51. *Id.*

courts, which should “not extend beyond its known and acknowledged limits.”⁵²

The Court appeared to take a more circumscribed view of inherent power in 1845 in *Cary v. Curtis*.⁵³ Writing for the Court, Justice Daniel held that “the courts created by statute must look to the statute as the warrant for their authority; certainly they cannot go beyond the statute, and assert an authority with which they may not be invested by it, or which may be clearly denied to them.”⁵⁴ He reasoned:

This argument is in nowise impaired by admitting that the judicial power shall extend to all cases arising under the Constitution and laws of the United States. Perfectly consistent with such an admission is the truth, that the organization of the judicial power, the definition and distribution of the subjects of jurisdiction in the federal tribunals, and the modes of their action and authority, have

52. *Id.* at 227–28 (“On this principle it is, that Courts of justice are universally acknowledged to be vested, by their very creation, with power to impose silence, respect, and decorum, in their presence, and submission to their lawful mandates, and, as a corollary to this proposition, to preserve themselves and their officers from the approach and insults of pollution. It is true, that the Courts of justice of the United States are vested, by express statute provision, with power to fine and imprison for contempts; but it does not follow, from this circumstance, that they would not have exercised that power without the aid of the statute, or not, in cases, if such should occur, to which such statute provision may not extend; on the contrary, it is a legislative assertion of this right, as incidental to a grant of judicial power, and can only be considered either as an instance of abundant caution, or a legislative declaration, that the power of punishing for contempt shall not extend beyond its known and acknowledged limits of fine and imprisonment.”).

53. *Cary v. Curtis*, 44 U.S. 236 (1845).

54. *Id.* at 245.

been, and of right must be, the work of the legislature. The existence of the Judicial Act itself, with its several supplements, furnishes proof unanswerable on this point. The courts of the United States are all limited in their nature and constitution, and have not the powers inherent in courts existing by prescription or by the common law.⁵⁵

A more generous doctrine of inherent authority emerged again in 1874 in *Ex Parte Robinson*,⁵⁶ in which the Supreme Court considered the power of a federal court to summarily disbar an attorney for insolence. The Court reiterated that the inherent authority to punish for contempt was “essential to the preservation of order in judicial proceedings, and to the enforcement of the judgments, orders, and writs of the courts, and consequently to the due administration of justice.”⁵⁷ It declared that the judiciary obtained its inherent powers through a combination of the grant of judicial power to the courts under the Constitution and the grant of subject matter jurisdiction to the courts by Congress.⁵⁸

In *Ex Parte Peterson*,⁵⁹ the Supreme Court addressed inherent authority in a different context: the power to appoint an auditor to prepare a summary of damages in the absence of statutory authority to make such an appointment. It found the exercise of such authority appropriate:

55. *Id.*

56. *Ex parte Robinson*, 86 U.S. (19 Wall.) 505 (1873).

57. *Id.* at 510.

58. *Id.* (“The moment the courts of the United States were called into existence and invested with jurisdiction over any subject, they became possessed of this power.”).

59. *Ex parte Peterson*, 253 U.S. 300 (1920).

Courts have (at least in the absence of legislation to the contrary) inherent power to provide themselves with appropriate instruments required for the performance of their duties. This power includes authority to appoint persons unconnected with the court to aid judges in the performance of specific judicial duties, as they may arise in the progress of a cause. From the commencement of our government it has been exercised by the federal courts, when sitting in equity, by appointing, either with or without the consent of the parties, special masters, auditors, examiners, and commissioners. To take and report testimony; to audit and state accounts; to make computations; to determine, where the facts are complicated and the evidence voluminous, what questions are actually in issue; to hear conflicting evidence and make [a] finding thereon are among the purposes for which such aids to the judges have been appointed.⁶⁰

In 1962, in *Link v. Wabash Railroad Co.*,⁶¹ the Supreme Court examined the power of a United States District Court to exercise its inherent authority to dismiss a plaintiff's action with prejudice *sua sponte* for lack of prosecution. The plaintiff asserted on appeal that Rule 41(b), and not the court's inherent authority controlled, and that the Rule required that any motion for involuntary dismissal be made by the defendant. Thus, the plaintiff argued, the District Court lacked authority to act on its own.⁶² In response, the Court held:

60. *Id.* at 312–13 (internal citations omitted).

61. *Link v. Wabash R. Co.*, 370 U.S. 626 (1962).

62. *Id.* at 630–32.

Neither the permissive language of the Rule—which merely authorizes a motion by the defendant—nor its policy requires us to conclude that it was the purpose of the Rule to abrogate the power of courts, acting on their own initiative, to clear their calendars of cases that have remained dormant because of the inaction or dilatoriness of the parties seeking relief. The authority of a court to dismiss *sua sponte* for lack of prosecution has generally been considered an “inherent power,” governed not by rule or statute but by the control necessarily vested in courts to manage their own affairs so as to achieve the orderly and expeditious disposition of cases. That it has long gone unquestioned is apparent not only from the many state court decisions sustaining such dismissals, but even from language in this Court’s opinion in *Redfield v. Ystalyfera Iron Co.*, 110 U.S. 174, 176. It also has the sanction of wide usage among the District Courts. It would require a much clearer expression of purpose than Rule 41 (b) provides for us to assume that it was intended to abrogate so well-acknowledged a proposition.⁶³

Thus, the Court adopted the principle that inherent authority is not supplanted by a rule, absent a clear indication that the rule was intended to achieve that result.

In *Roadway Express v. Piper*,⁶⁴ the Supreme Court addressed the exercise of inherent authority in connection with sanctions. Plaintiff’s counsel had failed to comply with discovery requirements and related orders of the District Court.⁶⁵ The

63. *Id.*

64. *Roadway Express v. Piper*, 447 U.S. 752 (1980).

65. *Id.* at 755.

defense moved for dismissal under Rule 37, and the District Court granted the motion, followed by a hearing on costs and fees.⁶⁶ Having concluded that plaintiff's counsel "'improvidently enlarged and inadequately prosecuted' the action, . . . [a]s a sanction, the court ordered them to pay Roadway's costs and attorney's fees for the entire lawsuit."⁶⁷ Plaintiff's counsel appealed on the basis that the sanction conflicted with the statutory scheme for setting of fees and costs codified in 28 U.S.C. § 1920 and § 1927. The Supreme Court held that, notwithstanding these statutes, "in narrowly defined circumstances federal courts have inherent power to assess attorney's fees against counsel."⁶⁸ The Court did caution, however, that "[b]ecause inherent powers are shielded from direct democratic controls, they must be exercised with restraint and discretion."⁶⁹ The Court then remanded the case for determination as to whether plaintiff's counsel had acted in bad faith so as to justify the use of inherent authority for issuing sanctions.⁷⁰

Chambers v. NASCO, Inc.,⁷¹ decided in 1991, brought together many of the threads of prior Supreme Court cases addressing inherent authority, and it did so in connection with sanctions. A vexatious litigant, Chambers, was found to have repeatedly abused the judicial process, attempted to deprive the court of its jurisdiction through a fraudulent transfer, and violated court orders. After determining the merits of the case in favor of NASCO, the District Court considered sanctions

66. *Id.*

67. *Id.* at 756.

68. *Id.* at 764.

69. *Id.* (citing *Gompers v. Bucks Stove & Range Co.*, 221 U.S. 418, 450–451 (1911); *Green v. United States*, 356 U.S. 165, 193–194 (1958) (Black, J., dissenting)).

70. *Id.* at 767–768.

71. *Chambers v. NASCO, Inc.*, 501 U.S. 32 (1991).

against Chambers under Rule 11, 28 U.S.C. § 1927, and the court's inherent authority. Concluding that the Rule 11 and § 1927 were inadequate to reach Chambers directly, the District Court utilized its inherent authority to impose monetary sanctions on Chambers in the amount of NASCO's entire litigation expense, noting that "the wielding of that inherent power is particularly appropriate when the offending parties have practiced a fraud upon the court."⁷² The Court of Appeals affirmed. The question presented to the Supreme Court was whether sanctions under the Court's inherent authority were appropriate in light of the existing statutory and rule-based sanctioning scheme established by Congress.

The Supreme Court held that Rule 11 and § 1927 did not abrogate "the inherent power to impose sanctions for the bad-faith conduct" that was found by the District Court.⁷³

These other mechanisms, taken alone or together, are not substitutes for the inherent power, for that power is both broader and narrower than other means of imposing sanctions. First, whereas each of the other mechanisms reaches only certain individuals or conduct, the inherent power extends to a full range of litigation abuses. At the very least, the inherent power must continue to exist to fill in the interstices.⁷⁴

Noting that it had previously "determined that 'Congress had not repudiated the judicially fashioned exceptions' to the American Rule, which were founded in the inherent power

72. *Id.* at 42 (citing the District Court opinion at 124 F.R.D. 120, 139 (W.D. La. 1989)).

73. *Id.* at 46.

74. *Id.*

of the courts,"⁷⁵ the Court stated that "[n]othing since then has changed that assessment, and we have thus reaffirmed the scope and the existence of the exceptions since the most recent amendments to § 1927 and Rule 11, the other sanctioning mechanisms invoked by NASCO here."⁷⁶ The Court went on to hold:

There is, therefore, nothing in the other sanctioning mechanisms or prior cases interpreting them that warrants a conclusion that a federal court may not, as a matter of law, resort to its inherent power to impose attorney's fees as a sanction for bad-faith conduct. This is plainly the case where the conduct at issue is not covered by one of the other sanctioning provisions. But neither is a federal court forbidden to sanction bad-faith conduct by means of the inherent power simply because that conduct could also be sanctioned under the statute or the Rules. A court must, of course, exercise caution in invoking its inherent power, and it must comply with the mandates of due process, both in determining that the requisite bad faith exists and in assessing fees. Furthermore, when there is bad-faith conduct in the course of litigation that could be adequately sanctioned under the Rules, the court ordinarily should rely on the Rules rather than the inherent power. But if in the informed discretion of the court, neither the statute nor the Rules are up to the task, the court may safely rely on its inherent power.⁷⁷

75. *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 260 (1975).

76. *Chambers*, 501 U.S. at 47–48.

77. *Id.* at 50 (internal citation omitted).

The most recent word from the Supreme Court on inherent authority is *Dietz v. Bouldin*,⁷⁸ decided after the 2015 amendments to the Federal Rules came into effect. There, the Court concluded that a district court possesses the inherent power in a civil case to rescind an order discharging a jury and recall the jurors for further deliberations where the court discovers an error in the jury's verdict.⁷⁹ In so holding, the Court noted that it had long recognized that district courts may exercise inherent power, independent of any statute or rule, to manage cases.⁸⁰ It then went on to identify two limitations on that power: First, the exercise of an inherent power must be a "reasonable response to the problems and needs" confronting the court's fair administration of justice. Second, the exercise of an inherent power cannot be contrary to any express grant of or limitation on the district court's power contained in a rule or statute.⁸¹

Significantly, the Court articulated these limits in the context of an issue that did not implicate the integrity of the judicial process; whether a discharged jury could be recalled might affect the efficiency of litigation, but a rule prohibiting recall would not threaten the dignity of the court or the legitimacy of any ultimate adjudication.⁸²

78. *Dietz v. Bouldin*, __ U.S. __, 136 S. Ct. 1885 (2016).

79. *Id.* at 1892, 1897.

80. *Id.* at 1891.

81. *Id.* at 1892 (internal citations omitted).

82. The case cited by the Court for the proposition that the exercise of inherent authority cannot be contrary to a rule dealt with Rule 52(a) of the Federal Rules of Criminal Procedure, which provides that "[a]ny error, defect, irregularity, or variance that does not affect substantial rights must be disregarded." *See Bank of Nova Scotia v. United States*, 487 U.S. 250, 254 (1988). There, as in *Dietz*, the rule in question did not threaten to undermine core judicial functions.

Regardless of how one comes down on the debate between advocates of the narrow and the expansive views of inherent authority, certain general principles reflecting the current state of the law can be derived from existing Supreme Court precedent: (1) even where Congress has addressed an issue by statute or rule, inherent judicial authority may be invoked to fill any remaining interstices where the statute or rule is not “up to the task”; (2) inherent authority may be exercised even where it conflicts with a statute or rule, where to do so is necessary to protect a core judicial function.⁸³

IV. APPLICATION OF INHERENT AUTHORITY TO RULE 37(E)

A. *The Advisory Committee Note*

This brings us to the question of what role, if any, inherent authority might play as a basis for imposing sanctions for spoliation in light of Rule 37(e). The advisory committee note to the 2015 amendment to Rule 37(e) suggests that it might have no role at all:

83. Summarizing the circumstances in which a court may exercise inherent powers, the Third Circuit has concluded that notwithstanding the absence of statutory authority, courts may: (1) issue contempt sanctions; (2) regulate the conduct of the members of the bar by disbarment, suspension from practice, or reprimand (including monetary sanctions) for abuse of the judicial process; (3) provide tools for docket management; (4) dismiss a case for failure to prosecute; (5) in the absence of a statute, tax costs in the appellate court; (6) declare attorneys who choose to be absent from docket call “ready for trial,” even though this may lead ineluctably to the entry of a default judgment; (7) appoint persons unconnected with the court to aid judges in the performance of specific judicial duties; (8) elect to use a state mechanism for certification of a question of doubtful state law; (9) grant bail in a situation not dealt with by statute; (10) dismiss a suit pursuant to the doctrine of *forum non conveniens*; and (11) process litigation to a just and equitable conclusion (when sitting in equity). *Eash v. Riggins Trucking, Inc.*, 757 F.2d 557, 561–64 (3d Cir. 1985) (en banc) (internal citations omitted).

New rule 37(e) replaces the 2006 rule. It authorizes and specifies measures a court may employ if information that should have been preserved is lost, and specifies the findings necessary to justify these measures. It therefore forecloses reliance on inherent authority or state law to determine when certain measures should be used.⁸⁴

But the intent of the Advisory Committee to proscribe reliance on inherent authority with respect to the entire arena of spoliation sanctions applicable to ESI is less than clear. And, even if it were, there is substantial question whether the Advisory Committee could effect such an outcome by means of a note.

“[A]n advisory committee’s note is not part of the Rule itself.”⁸⁵ Rather, “[a]n Advisory Committee note is an explanation of, or an aid to interpretation of, a procedural rule. It is somewhat similar to a legislative history not having the force of law.”⁸⁶ Perhaps the most complete explanation of this principle was articulated by Justice Scalia in *Tome v. United States*:⁸⁷

Having been prepared by a body of experts, the Notes are assuredly persuasive scholarly com-

84. FED. R. CIV. P. 37 advisory committee’s note to 2015 amendment.

85. *United States v. Bainbridge*, 746 F.3d 943, 947 (9th Cir. 2014).

86. *United States v. Sandini*, 816 F.2d 869, 875 n.7 (3d Cir. 1987); *see also* *Moody National Bank of Galveston v. GE Life and Annuity Assurance Co.*, 383 F.3d 249, 253 (5th Cir. 2004); *Clark v. Long*, 255 F.3d 555, 559 (8th Cir. 2001) (“An advisory committee note, of course, does not have the force of law”); *Coates v. Mystic Blue Cruises Inc.*, No. 11 C 1986, 2012 WL 3860036, at *2 n.2 (N.D. Ill. Aug. 9, 2012); *McKnight v. Purdue Pharma Co.*, 422 F. Supp. 2d 756, 758 (E.D. Tex. 2006); *In re Habeas Corpus Cases*, 216 F.R.D. 52, 53–54 (E.D.N.Y. 2003) (“An Advisory Committee note, while helpful, cannot replace the plain language of a rule or statute.”).

87. *Tome v. United States*, 513 U.S. 150, 167 (1995) (Scalia, J., concurring in part and concurring in the judgment).

mentaries—ordinarily *the* most persuasive—concerning the meaning of the Rules. But they bear no special authoritativeness as the work of the draftsmen, any more than the views of Alexander Hamilton (a draftsman) bear more authority than the views of Thomas Jefferson (not a draftsman) with regard to the meaning of the Constitution. It is the words of the Rules that have been authoritatively adopted—by this Court, or by Congress if it makes a statutory change. See 28 U.S.C. §§ 2072, 2074 (1988 ed. and Supp. IV). In my view even the adopting Justices' thoughts, unpromulgated as Rules, have no authoritative (as opposed to persuasive) effect, any more than their thoughts regarding an opinion (reflected in exchanges of memoranda before the opinion issues) authoritatively demonstrate the meaning of that opinion. And the same for the thoughts of congressional draftsmen who prepare statutory amendments to the Rules. Like a judicial opinion and like a statute, the promulgated Rule says what it says, regardless of the intent of its drafters. The Notes are, to be sure, submitted to us and to the Members of Congress as the thoughts of the body initiating the recommendations, see [28 U.S.C.] § 2073(d); but there is no certainty that either we or they read those thoughts, nor is there any procedure by which we formally endorse or disclaim them. That being so, the Notes cannot, by some power inherent in the draftsmen, change the meaning that the Rules would otherwise bear.⁸⁸

88. *Id.* at 168.

Furthermore, like legislative history, advisory committee notes are most persuasive when they elucidate an otherwise unclear or ambiguous aspect of a rule.⁸⁹

Here, the text of Rule 37(e) is devoid of any reference to inherent authority. Thus, the advisory committee note cannot be said to aid in the interpretation of some textual ambiguity. And the import of the note, if construed in the broadest terms, would be to overrule *sub silentio Chambers*⁹⁰ and similar Supreme Court precedent that stands for the proposition that courts retain inherent authority to exercise power where the integrity of the judicial process is at issue. It strains credulity to suggest that this would be accomplished by means of a note which, as Justice Scalia pointed out, might never have been read by the Justices or the Members of Congress who reviewed the proposed amendments.

Furthermore, the 2015 advisory committee note to Rule 37 does not specifically allude to *Chambers* or other relevant Supreme Court jurisprudence, and does not flag the substantial constitutional and separation-of-powers issues that would be raised in any attempt to foreclose entirely the exercise of inherent authority.⁹¹ Yet, when the Advisory Committee did intend to abrogate precedent in the 2015 amendments to the Federal Rules of Civil Procedure, it identified the specific case law that

89. See *United States v. Vonn*, 535 U.S. 55, 64 (2002) (“In the absence of a clear legislative mandate, the Advisory Committee Notes provide a reliable source of insight into the meaning of a rule, especially when, as here, the rule was enacted precisely as the Advisory Committee proposed.”); *Federal Trade Commission v. Boehringer Ingelheim Pharmaceuticals, Inc.*, 778 F.3d 142, 154–55 (D.C. Cir. 2015); *Republic of Ecuador v. Kelsh*, 742 F.3d 860, 865 (9th Cir. 2014).

90. *Chambers v. NASCO, Inc.*, 501 U.S. 32 (1991).

91. See Section III.C., *supra*.

the rule was designed to supersede.⁹² Thus, even if an advisory committee note accompanying an amendment to the Federal Rules of Civil Procedure could in some circumstances displace Supreme Court precedent, this note does not do so with the requisite specificity in regards to inherent authority and the long line of Supreme Court cases.

B. *Spoilation Remedies and Inherent Authority*

As discussed above, inherent powers are those “which cannot be dispensed with in a Court, because they are necessary to the exercise of all others.”⁹³ The Supreme Court has found these powers to include the authority to admit and discipline attorneys,⁹⁴ to punish contempt,⁹⁵ to vacate a judgment upon proof of fraud on the court,⁹⁶ to bar a disruptive criminal defendant from the courtroom,⁹⁷ to dismiss a lawsuit for failure to

92. For example, the Advisory Committee addressed a split among the circuits concerning the degree of culpability necessary for the imposition of severe sanctions such as dismissal, default, or an adverse inference. The note states that the amendment to Rule 37(e) “is designed to provide a uniform standard in federal court for use of these serious measures when addressing failure to preserve electronically preserved information. It rejects cases such as *Residential Funding Corp. v. DeGeorge Financial Corp.*, 306 F.3d 99 (2d Cir. 2002), that authorize the giving of adverse-inference instructions on a finding of negligence or gross negligence.” FED. R. CIV. P. 37 advisory committee’s note to 2015 amendment. There is no such reference to *Chambers*.

93. *United States v. Hudson*, 11 U.S. (7 Cranch) 32, 34 (1812).

94. *Ex parte Burr*, 22 U.S. (9 Wheat.) 529, 531 (1824).

95. *Ex parte Robinson*, 86 U.S. (19 Wall.) 505, 510 (1874).

96. *Universal Oil Products Co. v. Root Refining Co.*, 328 U.S. 575, 580 (1946); *Hazel-Atlas Glass Co. v. Hartford-Empire Co.*, 322 U.S. 238, 244–50 (1944).

97. *Illinois v. Allen*, 397 U.S. 337, 343 (1970).

prosecute,⁹⁸ and to impose attorneys' fees as a sanction for bad faith litigation.⁹⁹

Similarly, courts must have the power to deter spoliation and to remedy its effects, since the destruction of evidence undermines the integrity of the fact-finding process. Although the Supreme Court has not addressed it, lower courts have explicitly recognized that the ability to use their inherent powers to impose spoliation sanctions is necessary to the exercise of the judicial function. "The policy underlying this inherent power of the courts is the need to preserve the integrity of the judicial process in order to retain confidence that the process works to uncover the truth."¹⁰⁰ One federal court has described, rather colorfully, the negative consequences that would flow if the judiciary lacked such power:

Aside perhaps from perjury, no act serves to threaten the integrity of the judicial process more than the spoliation of evidence. Our adversarial process is designed to tolerate human failings—erring judges can be reversed, uncooperative counsel can be shepherded, and recalcitrant witnesses compelled to testify. But, when critical documents go missing, judges and litigants alike descend into a world of *ad hocery* and half measures—and our civil justice system suffers.¹⁰¹

98. *Link v. Wabash Railway Co.*, 370 U.S. 626, 630–31 (1962).

99. *Chambers v. NASCO, Inc.*, 501 U.S. 32, 45–46 (1991).

100. *Silvestri v. General Motors Corp.*, 271 F.3d 583, 590 (4th Cir. 2001); *accord Pension Committee of University of Montreal Pension Plan v. Banc of America Securities*, 685 F. Supp. 2d 456, 465 (S.D.N.Y. 2010); *Victor Stanley, Inc. v. Creative Pipe, Inc.*, 269 F.R.D. 497, 517–18 (D. Md. 2010).

101. *United Medical Supply Co. v. United States*, 77 Fed. Cl. 257, 258–59 (2007).

Another court has observed that “[s]anctions for spoliation may also be designed to promote accurate fact finding by the court or jury.”¹⁰² Still another has tied spoliation sanctions to the need to preserve the judicial process both by deterring misconduct and by remediating its effects:

Sanctions are appropriate when there is evidence that a party’s spoliation of evidence threatens the integrity of this Court. Spoliation sanctions serve a remedial function by leveling the playing field or restoring the prejudiced party to the position it would have been without spoliation. They also serve a punitive function, by punishing the spoliator for its actions, and a deterrent function, by sending a clear message to other potential litigants that this type of behavior will not be tolerated and will be dealt with appropriately if need be.¹⁰³

State courts, as well, recognize the need to exercise inherent authority in order to defend the fact-finding process against the destruction of evidence. The Supreme Court of Montana has articulated the relationship this way:

Relevant evidence is critical to the search for the truth. The intentional or negligent destruction or spoliation of evidence cannot be condoned and threatens the very integrity of our judicial system. There can be no truth, fairness, or justice in a civil action where relevant evidence has been de-

102. *United States ex rel. Koch v. Koch Industries, Inc.*, 197 F.R.D. 488, 490 (D. Kan. 1999); *accord* *United States ex rel. Baker v. Community Health Systems, Inc.*, No. CIV. 05-297, 2012 WL 12294413, at *17 (D.N.M. Aug. 31, 2012).

103. *Mosaid Technology, Inc. v. Samsung Electronics, Co.*, 348 F. Supp. 2d 332, 335 (D.N.J. 2004).

stroyed before trial. Historically, our judicial system has fostered methods and safeguards to insure that relevant evidence is preserved. Ultimately, the responsibility rests with both the trial and appellate courts to insure that the parties to the litigation have a fair opportunity to present their claims or defenses.¹⁰⁴

Likewise, the Supreme Court of California has observed that “[d]estroying evidence can destroy fairness and justice, for it increases the risk of an erroneous decision on the merits of the underlying cause of action.”¹⁰⁵

Indeed, at the state level, concern for the integrity of the judicial system has led to advocacy for the creation of a common law tort of spoliation.¹⁰⁶ One commentator presented the argument in favor of such a cause of action as follows:

The practice of spoliation is universally acknowledged as an affront to the integrity of the judicial system. Evidence destruction flies in the face of the liberal discovery rules that provide a vehicle for both damning and exculpatory evidence to come to the light. Judgments can be relied upon only when the trier of fact has examined and weighed the best and most probative evidence

104. *Oliver v. Stimson Lumber Co.*, 297 Mont. 336, 344–45, 993 P.2d 11, 17 (1999).

105. *Cedars-Sinai Medical Center v. Superior Court*, 18 Cal 4th 1, 8, 254 P.2d 511, 515 (1998).

106. See Danielle “Dani” Borel, *The Land of OZ: Spoliation of Evidence in Louisiana*, 74 LA. L. REV. 507, 540–41 (2014); Michael A. Zuckerman, *Yes, I Destroyed the Evidence — Sue Me? Intentional Spoliation of Evidence in Illinois*, 27 J. MARSHALL J. COMPUTER & INFO. L. 235, 251–52 (2009); Rachel L. Sykes, *A Phantom Menace: Spoliation of Evidence in Idaho*, 42 IDAHO L. REV. 821, 846–49 (2006).

each litigant has to offer. When a jury must render a verdict despite the loss of a crucial piece of proof, the accuracy of its findings is compromised, which in turn substantially impairs an individual's chances of receiving a remedy for his injury. The act of evidence destruction should give rise to an independent claim in tort when the loss occurs with a state of mind typifying any measure of culpability—intentionality, recklessness, or negligence.¹⁰⁷

Heeding such admonitions, about half the states recognize spoliation as an actionable tort.¹⁰⁸ Alaska,¹⁰⁹ Louisiana,¹¹⁰ New Mexico,¹¹¹ Ohio,¹¹² and West Virginia¹¹³ are among the states that have recognized a cause of action for intentional destruction of evidence.¹¹⁴ Florida, Illinois, New Jersey, Kansas,

107. Virginia L. H. Nesbitt, *A Thoughtless Act of a Single Day: Should Tennessee Recognize Spoliation of Evidence as an Independent Tort?*, 37 U. MEM. L. REV. 555, 614 (2007).

108. 22 CHARLES ALAN WRIGHT AND KENNETH W. GRAHAM, JR., FEDERAL PRACTICE AND PROCEDURE § 5178 (2d ed. 2012).

109. *Hazen v. Municipality of Anchorage*, 718 P.2d 456 (Alaska 1986).

110. *Guillory v. Dillard's Dept. Store, Inc.*, 777 So. 2d 1 (La. App. 3 Cir. 2000).

111. *Coleman v. Eddy Potash, Inc.*, 120 N.M. 645, 905 P.2d 185 (N.M. 1995).

112. *Smith v. Howard Johnson Co., Inc.*, 67 Ohio St. 3d 28, 615 N.E.2d 1037 (Ohio 1993).

113. *Hannah v. Heeter*, 213 W.Va. 704, 584 S.E.2d 560 (W. Va. 2003).

114. While the California intermediate appellate courts adopted an independent tort of spoliation, *see Smith v. Superior Court*, 151 Cal. App. 3d 491, 495-96, 198 Cal. Rptr. 829, 832 (Cal. Ct. App. 1984), in 1998 the California Supreme Court subsequently rejected such a cause of action, in part on the ground that existing remedies, including the authority to impose an adverse inference, were sufficient to cure any prejudice. *Cedars-Sinai Medical Center v. Superior Court*, 18 Cal 4th 1, 11-13, 254 P.2d 511, 517-18 (Cal. 1998).

and the District of Columbia have gone further: they have created a tort for negligent spoliation.¹¹⁵ Spoliation, then, is widely recognized as conduct that, because it threatens the reliability of the judicial process, warrants the exercise of inherent authority.

C. *Inherent Authority in the Interstices in Rule 37(e)*

The need for inherent authority to remedy spoliation is most evident in circumstances where Rule 37(e) itself does not clearly apply. It is in those situations that the Rule is most clearly not “up to the task.”¹¹⁶ And, as long as inherent authority is used only to fill the interstices in the Rule, Federal courts avoid the difficult separation-of-powers issues that arise when judges assert inherent power where Congress has directly addressed an issue through the rulemaking process.

Because Rule 37(e) establishes certain threshold requirements that must be met before a court may impose remedies for spoliation, it necessarily creates lacunae where inherent authority might continue to play a role.

1. Spoliation of Physical Evidence

The express language of Rule 37 states that it only applies to electronically stored information.¹¹⁷ Accordingly, it seems uncontroversial that a court would retain the inherent authority to impose sanctions for the destruction of physical evidence for which Rule 37(e) does not apply. Indeed, in transmitting the proposed amendment to the Standing Committee on Rules of Practice and Procedure, the Advisory Committee on Federal Rules of Civil Procedure specifically noted that “[a]lthough the

115. Carole S. Gailor, *In-Depth Examination of the Law Regarding Spoliation in State and Federal Courts*, 23 J. AM. ACAD. MATRIM. LAW. 71, 92 (2010).

116. *Chambers v. NASCO, Inc.*, 501 U.S. 32, 50 (1991).

117. FED. R. CIV. P. 37(e) (“If electronically stored information that should have been preserved in anticipation of litigation . . .”).

Committee considered proposing a rule that would apply to all forms of information, it ultimately concluded that an ESI-only rule was appropriate for several reasons.”¹¹⁸ One of those reasons was that

the law of spoliation for evidence other than ESI is well developed and longstanding, and should not be supplanted without good reason. There has been little complaint to the Committee about this body of law as applied to information other than ESI, and the Committee concludes that this law should be left undisturbed by a new rule designed to address the unprecedented challenges presented by ESI.¹¹⁹

Whether inherent authority may be used to fill latent gaps in Rule 37(e) may prove more contentious.

2. Attempted Destruction of Evidence

Take, for example, attempted spoliation, where a party tries, but fails, to destroy evidence, sometimes informally referred to as the problem of the “incompetent spoliator.” In this instance, the amended rule would seem not to apply because the information at issue has not been “lost.”¹²⁰

Victor Stanley, Inc. v. Creative Pipe, Inc.,¹²¹ was a prominent case, decided prior to the current version of Rule 37(e), which

118. Judicial Conference Comm. on Rules of Practice & Procedure, Report of the Judicial Conference Committee on Rules of Practice and Procedure, app. B-15 (Sept. 2014), <http://www.uscourts.gov/rules-policies/archives/committee-reports/reports-judicial-conference-september-2014> [hereinafter Sept. 2014 Report].

119. *Id.* at app. B-16.

120. FED. R. CIV. P. 37(e).

121. *Victor Stanley, Inc. v. Creative Pipe, Inc.*, 269 F.R.D. 497, 517–18 (D. Md. 2010).

involved attempted spoliation. In that action, the individual defendant, Mark Pappas, engaged in “dogged but unsuccessful attempts to prevent the discovery of ESI evidence against him.”¹²² Moreover, he also accomplished “successful, permanent deletions of countless ESI.”¹²³ The court observed that

Plaintiff [] is fortunate that Pappas’s zeal considerably exceeded his destructive skill and his judgment in selecting confederates to assist in his efforts to destroy ESI without detection. While Pappas succeeded in destroying a considerable amount of ESI, Plaintiff was able to document this fact and ascertain the relevance of many deleted files. At the end of the day, this is the case of the “gang that couldn’t spoliating straight.”¹²⁴

Some “attempted deletions” thus “caused delay but no loss of evidence.”¹²⁵ Nevertheless, the spoliating party was subject to sanctions.

Indeed, attempted spoliation has long been sanctionable. *The Stephen Hart*,¹²⁶ a “prize case” arising out of the seizure of a vessel during the Civil War, provides a dramatic example. On January 29, 1862, a United States vessel enforcing the blockade of the Confederate states captured the schooner *Stephen Hart* as a prize of war in the waters between Key West and Cuba.¹²⁷ When boarded, she was found to contain a substantial cargo of

122. *Id.* at 501.

123. *Id.*

124. *Id.*

125. *Id.*

126. *The Stephen Hart*, 22 F. Cas. 1253 (S.D.N.Y. 1863).

127. *Id.* at 1255.

munitions and other military supplies.¹²⁸ The owners of the vessel and of her cargo filed claims, contending that The Stephen Hart was a British vessel carrying cargo between neutral ports in England and Cuba, and was therefore not subject to seizure.¹²⁹ The evidence showed that, as the ship was being seized, the first mate, one Benjamin H. Chadwick, gave letters to the ship's cook, with directions to put them out of sight by placing them in a teapot.¹³⁰ Unfortunately, the letters were found by one of the boarding officers.¹³¹ In his testimony, the cook described the demeanor of the first mate:

When the first officer handed me those papers, he seemed anxious and uneasy, and, when he returned to the schooner to get his clothes, the first thing he said to me was, "Have you got those papers?" I told him they were found by the officer. He then said, "Why in hell did you not destroy them?" and likewise, "By God, I am done."¹³²

The letters were indeed incriminating, for they included communications from a Confederate agent and directions for entering Charleston harbor; one letter concluded, "If you should fail, destroy."¹³³

The court observed that, even if the papers had not been recovered, it would have been appropriate to draw what in modern terms is known as an adverse inference: "In all cases [spoliation] must be considered as proof of mala fides; and, where that appears, it is a universal rule to presume the worst

128. *Id.* at 1256.

129. *Id.* at 1255, 1262.

130. *Id.* at 1256, 1270.

131. *Id.* at 1270.

132. *Id.*

133. *Id.* at 1270–71.

against those who are convicted of it.”¹³⁴ So, too, with failed attempts at the destruction of evidence:

So, also, the concealment by Chadwick of the letters to him, which showed the true character of the enterprise of the Stephen Hart, would have been as effectually a destruction of those papers, for the purposes of this case, if they had not been found in the search, as if they had been actually thrown into the sea and lost. And the suspicion which the law attaches to a spoliation of papers arises with equal force from an attempted spoliation.¹³⁵

Notwithstanding that courts have thus traditionally treated such acts as spoliation, they would seem to be beyond the reach of Rule 37(e) because no evidence has been “lost.”

3. Attempted Alteration of Evidence

The same is true of circumstances in which evidence is fabricated or materially altered. Fabrication, like destruction, is simply a form of spoliation of evidence intended to skew the fact-finding process. Dean Wigmore recognized this in his seminal treatise on evidence when addressing the adverse inference:

It has always been understood—the inference, indeed, is one of the simplest in human experience—that a party’s falsehood or other fraud in the preparation and presentation of his cause, his fabrication or suppression of evidence by bribery or spoliation, and all similar conduct, is receivable against him as an indication that his case is a weak or unfounded one; and from that consciousness

134. *Id.* at 1271.

135. *Id.* (emphasis added).

may be inferred the fact itself of the cause's lack of truth or merit.¹³⁶

Courts have traditionally treated fabrication and destruction cases alike.¹³⁷ Yet, by definition, where information is fabricated, it has not been "lost," and this conduct is therefore not addressed by Rule 37(e).

A similar gap in Rule 37(e) exists where information has, in fact, been lost or materially altered, but can be restored or replaced. An example of this arose in *Cat3, LLC v. Black Lineage, Inc.*¹³⁸ There, the court addressed alleged spoliation under amended Rule 37(e).¹³⁹ In that case, the plaintiffs asserted rights in the trademark "SLAMXHYPE" and the domain name www.slamxhype.com, which they used in connection with the sale of clothing and the operation of a website and online magazine.¹⁴⁰ The plaintiffs asserted that the defendants' use of the trademark "FLASHXHYPE" and the domain name www.flashxhype.com infringed their trademark rights.¹⁴¹ Since one of the key issues in the case was whether the defendants developed their FLASHXHYPE mark independently or, instead, sought to trade on the plaintiffs' reputation after learning of the SLAMXHYPE mark, it was significant at what point in

136. J. WIGMORE, EVIDENCE, § 278 (3d ed. 1940) (emphasis omitted).

137. See, e.g., *Guttierez v. P.A.L. Ltd.*, No. 10 CV 4152, 2011 WL 6019393, at *2 (N.D. Ill. Nov. 23, 2011); *Jackson v. N'Genuity*, No. 09 C 6010, 2011 WL 1134302, at *1–2 (N.D. Ill. March 28, 2011); *Flottman v. Hickman County*, No. 3:09-770, 2010 WL 4537911, at *1 (M.D. Tenn. Nov 3, 2010).

138. *Cat3, LLC v. Black Lineage, Inc.*, __ F. Supp. 3d __, 2016 WL 154116, 2015 U.S. Dist. LEXIS 125879 (S.D.N.Y. 2016).

139. One of the authors of this article wrote the opinion in *Cat3*; the case has been settled.

140. *Id.* at *1.

141. *Id.*

time the defendants learned of the plaintiffs' mark. The plaintiffs alleged that they had disclosed to the defendants their use of the SLAMXHYPE mark before the defendants adopted the FLASHXHYPE mark, and the plaintiffs produced emails they had sent to the defendants from an email address with the domain name slamxhype.com, apparently supporting this assertion.¹⁴²

However, when the defendants located the copies of the same emails that they had received, the defendants' copies showed that the emails were sent from a different address—one that did not have a slamxhype extension.¹⁴³ After an investigation, the defendants moved for sanctions under Rule 37 on the ground that the plaintiffs had spoliated evidence by altering the emails at issue.¹⁴⁴ They presented expert evidence that the plaintiffs' computer system contained two versions of the relevant emails: the most recent version, which contained the slamxhype extension, and an underlying, deleted version, that did not.¹⁴⁵ The plaintiffs opposed the motion, arguing in part that, under Rule 37(e), the evidence could be "restored or replaced" since the defendants had their own versions of the emails.¹⁴⁶ In effect, the plaintiffs argued that, at worst, they could only be charged with attempted spoliation, which would not be sanctionable under the rule.¹⁴⁷

The court responded to this argument in two ways. First, it found that, because the existence of duplicate emails with different file extensions had cast doubt on the authenticity of both

142. *Id.*

143. *Id.*

144. *Id.* at *2–3.

145. *Id.* at *2.

146. *Id.* at *5.

147. *Id.* at *6.

versions, the original emails had not been fully restored, so Rule 37(e) applied.¹⁴⁸ Second, if this were not the case, and there was a gap in the rule such that it did not address the conduct at issue, the court held that it could exercise inherent authority to remedy any prejudice to the defendants.¹⁴⁹

4. Spoliation of Metadata and Other Non-Apparent Information

A variant of this is the situation in which a party that is subject to a litigation hold downgrades electronically stored information to a less usable and accessible form, thereby increasing both the cost and burden to the requesting party to review, and potentially destroying relevant, discoverable information not contained on the face of an electronic document. The 2006 advisory committee notes expressed a clear and persuasive assertion that parties should avoid intentionally degrading ESI,¹⁵⁰ and courts have regularly characterized such conduct as spoliation.¹⁵¹ Yet, because the information can still be obtained in some

148. *Id.*

149. *Id.* at *6–7.

150. FED. R. CIV. P. 34 advisory committee’s note to 2006 amendment (“If the responding party ordinarily maintains the information it is producing in a way that makes it searchable by electronic means, the information should not be produced in a form that removes or significantly degrades this feature.”).

151. *Mazzei v. The Money Store*, No. 01 Civ. 5694, 2014 WL 3610894, at *2, 5, 8 (S.D.N.Y. July 21, 2014); *Orbit One Communications, Inc. v. Numerex Corp.*, 271 F.R.D. 429, 437 (S.D.N.Y. 2010); *Scalera v. Electrograph Systems, Inc.*, 262 F.R.D. 162, 175 (E.D.N.Y. 2009); *Treppel v. Biovail Corp.*, 233 F.R.D. 363, 372 n.4 (S.D.N.Y. 2006) (“[P]ermitting the downgrading of data to a less accessible form—which systematically hinders future discovery by making the recovery of information more costly and burdensome—is a violation of the preservation obligation.”). This view is not universal. In *Quinby v. WestLB AG*, No. 04 Civ. 8406, 2005 WL 3453908, at *8 n.10 (S.D.N.Y. Dec. 15, 2005), the court declined to sanction a party for converting data from an accessible

form,¹⁵² it would seem not to come within the purview of Rule 37(e).

Each of these examples, then, is a circumstance where spoliation may be beyond the reach of the amended Rule 37(e), yet where the court could properly exercise its inherent powers to remedy any prejudice.

5. The Use of Inherent Authority to Remedy Negligent Spoliation

Are there also situations where the Rule is inapplicable but inherent authority is precluded? One such instance arises when information is lost as the result of negligent conduct by the party that had a duty to preserve. Rule 37(e) provides that serious sanctions, including dismissal, entry of a default judgment, and imposition of an adverse inference, may only be imposed where the court has found an intent to deprive the innocent party of the use of the evidence in the litigation.¹⁵³ Thus, by

to an inaccessible form, stating, "I am unaware of any case[] that states that the duty to preserve electronic data includes a duty to keep the data in an accessible format." That position has been subjected to criticism. See *Orbit One*, 271 F.R.D. at 437; Kara A. Schiermeyer, *The Artful Dodger: Responding Parties' Ability to Avoid Electronic Discovery Costs Under 26(b)(2)(B) and 26(b)(2)(C) and the Preservation Obligation*, 42 CREIGHTON L. REV. 227 (2009) (discussing *Treppel* and *Quinby* and arguing that downgrading form of ESI should be considered spoliation). In any event, even a subsequent opinion in *Quinby* held that the responding party should bear the greater costs of production caused by its downgrading of data. *Quinby v. WestLB AG*, 245 F.R.D. 94, 111 (S.D.N.Y. 2006).

152. Intentional degradation of ESI from searchable to non-searchable forms virtually always results in the loss of metadata, and so constitutes the destruction of evidence if the metadata is relevant to the litigation. It also may make access to information more difficult and expensive, and lead to discovery disputes and motion practice.

153. FED. R. CIV. P. 37(e)(2).

its terms, the Rule does not authorize such serious sanctions where the spoliation is merely negligent.

The Advisory Committee made clear that it affirmatively sought to prevent the use of severe sanctions in response to negligent conduct.¹⁵⁴ In its memorandum to the Standing Committee on Rules of Practice and Procedure, the Advisory Committee reasoned that “[p]reservation of ESI is a major issue confronting parties and courts, and loss of ESI has produced a significant split in the circuits. Some circuits hold that adverse inference instructions (viewed by most as a serious sanction) can be imposed for the negligent loss of ESI. Others require a showing of bad faith.”¹⁵⁵ The Advisory Committee then examined at length the rationales behind the competing holdings, epitomized on one side by *Aramburu v. Boeing Co.*,¹⁵⁶ which held that “[t]he adverse inference must be predicated on the bad faith of the party destroying records,”¹⁵⁷ and on the other by *Residential Funding Corp. v. DeGeorge Financial Corp.*,¹⁵⁸ which found negligent spoliation to be a sufficient basis for an adverse inference.¹⁵⁹ The

154. *Id.* (“only upon finding that the party acted with the intent to deprive another party of the information’s use in the litigation”).

155. Sept. 2014 Report, *supra* note 118, at app. B-14.

156. *Aramburu v. Boeing Co.*, 112 F.3d 1398 (10th Cir. 1997).

157. *Id.* at 1407. The Advisory Committee observed that “[adverse inference] instructions historically have been based on a logical conclusion: when a party destroys evidence for the purpose of preventing another party from using it in litigation, one reasonably can infer that the evidence was unfavorable to the destroying party. Some courts hold to this traditional rationale and limit adverse inference instructions to instances of bad faith loss of the information.” Sept. 2014 Report, *supra* note 118, at app. B-17.

158. *Residential Funding Corp. v. DeGeorge Financial Corp.*, 306 F.3d 99 (2d Cir. 2002).

159. *Id.* at 102. The Advisory Committee stated that:

Advisory Committee came down decisively on the side of requiring a showing of intent.¹⁶⁰ This is reflected in the advisory committee note addressing the pertinent part of the rule:

[c]ircuits that permit adverse inference instructions on a showing of negligence adopt a different rationale: the adverse inference restores the evidentiary balance, and the party that lost the information should bear the risk that it was unfavorable. Although this approach has some equitable appeal, the Committee has several concerns when it is applied to ESI. First, negligently lost information may have been favorable or unfavorable to the party that lost it—negligence does not necessarily reveal the nature of the lost information. Consequently, an adverse inference may do far more than restore the evidentiary balance; it may tip the balance in ways the lost evidence never would have. Second, in a world where ESI is more easily lost than tangible evidence, particularly by unsophisticated parties, the sanction of an adverse inference instruction imposes a heavy penalty for losses that are likely to become increasingly frequent as ESI multiplies. Third, permitting an adverse inference for negligence creates powerful incentives to over-preserve, often at great cost. Fourth, the ubiquitous nature of ESI and the fact that it often may be found in many locations presents less risk of severe prejudice from negligent loss than may be present due to the loss of tangible things or hard-copy documents.

Sept. 2014 Report, *supra* note 118, at app. B-17–18.

160. In the memorandum to the Standing Committee, the Advisory Committee wrote, “These reasons have caused the Committee to conclude that the circuit split should be resolved in favor of the traditional reasons for an adverse inference. ESI-related adverse inferences drawn by courts when ruling on pretrial motions or ruling in bench trials, and adverse inference jury instructions, should be limited to cases where the party who lost the ESI did so with an attempt to deprive the opposing party of its use in the litigation.” Sept. 2014 Report, *supra* note 118, at app. B-18.

This subdivision authorizes courts to use specified and very severe measures to address or deter failures to preserve electronically stored information, but only on finding that the party that lost the information acted with the intent to deprive another party of the information's use in the litigation. It is designed to provide a uniform standard in federal court for use of these serious measures when addressing failure to preserve electronically stored information. It rejects such cases as *Residential Funding Corp. v. DeGeorge Financial Corp.*, 306 F.3d 99 (2d Cir. 2002), that authorize the giving of adverse-inference instructions on a finding of negligence or gross negligence.¹⁶¹

Thus, the limitation of sanctions specified in Rule 37(e)(2) to instances of spoliation resulting from the specific intent to deprive another party of the information in the litigation is not a gap to be filled by the exercise of inherent authority under the Supreme Court precedent.¹⁶²

Furthermore, even if it were, mere negligent destruction of ESI is not the type of instance where inherent authority has traditionally been exercised. Recall that the justification for relying on inherent power is that, without it, the integrity of the judicial process is threatened. There is no doubt that if intentional spoliation went unremedied, the judicial process would be in jeopardy since parties would not be deterred from destroying unfavorable evidence. On the other hand, while the negligent spoliation of information may significantly affect the outcome in any particular case, acts of unintentional carelessness are less likely to jeopardize the integrity of the system as a

161. FED. R. CIV. P. 37(e) advisory committee's note to 2015 amendment.

162. See Section III.C, *supra*.

whole, particularly since there are a variety of factors apart from sanctions under either Rule 37(e) or the inherent power of the courts that would discourage the careless loss of evidence.¹⁶³

Indeed, even within a specific case, the “gap” left by Rule 37(e) is a narrow one, since potent tools remain available to the courts to address negligent spoliation. For example, in order to prevent the party that has destroyed evidence from obtaining an unfair advantage, a court may issue an order precluding that party from asserting certain claims or introducing certain evidence.¹⁶⁴

Thus, the severe sanctions of dismissal, judgment by default, or imposition of an adverse inference recognized under

163. These include the simple motivation of self-interest: a party would tend to safeguard information that may be as likely to be beneficial as to be detrimental to its legal interests. Moreover, the obligation to preserve information in anticipation of litigation remains. As the Advisory Committee noted, “the proposed Rule 37(e) does not purport to create a duty to preserve. The new rule takes the duty as it is established by case law, which uniformly holds that a duty to preserve information arises when litigation is reasonably anticipated.” 2014 Report, *supra* note 118, at app. B-15; *see, e.g.*, *Fujitsu Ltd. V. Federal Express Corp.*, 247 F.3d 423, 436 (2d Cir. 2001) (“The obligation to preserve evidence arises when the party has notice that the evidence is relevant to litigation or when a party should have known that the evidence may be relevant to future litigation.”). Even when the most severe sanctions for a violation of the duty to preserve evidence are unavailable under Rule 37(e)(2), other forms of remedial measures remain available to the courts under Rule 37(e)(1) that should, under most circumstances, serve as a general deterrent against spoliation.

164. *See* *Cat3, LLC v. Black Lineage, Inc.*, __ F. Supp. 3d at __, 2016 WL 154116, at *10–11 (S.D.N.Y. 2016) (precluding party from relying on evidence found to have been fabricated); *see also In re Wrt Energy Securities Litigation*, 246 F.R.D. 185, 199–201 (S.D.N.Y. 2007) (precluding party from challenging representativeness of sample data after that party had permitted destruction of remainder of universe of data).

Rule 37(e)(2) are not available to the courts under their inherent authority for the negligent destruction of evidence.¹⁶⁵

6. Remedial Measures v. Sanctions

Finally, what role might inherent authority play in any gap that exists between remedial measures available under Rule 37(e)(1) and severe measures permitted only after a finding of intent to deprive under Rule 37(e)(2)? This question is prompted by the Advisory Committee note to subdivision (e)(1), which states:

[i]n an appropriate case, it may be that serious measures are necessary to cure prejudice found by the court, such as forbidding a party that failed to preserve information from putting on certain evidence, permitting the parties to present evidence and argument to the jury regarding the loss of information, or giving the jury instructions to assist in its evaluation of such evidence or argument,

165. Justice Scalia might have disagreed. He dissented from the Court's opinion in *Chambers* not because he did not believe that a court could exercise inherent power to impose sanctions, but because he concluded the district court imposed sanctions for the "petitioner's flagrant, bad-faith breach of contract," not for his abuse of the judicial process during the litigation. *Chambers v. NASCO, Inc.*, 501 U.S. 32, 60 (1991) (Scalia, J., dissenting). Justice Scalia agreed with the majority that "[s]ome implied powers must necessarily result to our Courts of justice from the nature of their institution." *Id.* (quoting *United States v. Hudson*, 11 U.S. (7 Cranch) 32, 34 (1812)). But then he went on to point out that "[s]ince necessity does not depend upon a litigant's state of mind, the inherent sanctioning power must extend to situations involving less than bad faith. For example, a court has the power to dismiss when counsel fails to appear for trial, even if this is a consequence of negligence rather than bad faith." *Id.* Accordingly, Justice Scalia might have considered negligent spoliation to warrant sanctions under the inherent power, since it has consequences, at least in any particular case, equivalent to those that flow from the intentional destruction of evidence.

other than instructions to which subdivision (e)(2) applies. Care must be taken, however, to ensure that curative measures under subdivision (e)(1) do not have the effect of measures that are permitted under subdivision (e)(2) only on a finding of intent to deprive another party of the lost information's use in the litigation. An example of an inappropriate (e)(1) measure might be an order striking pleadings related to, or precluding a party from offering any evidence in support of, the central or only claim or defense in the case. On the other hand, it may be appropriate to exclude a specific item of evidence to offset prejudice caused by failure to preserve other evidence that might contradict the excluded item of evidence.¹⁶⁶

If the note is taken to suggest that some remedies under subdivision (e)(2) are forbidden because they "look" too much like the severe sanctions enumerated in (e)(2), even if those remedies are necessary to cure prejudice, then there is a gap in the Rule. However, this note is better read as simply reinforcing the concept that remedial measures may be no greater than necessary to cure any prejudice to the innocent party. So long as that is the case, there is no gap to be filled and no occasion for a court to invoke its inherent authority.¹⁶⁷

166. FED. R. CIV. P. 37 advisory committee's note to 2015 amendment.

167. There are at least two other instances in which there may be gaps relating to Rule 37(e)(2), to the extent that it specifically requires a finding that "the party acted with the intent to deprive another party of the information's use in the litigation." First, suppose that a party destroys electronically stored information that it was under a duty to preserve with the intent of depriving a government agency of the use of that information in connection with a regulatory or criminal investigation. Although related civil litigation was reasonably anticipated and subsequently filed, the party destroyed

V. CONCLUSION

Regardless of one's view of the proper scope of inherent judicial power under the Constitution, the use of inherent authority to protect the integrity of the courts and the judicial process has been endorsed by the Supreme Court for more than two centuries. Under existing precedent, that authority may be exercised where a statute or rule governing procedure contains gaps or where necessary to enable the courts to fulfill their core functions. Therefore, Rule 37(e) does not displace inherent authority insofar as there are interstices in the Rule or the Rule is not up to the task of ensuring the ability of the federal courts to exercise their constitutional role. Going forward, the issue will be not whether the federal courts retain inherent authority to issue spoliation sanctions, but under what circumstances and to what extent they may exercise that authority.

the evidence specifically out of concern about its use in the government inquiry. Does this constitute the "intent to deprive another party of the information's use in the litigation"? Second, assume that a party, fully intending to prevent its adversary in litigation from obtaining information, simply does nothing to preserve the evidence, willfully failing to institute a litigation hold. As a result, electronically stored information is automatically deleted or overwritten. Has the party, by inaction, "acted with the intent to deprive"? A complete analysis of whether Rule 37(e) adequately addresses these and similar situations, and whether a court has inherent authority to respond in such circumstances with an adverse inference instruction or case-terminating sanctions, is beyond the scope of this article.

APPENDIX "A"

Draft of the United States Constitution, Article XI, prepared by the Committee of Detail and reported to the Convention on Monday, August 6, 1787.¹⁶⁸

Article XI

Sect. 1. The Judicial Power of the United States shall be vested in one Supreme Court, and in such inferior Courts as shall, when necessary, from time to time, be constituted by the Legislature of the United States.

Sect. 2. The Judges of the Supreme Court, and of the Inferior Courts, shall hold their offices during good behaviour. They shall, at stated times, receive for their services, a compensation, which shall not be diminished during their continuance in office.

Sect. 3. The Jurisdiction of the Supreme Court shall extend to all cases arising under laws passed by the Legislature of the United States; to all cases affecting Ambassadors, other Public Ministers and Consuls; to the trial of impeachments of Officers of the United States; to all cases of Admiralty and maritime jurisdiction; to controversies between two or more States, (except such as shall regard Territory or Jurisdiction) between a State and Citizens of another State, between Citizens of different States, and between a State or the Citizens thereof and foreign States, citizens or subjects. In cases of impeachment, cases affecting Ambassadors, other Public Ministers and Consuls, and those in which a State shall be party, this jurisdiction shall be original. In all the other cases before mentioned, it shall be appellate, with such exceptions and under such regulations as the Legislature shall make. The Legislature may assign any part of

168. THE RECORDS OF THE FEDERAL CONVENTION OF 1787, vol. 2, 186–187 (Max Farrand, ed. 1911).

the jurisdiction above mentioned (except the trial of the President of the United States) in the manner, and under the limitations which it shall think proper, to such Inferior Courts, as it shall constitute from time to time.

Sect. 4. The trial of all criminal offences (except in cases of impeachments) shall be in the State where they shall be committed; and shall be by Jury.

Sect. 5. Judgment, in cases of Impeachment, shall not extend further than to removal from Office, and disqualification to hold and enjoy any office of honour, trust or profit, under the United States. But the party convicted shall, nevertheless be liable and subject to indictment, trial, judgment and punishment according to law.

LITIGATING STANDARD ESSENTIAL PATENTS AT THE
U.S. INTERNATIONAL TRADE COMMISSION

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I. INTRODUCTION

Technical industry groups often form voluntary organizations to develop and adopt technical standards that advance the state of the technology and allow compatibility between different products made by different manufacturers so that any of those standard-compliant products can work together. For example, an industry group may develop a standard protocol for wireless communication so that wireless signals transmitted by one standard-compliant device can be received and understood by other standard-compliant devices no matter who made them. These standard setting organizations (“SSOs”) often have policies concerning what its participants should do if they own intellectual property relevant to a standard that the SSO is developing.¹ Such intellectual property rights (“IPR”) policies may require a participant to let the SSO know if they have a patent that may cover or is *essential* for someone to implement the standard (also called “standard essential patents” or “SEPs”).² The IPR policies also may require the patent owner to let the SSO know if they are willing to license patents that are essential to the standard and, if so, under what terms. For example, a patent owner may submit a declaration or letter of assurance to an

1. This paper generically uses the term standard setting organizations (“SSOs”) to mean any organizations whose efforts include setting an industry standard. But there may be significant differences between such organizations, such as differences between those that simply set standards and those that actively innovate and develop the next generation of technology, sometimes referred to as standard development organizations (“SDOs”). The specific purpose, incentives, and policies of an individual SSO should be considered when its standard is at issue.

2. SSO IPR policies may define what would make a patent *essential* under the standard at issue, which definition may differ from one SSO to another. The specific SSO IPR policy at issue should be considered in determining whether a patent is essential to that SSO’s standard.

SSO stating that it is willing to license its patents on fair, reasonable, and non-discriminatory (“FRAND”) terms if those patents are essential to implementing the standard.

Standard essential patents, including those with FRAND or related commitments to SSOs, have been around for decades for all types of industries. But recent years have seen an increase in litigation concerning such standard essential patents. As with other types of patents, the U.S. International Trade Commission (“ITC” or “the Commission”) has been a popular venue for patent owners to seek relief that excludes the importation of infringing products into the United States. In 2013, for the first time in twenty-five years, the U.S. Trade Representative (“USTR”) invoked a rarely used discretionary power to disapprove the ITC’s granting of exclusionary relief that would have prevented importation of certain mobile devices found to infringe patents alleged to be essential to wireless standards. In doing so, the USTR explained what factual investigation and determinations he expects the ITC to provide in the future before granting exclusionary relief on alleged standard essential patents.

This paper explores the distinct process of litigating standard essential patent disputes before the ITC. Specifically, this paper will review ITC investigations involving standard essential patents that were pending during and after the USTR’s 2013 disapproval and lessons learned from those investigations.

II. GENERAL PROCEDURE AND REMEDIES AT THE ITC

The ITC is an “independent quasi-judicial federal agency with broad investigative responsibilities on matters of trade.”³ The ITC shields domestic industry and American workers from

3. *About the USITC*, U.S. INT’L TRADE COMMISSION, http://www.usitc.gov/press_room/about_usitc.htm (last visited Sept. 16, 2016).

illegal foreign trade practices and is an important forum for patent litigation in what are called Section 337 investigations. The ITC derives statutory authority from Section 337 of the Tariff Act of 1930 which “makes it unlawful, among other unfair acts, to import any article that infringes a patent, trademark or copyright that is valid and enforceable in the United States.” By and large, almost all of the ITC’s Section 337 investigations focus on patent infringement.⁴

The ITC can be an appealing forum for patent litigation over federal district courts for many reasons: it offers rapid decisions (investigations can be completed within 12 to 16 months) and boasts administrative law judges who are well-versed in the nuances of complex patent cases and technology.⁵ The bulk of Section 337 investigations involve technology-related industries, such as patents dealing with wireless communications, electronics, and computers.⁶ Because the ITC has *in rem* jurisdiction over, and can exclude, the actual infringing products as they seek entry into the U.S., its decision can impact foreign companies that otherwise may be beyond the purview of federal courts. The ITC also has robust discovery similar to what is available in U.S. district courts.

A. General Procedure

Litigation before the ITC begins with the patent owner (or “complainant”) filing a complaint that seeks to block infring-

4. See Sapna Kumar, *The Other Patent Agency: Congressional Regulation of the ITC*, 61 FLA. L. REV. 529, 532 (2009).

5. See IAN FEINBERG & GARY M. HNATH, FUNDAMENTALS OF PATENT LITIGATION 2012, at 6–7 (Practicing Law Institute ed., 2012).

6. Christopher A. Cotropia, *Strength of the International Trade Commission as a Patent Venue*, 20 TEX. INTELL. PROP. L. J. 1, 24 (2011).

ing products of accused infringers (or “respondents”) from being imported into the United States.⁷ The ITC will institute an investigation if it decides that the claim has merit. The ITC assigns the investigation to an administrative law judge (“ALJ”) charged with conducting an evidentiary hearing. The hearing occurs about six or seven months after the investigation begins, generally following a brief discovery period. Following the hearing, the ALJ will issue an Initial Determination (“ID”) on the investigation as to whether there has been a Section 337 violation and what remedy should be imposed if there is a violation. Such remedies are injunctive in nature comprising an order that excludes infringing products from entering the U.S. or a cease and desist order that prevents an accused infringer from doing certain activity related to imported infringing products, such as selling imported infringing products that already are in the U.S. The ITC cannot award any other remedies—e.g., the ITC cannot award monetary damages. In determining the proper remedy, the ITC must consider the effect that an exclusionary remedy would have on the public interest.⁸

Upon entry of the Initial Determination by the ALJ, the full Commission has several options: the Commission can decline to review the Initial Determination, in which case it will become the Final Determination of the ITC; or the Commission can review all or part of the Initial Determination, which may result in a Final Determination that is based in whole or in part on the ALJ’s Initial Determination. The USTR, on behalf of the President, has sixty days after the Commission issues a Final Determination to disapprove the ITC’s decision so that it does not go into effect, but such disapprovals are rare.⁹

7. *An Overview of Section 337 Litigation Before the ITC*, LAW360.COM (Aug. 9, 2010, 11:58 AM EDT), <http://www.law360.com/articles/183706/an-overview-of-section-337-litigation-before-the-itc>.

8. See 19 U.S.C. § 1337(d)(1).

9. See 19 U.S.C. § 1337(j)(2).

B. Remedies

In Section 337 litigation, the ITC can issue two kinds of remedial orders: (1) limited or general exclusion orders and (2) cease and desist orders. An exclusion order bars importation into the United States of infringing products. A cease and desist order instructs the respondent to cease its domestic unfair acts, such as selling infringing products that already have been imported.¹⁰ The ITC must consider the effect of exclusionary relief.¹¹ The ITC can use early proceedings on issues of public interest and remedy to extend notice to litigants about the likelihood of an exclusion order. Parties can move for a summary determination on any issue in a Section 337 investigation, similar to how parties in a district court proceeding may move for summary judgment.¹² However, these summary determination proceedings rarely involve issues of remedy.¹³

The enabling statute requires the ITC to weigh the public interest every time it considers issuing a remedy.¹⁴ The Federal Circuit has identified four separate public interest factors, which include (1) the public health and welfare; (2) competitive conditions in the United States economy; (3) the production of

10. See 19 U.S.C. § 1337(f)(1).

11. See 19 U.S.C. § 1337.

12. See 19 C.F.R. § 210.18 (summary determinations).

13. See Taras M. Czebinak, *When Congress Gives Two Hats, Which Do You Wear? Choosing Between Domestic Industry Protection and IP Enforcement in Section 337 Investigations*, 26 BERKELEY TECH. L.J. 93, 107 (2011).

14. See, e.g., 19 U.S.C. § 1337(d)(1) (covering exclusion orders); *Certain Automated Mechanical Transmission Sys. for Medium-Duty and Heavy-Duty Trucks and Components Thereof*, Inv. No. 337-TA-503, USITC Pub. 3934, Final at 7 (May 9, 2005) (Comm'n Opinion) ("Section 337(d) and (f) direct the Commission to consider public interest factors before issuing remedial orders, including the effect of any such remedial order on the 'public health and welfare, competitive conditions in the United States economy, the production of like or directly competitive articles in the United States, and United States consumers.'").

like or directly competitive articles in the United States; and (4) United States consumers.¹⁵ In practice, the ITC often determines in Section 337 cases that excluding goods from entering the U.S. marketplace does not threaten the public interest. Indeed, the legislative history of the ITC statute supports excluding infringing products: “The legislative history of the amendments to Section 337 indicates that Congress intended injunctive relief to be the normal remedy for a Section 337 violation and that a showing of irreparable harm is not required to receive such injunctive relief.”¹⁶

The ITC’s flexibility in fashioning a remedy comes from 19 U.S.C. § 1337, which provides the ITC with “broad discretion” to create an appropriate remedy. The ITC’s process and procedure also plays an important role. Once the ITC determines that a violation has occurred, it can enter an exclusion order that prevents infringing products from entering the United States. In some cases, the ITC has held a separate hearing after a liability finding to weigh what particular form of exclusionary relief may be appropriate.¹⁷ If the ITC decides to impose an exclusion order, then the injunction goes into effect immediately, although it remains subject to the sixty-day Presidential review period.¹⁸ When the ITC’s order is final, the respondent can appeal to the Federal Circuit.

The ITC has several options to create a remedy. The ITC can decide what products the exclusion order will cover, when it will implement its exclusion order (e.g., whether the order will be delayed), or set a bond that permits continued importation of the product during the Presidential review period. For

15. *See* *Spansion, Inc. v. ITC*, 629 F.3d 1331, 1358 (Fed. Cir. 2010).

16. *Spansion*, 629 F.3d at 1358.

17. *See* *Certain Personal Data and Mobile Commc’ns Devices and Related Software*, Inv. No. 337-TA-710, USITC Pub. 4331, Final at 3–7 (July 15, 2011).

18. 19 U.S.C. § 1337(j)(2).

example, the ITC can decide that an exclusion order should only apply to foreclose future versions or units of products, which would allow existing, older models to remain for sale.¹⁹

C. Weighing Public Interest Factors

Before 2010, the ITC generally did not authorize administrative law judges (ALJs) to hear public interest evidence during the course of a regular investigation unless special circumstances were present or in the case of temporary relief proceedings.²⁰ Because the full ITC itself bore the responsibility for weighing the public interest before issuing a remedy, the ALJs were instructed to refrain from addressing public interest factors in their remedy recommendation except in rare instances where they were ordered to do so.²¹

That changed in 2010. In 2010, the ITC adopted a pilot program to identify Section 337 investigations in which an exclusion order would present considerable concerns under the “public interest” test. The pilot program allowed developing earlier in the investigation a factual evidentiary record on the public interest issues. The program ran from July 2010 until November 2011, and the ITC directed ALJs to take evidence on the

19. *See* Certain Baseband Processor Chips and Chipsets, Transmitter and Receiver (Radio) Chips, Power Control Chips, and Prods. Containing Same, Including Cellular Tel. Handsets, Inv. No. 337-TA-543, USITC Pub. 4258, Final at 153 (June 19, 2007) (Comm’n Opinion) (finding that a full-scale exclusion order was not permitted in the investigation based on the public interest factor of harm to third parties, but that an adjusted exclusion order should be issued that would grandfather in existing models of handsets).

20. *See* 61 Fed. Reg. 39468-69 (July 29, 1996) (Institution of Inv. No. 337-TA-389 for Certain Diagnostic Kits for the Detection and Quantification of Viruses) (“In light of the public health issues which may arise in this investigation, the Commission has directed the administrative law judge to gather evidence, hear argument, and make findings on public interest issues related to any remedy ultimately adopted by the Commission.”).

21. 19 C.F.R. § 210.42(a)(1)(ii)(C).

public interest factors in 10 out of 80 investigations instituted during that time period. Following the end of the pilot program, new rules went into effect that require a complainant to file a separate statement of public interest concurrent with its complaint, solicit voluntary comments on the public interest from proposed respondents and other parties, and require respondents to file post-institution public interest comments in investigations where the ITC has delegated the taking of evidence to the ALJ.²²

One benefit of having the ALJ conduct fact finding on public interest issues is that matters before the ALJ are subject to the Administrative Procedures Act, and more specifically, to the ITC Rules of Practice and Procedure. Under these rules, parties “shall have the right to adequate notice, cross-examination, presentation of evidence, objection, motion, argument, and all other rights essential to a fair hearing.”²³ Under prior ITC practice, the parties submitted public interest evidence during the ITC’s review period after the ALJ’s Initial Determination, which would be written submissions and comments only because the ITC generally does not hold hearings on the public interest. Such review-period, public-interest submissions are not subject to evidentiary hearings, so there would be no opportunity for cross examination or rebuttal evidence. Delegating the public interest issue to the ALJ provides such opportunity. This has led to new discovery obligations and costs for the parties, as both parties often retain at least one expert witness to opine on public interest issues.²⁴

22. See Rules of Adjudication and Enforcement, 76 Fed. Reg. 64,803 and 64,804 (Oct. 19, 2011) (effective date Nov. 18, 2011).

23. See ITC Rule 210.36(d).

24. See, e.g., Certain Wireless Devices With 3G and/or 4G Capabilities and Components Thereof, Inv. No. 337-TA-868, Order No. 84 (Dec. 18, 2013) (granting complainant’s motion to strike the expert report of respondent’s public interest expert).

Whether the public interest factors are weighed by an ALJ or by the full ITC, there has been a significant reexamination of how public interest considerations are incorporated into decisions in recent years. In 2011, in a case involving smartphones, the ITC decided not to outright deny, but instead, to delay the start of an exclusion order.²⁵ As a result of the pilot program and the new rule, the ITC now permits ALJs (under ITC order) to take evidence on public interest factors at the beginning of a case, rather than waiting until the end.²⁶ As such, the evidence gathered pertaining to the public interest factors can be used to pinpoint likely remedies earlier in the proceeding.

Moreover, as discussed below, making a record concerning defenses related to standard essential patents has implications for affirmative defenses as well as for the public interest inquiry. So ALJs now are often asked to develop the record and make factual determinations on the public interest inquiry for investigations concerning standard essential patents.

Another opportunity for the parties to address public interest issues (as well as others) is in a petition for Commission review of an Initial Determination, including a request for a hearing on the issues before the full Commission.²⁷ The Commission often may grant review of an Initial Determination and ask the parties or public to provide additional written comments on specific issues presented, which it frequently has done in investigations involving standard essential patents.²⁸ But an oral hearing before the Commission is rarely held and occurs

25. See *Certain Pers. Data and Mobile Commc'ns Devices and Related Software*, Inv. No. 337-TA-710, USITC Pub. 4331, Final at 3 (Dec. 19, 2011) (adopting a "limited" exclusion order).

26. 19 C.F.R. §§ 210.8, 210.10(b), 210.14(f), 210.42(a)(1)(ii)(C), 210.50(a)(4) (2012).

27. 19 C.F.R. § 210.45(a).

28. See 19 C.F.R. § 210.43(d)(3).

only if specifically ordered by the Commission.²⁹ If a party requests a hearing to present oral argument, that request will be granted “when at least one of the participating Commissioners votes in favor of granting the request.”³⁰

III. THE U.S. TRADE REPRESENTATIVE’S DISAPPROVAL HEARD AROUND THE WORLD: *SAMSUNG V. APPLE* (INV. NO. 337-TA-794)

In June 2011, Samsung filed in the ITC a somewhat routine complaint against Apple styled *In the Matter of Certain Electronic Devices, Including Wireless Communication Devices, Portable Music and Data Processing Devices, and Table Computers*, Investigation No. 337-TA-794. This investigation led to a significant moment two years later when, for the first time in twenty-five years, the U.S. Trade Representative invoked his rarely used discretion to disavow and nullify the ITC’s exclusion order. The case fizzled-out after that, leaving substantial questions in its wake on how parties should litigate standard essential patents before the ITC. The following is a summary of that litigation, which has greatly influenced the proceedings of all Section 337 investigations involving standard essential patents.

A. The Initial Determination

In June 2011, Samsung filed a complaint in the ITC alleging that some models of Apple’s iPhones and iPads infringed five Samsung patents, including two patents (U.S. Patent Nos. 7,706,348 and 7,486,644) alleged to be essential to the Universal Mobile Telecommunications Standard (“UMTS”) 3G cellular standard set by the European Telecommunications Standards Institute (“ETSI”) standard setting organization. Apple asserted that it did not infringe those patents and, in any event, Samsung’s commitment to ETSI that it would license those patents

29. 19 C.F.R. § 210.43(d)(2).

30. 19 C.F.R. § 210.45(a).

on fair, reasonable, and non-discriminatory terms (FRAND) precluded the ITC from entering an exclusion order on them. Administrative Law Judge E. James Gildea held a hearing in June 2012 and issued his Initial Determination that rejected Apple's FRAND defense, but found that the alleged standard essential patents were not infringed.³¹

Judge Gildea stated that Section 337 investigations were different from district court litigations. District court litigations involve personal relief that may include injunctive and monetary awards to make the private litigant whole.³² But Section 337 investigations go beyond the litigants' private interests and extend to "time sensitive" issues of the public interest and "irremediable effects that unfair competition, including entry of patent infringing articles, might have on domestic industries."³³ He stated that the ETSI intellectual property rights (IPR) policy at issue itself states that "the national courts of law have the sole authority to resolve IPR disputes."³⁴ The ETSI IPR policy further counsels its members to resolve their disputes through bilateral negotiations and, if that fails, they are "invited to inform the ETSI [General Assembly] in case a friendly mediation can be offered by other ETSI Members and/or the ETSI Secretariat."³⁵ This ETSI idea for seeking "harmony between and among the consensus-building ETSI membership" may not be readily met in patent disputes and can lead to a "delayed and protracted dispute resolution."³⁶ But Section 337 investigations have a

31. Certain Electronic Devices, Including Wireless Communication Devices, Portable Music and Data Processing Devices, and Tablet Computers, Inv. No. 337-TA-794, Initial Det. (Sep. 14, 2012).

32. *Id.* at 461.

33. *Id.*

34. *Id.* at 461–462 (quoting ETSI Guide on IPRs at § 4.3).

35. *Id.* at 462 (quoting ETSI Guide on IPRs at § 4.3).

36. *Id.*

wider and immediate public concern that transcends ETSI's objectives.³⁷ He expressed concern that "an infringing party could, by making unrealistic counter-offers to the patent holder, while claiming that such counter-offers more accurately reflect FRAND than the offers proposed by the patent holder, hold up or frustrate Section 337 investigations."³⁸ This could allow an "uncooperative party" to "do an end-around of a Section 337 investigation in cases of standard essential patents."³⁹

On the merits, Judge Gildea ruled that "the evidence does not support Apple's allegation that Samsung failed to offer Apple licenses to Samsung's declared-essential patents on FRAND terms."⁴⁰ Apple did not show that it availed itself of the mediation procedure suggested by the ETSI IPR policy.⁴¹ Further, Apple's complaint that Samsung unreasonably offered a royalty at 2.4 percent of the selling price of Apple's products was not supported by sufficient "evidence of customers and practices of industry participants showing that Samsung's demand is invidious with respect to Apple."⁴² Further, "Apple's evidence does not demonstrate that Apple put forth a sincere, bona fide effort to bargain with Samsung."⁴³ Rather, both parties decided to negotiate "through the tortuous, and expensive, process of litigation."⁴⁴ Apple had not provided sufficient evidence to establish that Samsung violated its FRAND obligation.

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.* at 469.

41. *Id.* at 470.

42. *Id.*

43. *Id.*

44. *Id.*

B. The Commissions Review and Final Determination

In November 2012, the full Commission decided to review Judge Gildea's Initial Determination in its entirety. The Commission also sought comments from the parties and the public on several questions on standard essential patent-related issues:

1. Does the mere existence of a FRAND undertaking with respect to a particular patent preclude issuance of an exclusion order based on infringement of that patent? Please discuss theories in law, equity, and the public interest, and identify which (if any) of the 337(d)(1) public interest factors preclude issuance of such an order.
2. Where a patent owner has offered to license a patent to an accused infringer, what framework should be used for determining whether the offer complies with a FRAND undertaking? How would a rejection of the offer by an accused infringer influence the analysis, if at all?
3. Would there be substantial cost or delay to design around the technology covered by the [two standard essential patents] asserted in this investigation? Could such a design-around still comply with the relevant ETSI standard?
4. What portion of the accused devices is allegedly covered by the asserted claims of each of the [two asserted standard essential] patents? Do the patents cover relatively minor features of the accused devices?
5. [Directed Only To The Parties] What evidence in the record explains the legal significance of

Samsung's FRAND undertaking under French law?⁴⁵

In response, the ITC received submissions from the parties as well as many non-parties with interests in standard essential patents. The ITC extended the date for its decision several times. In March 2013, the ITC asked the parties to provide additional submissions on the standard essential patent issues presented, indicating that their deliberations were inclined to find a violation as to at least one of the alleged standard essential patents (the '348 patent):

5. Please summarize the history to date of negotiations between Samsung and Apple concerning any potential license to the '348 patent, either alone or in conjunction with other patents. Please provide copies of all written offers and counteroffers concerning a license that would cover the '348 patent, whether made by Samsung or Apple.
6. Please summarize all licenses to the '348 patent granted by Samsung to any entity. Please provide copies of, or cite to their location in the record of this investigation, all agreements wherein Samsung grants any entity a license to the '348 patent.
7. Samsung and Apple are each requested to submit specific licensing terms for the '348 patent that each believes are fair, reasonable, and non-discriminatory. Would Samsung's terms change if the Commission were to enter remedial orders against Apple's products accused in this investigation? If so, please explain whether such an offer would be fair, reasonable, and non-discriminatory.

45. Notice of Review, 77 Fed. Reg. 227 (Nov. 26, 2012).

8. Which factors in *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970) are most relevant to determining whether Samsung has offered to license the '348 patent to Apple on fair, reasonable, and non-discriminatory terms? Please apply any relevant *Georgia-Pacific* factors to Samsung's offer(s) to license the '348 patent to Apple. This analysis should include a comparison of Samsung's licensing offers to a hypothetical negotiation between the parties prior to adoption of the '348 patent into the standard at issue here. What other factors, if any, are relevant in determining whether Samsung has made a fair, reasonable, and non-discriminatory offer?⁴⁶

On June 4, 2013, the ITC issued its Final Determination that found that Apple's products at issue infringed Samsung's '348 patent and issued both a limited exclusion order barring importation of those products and a cease and desist order that would prevent Apple from selling or distributing such products that already were in the United States.⁴⁷ The ITC ruled that "[i]t is Apple's burden to show by a preponderance of the evidence that its FRAND defense precludes the Commission from finding a violation of section 337."⁴⁸ Apple had not met this burden for several reasons.

First, Apple had not provided any binding legal authority that the ITC was precluded from investigating a Section 337 violation based on the FRAND undertaking.⁴⁹ Section 337 requires the ITC to investigate violations without any distinction

46. Notice of Review, 77 Fed. Reg. 227 (Nov. 26, 2012).

47. Certain Electronic Devices, Including Wireless Communication Devices, Portable Music and Data Processing Devices, And Tablet Computers, Inv. No. 337-TA-794, Final Det. (June 4, 2013).

48. *Id.* at 45.

49. *Id.*

between patents that do or do not have a FRAND commitment.⁵⁰ Further, ETSI itself declined to adopt into its IPR Policy a prohibition against injunctive relief.⁵¹

Second, Apple failed to argue a cognizable defense. For example, “Apple has not identified the basic elements necessary to prove a contract: the parties, the offer, the acceptance, the consideration, and definite terms.”⁵²

Third, Apple failed to “identify what the specific obligations may be that flow from Samsung’s FRAND declarations.”⁵³ Apple did not “preserve” arguments on interpreting Samsung’s FRAND declarations. For example, those declarations state that they “shall be governed by the laws of France,” but Apple presented no evidence on how such laws would view Samsung’s obligations.⁵⁴

Fourth, Samsung’s FRAND declarations to ETSI were conditioned on the patents being essential to the standard, but Apple argued that the patents were not essential.⁵⁵ The ALJ was not asked to decide, and did not decide, whether the patents actually were essential to the standard: “the ID contains no comparison of the asserted claims of the ‘348 or ‘644 patents to the technical disclosures of the ETSI standards in question.”⁵⁶

Fifth, similar to the first point above, Apple argued but did not show that the ITC can address infringement of a FRAND-committed patent only where the accused infringer refuses to pay a U.S. court determined FRAND royalty or the U.S. court has no jurisdiction over the accused infringer. Such drastic

50. *Id.* at 46.

51. *Id.* at 47.

52. *Id.*

53. *Id.* at 48.

54. *Id.* at 49.

55. *Id.* at 50.

56. *Id.* at 50–51.

limitations would make the ITC “a forum of last resort” and is “directly contrary to the Commission’s enabling statute.”⁵⁷

Even if Apple had shown that it had a breach of contract claim, it would appear to be enforcing an “agreement to agree” that “imposes an obligation on the parties to negotiate in good faith.”⁵⁸ The ITC reviewed the history of negotiations between Apple and Samsung and found that “Apple has not proved a failure by Samsung to negotiate in good faith.”⁵⁹ Among other things, the ITC rejected Apple’s argument that Samsung’s initial offer must reflect a FRAND royalty rate.⁶⁰ Rather “it is expected that parties arrive at a FRAND license through negotiation.”⁶¹

The ITC also was concerned by Apple’s position that it would pay FRAND royalties only after full litigation and appeal on the patents’ infringement, validity, and enforceability, finding this raised reverse patent hold-up concerns:

Apple’s position illustrates the potential problem of so-called reverse patent hold-up, a concern identified in many of the public comments received by the Commission. In reverse patent hold-up, an implementer utilizes declared-essential technology without compensation to the patent owner under the guise that the patent owner’s offers to license were not fair or reasonable. The patent owner is therefore forced to defend its rights through expensive litigation. In the meantime, the

57. *Id.* at 51.

58. *Id.* at 52.

59. *Id.* at 59.

60. *Id.* at 60.

61. *Id.*

patent owner is deprived of the exclusionary remedy that should normally flow when a party refuses to pay for the use of a patented invention.⁶²

In addition to considering the FRAND defense for purposes of whether a Section 337 violation occurred, the ITC also addressed Apple's FRAND-based arguments that an exclusionary remedy would be against the public interest. The ITC rejected Apple's arguments on the public interest for the same or similar reasons why it rejected Apple's FRAND defense for liability. The ITC rejected Apple's argument that there is any *per se* prohibition against exclusionary relief for a FRAND-obligated patent.⁶³ The ITC also rejected the argument that Samsung had breached any such obligation.⁶⁴ Further, Commissioner Aranoff specifically rejected the argument that the ITC has "an independent duty to examine whether Samsung has satisfied its alleged FRAND obligation under the statutory public interest factors," finding that the issue is more appropriately addressed in the liability inquiry of whether a violation has occurred as a FRAND-based affirmative defense.⁶⁵ By analogy, it may be against the public interest to enter an exclusionary order based on invalid patent claims, but whether or not the patent claims are invalid is determined as an affirmative invalidity defense argument in the liability phase that is not addressed again for the public interest inquiry.

Commissioner Pinkert dissented from the grant of exclusionary relief, because he found it would be against the public interest given the FRAND issues presented.⁶⁶ He found that "Samsung has made no effort to demonstrate that the license terms it has offered Apple . . . satisfy an objective standard of

62. *Id.* at 62–63.

63. *Id.* at 111–112.

64. *Id.* at 112.

65. *Id.* at 112 n.22.

66. *Id.* at D1–D2.

reasonableness.”⁶⁷ Where evidence indicates the complainant is not offering FRAND licensing terms on “a patent covering a minor element of a complex multi-component product,” granting exclusionary relief “would in all likelihood impose substantial costs on consumers while undermining the standards process and thus public welfare and competitive conditions in the U.S. economy.”⁶⁸ He found that the ‘348 patent at issue was “nothing more than a ‘tweak’ to the UMTS standard” and exclusionary relief in this case would adversely affect U.S. consumers.⁶⁹

C. U.S. Trade Representative Disapproves of Exclusionary Relief

On August 3, 2013, U.S. Trade Representative Michael B.G. Froman (“USTR”) disapproved the ITC’s determination to enter exclusionary relief.⁷⁰ In doing so, he cited concerns about patent hold-up by a patent owner and patent hold-out by potential licensees that were raised in a 2013 Joint Policy Statement by the Department of Justice (“DOJ”) and U.S. Patent & Trademark Office (“USPTO”) concerning FRAND-committed standard essential patents:

The Policy Statement expresses substantial concerns, which I strongly share, about the potential harms that can result from owners of standards-essential patents (“SEPs”) who have made a voluntary commitment to offer to license SEPs on terms that are fair, reasonable, and non-discriminatory (“FRAND”), gaining undue leverage and

67. *Id.* at D3.

68. *Id.* at D5.

69. *Id.* at D6–D7.

70. See Letter from Ambassador Michael B.G. Froman, U.S. Trade Representative, Exec. Office of the President, to Honorable Irving A. Williamson, Chairman, U.S. Int’l Trade Comm’n (Aug. 3, 2013) [hereinafter Froman Letter].

engaging in “patent hold-up”, i.e., asserting the patent to exclude an implementer of the standard from a market to obtain a higher price for use of the patent than would have been possible before the standard was set, when alternative technologies could have been chosen. At the same time, technology implementers also can cause potential harm by, for example, engaging in “reverse hold-up” (“hold-out”), e.g., by constructive refusal to negotiate a FRAND license with the SEP owner or refusal to pay what has been determined to be a FRAND royalty.⁷¹

USTR Froman did not give specific reasons for disavowing the exclusionary relief in this case beyond referring to the various broad public interest policy concerns as they relate to “competitive conditions in the U.S. economy and the effect on U.S. consumers.”⁷² He did give guidance on what he would look for in future cases, indicating the ITC should take affirmative, proactive steps to develop a record and make specific findings on FRAND issues “in its public interest determinations,” stating:

I would like to underscore that in any future cases involving SEPs that are subject to voluntary FRAND commitments, the Commission should be certain to (1) examine thoroughly and carefully on its own initiative the public interest issues presented both at the outset of its proceeding and when determining whether a particular remedy is

71. Froman Letter, *supra* note 70, at 1–2 (citing U.S. Dep’t of Justice and U.S. Patent and Trademark Office, Policy Statement on Remedies for Standard-Essential Patents Subject to Voluntary F/RAND Commitments (2013), <http://www.justice.gov/atr/public/guidelines/290994.pdf>).

72. Froman Letter, *supra* note 70, at 3.

in the public interest and (2) seek proactively to have the parties develop a comprehensive factual record related to these issues in the proceedings before the Administrative Law Judge and during the formal remedy phase of the investigation before the Commission, including information on the standard-essential nature of the patent at issue if contested by the patent holder and the presence or absence of patent hold-up or reverse hold-up. In addition, the Commission should make explicit findings on these issues to the maximum extent possible. I will look for these elements in any future decisions involving FRAND-encumbered SEPs that are presented for policy review. The Commission is well-positioned to consider these issues in its public interest determinations.⁷³

The USTR's admonition here is somewhat unclear for the instant case. As discussed above, the ITC specifically sought detailed evidence and made factual findings targeting FRAND defense issues, which included two requests for additional evidence and arguments from the parties and the public on the FRAND related defenses.

USTR Froman also provided further guidance in a footnote where he quotes the joint DOJ/USPTO Policy Statement's non-exhaustive list of examples of when an exclusion order may be appropriate, stating:

[a]n exclusion order may still be an appropriate remedy in some circumstances, such as where the putative licensee is unable or refuses to take a FRAND license and is acting outside the scope of the patent holder's commitment to license on

73. *Id.* at 3.

FRAND terms. For example, if a putative licensee refuses to pay what has been determined to be a FRAND royalty, or refuses to engage in a negotiation to determine F/RAND terms, an exclusion order could be appropriate. Such a refusal could take the form of a constructive refusal to negotiate, such as by insisting on terms clearly outside the bounds of what could reasonably be considered to be F/RAND terms in an attempt to evade the putative licensee's obligation to fairly compensate the patent holder. An exclusion order also could be appropriate if a putative licensee is not subject to the jurisdiction of a court that could award damages. This list is not an exhaustive one. Rather, it identifies relevant factors when determining whether the public interest considerations should prevent the issuance of an exclusion order based on infringement of a F/RAND-encumbered standards-essential patent or when shaping such a remedy.⁷⁴

USTR Froman's disapproval ended the case on the FRAND patents, because his decision was final and not subject to appeal.

IV. ITC LITIGATIONS AFTER USTR'S 2013 DISAPPROVAL OF EXCLUSIONARY REMEDY

To date, there has been no decision by the full Commission on whether FRAND defenses would or would not preclude entry of exclusionary relief. The issue has arisen a few times and

74. *Id.* at 2 n.3 (quoting U.S. Dep't of Justice and U.S. Patent and Trademark Office, Policy Statement on Remedies for Standard-Essential Patents Subject to Voluntary F/RAND Commitments, at 7–8 (2013), <http://www.justice.gov/atr/public/guidelines/290994.pdf>).

the Commission has solicited party and public comments on specific questions directed to FRAND defenses, but those cases have settled or have been decided on other grounds—e.g., no infringement—without the Commission reaching the FRAND issues. Following is a discussion of some of those cases and issues presented.

A. *Adaptix v. Ericsson* (Inv. No. 337-TA-871)

In February 2013, the ITC instituted a Section 337 investigation based on Adaptix Inc.'s ("Adaptix") complaint that Ericsson infringed a patent alleged to be essential to the ETSI 4G LTE standard: *Certain Wireless Communications Base Stations and Components Thereof*, Inv. No. 337-TA-871.⁷⁵ Importantly, Adaptix alleged that it "did not participate in the standard-setting process for LTE development, and Adaptix has no FRAND licensing obligations regarding the asserted patent."⁷⁶

Ericsson's original response to the complaint did not raise any FRAND defenses. But Ericsson later sought leave to amend its response to add a defense based on "Breach of FRAND obligations (breach of contract, estoppel, patent misuse, unclean hands)."⁷⁷ Ericsson raised a novel theory based on Adaptix's licensee Samsung having participated in ETSI's development of the LTE standard and not disclosing the patent to ETSI in violation of ETSI's IPR Policy.⁷⁸ Ericsson argued that

75. *Certain Wireless Communications Base Stations and Components Thereof*, Inv. No. 337-TA-871, 78 Fed. Reg. 13,895, Notice of Institution of Investigation (Feb. 25, 2013).

76. *Certain Wireless Communications Base Stations and Components Thereof*, Inv. No. 337-TA-871, Adaptix Statement of Public Interest at 2 (Jan. 24, 2013).

77. *Certain Wireless Communications Base Stations and Components Thereof*, Inv. No. 337-TA-871, Ericsson Motion for Leave to File An Amended Response to the Complaint (May 23, 2013) (Motion Docket No. 871-010).

78. *Id.* (Ericsson Br. Ex. 1: Proposed Amendment ¶¶ 36-43).

Adaptix should be estopped from enforcing the patent based on Samsung's breach of ETSI's IPR Policy. Ericsson argued it had good cause for delay in seeking to amend its response, because it had been misled by Adaptix's representation that the patents had no FRAND obligations.

Administrative Law Judge Essex disagreed and denied Ericsson's request to add the FRAND-based defenses.⁷⁹ He found that Ericsson did not provide good cause for the delay because, among other things, the Samsung agreement with Adaptix was part of the original complaint and Ericsson did not point to any misrepresented facts in the complaint or that Adaptix's assertion of no FRAND obligation was unreasonable.⁸⁰ Substantively, Ericsson had not shown "that there is any legal support for its defense."⁸¹ Ericsson had not provided any support for the raised theories of "breach of contract, estoppel, patent misuse, [or] unclean hands."⁸² And, procedurally, it was late in the investigation and Ericsson had not provided prior notice of this potential defense.⁸³

Although the full Commission could have reviewed this ruling, that opportunity did not arise. On the eve of trial, patent owner Adaptix moved to withdraw its complaint and terminate the investigation, which motion was granted.⁸⁴

79. Certain Wireless Communications Base Stations and Components Thereof, Inv. No. 337-TA-871, 2013 ITC LEXIS 1088, Order Denying Ericsson's Motion to Amend Its Response to the Complaint (July 5, 2013) (Order No. 11).

80. *Id.* at *7.

81. *Id.* at *8.

82. *Id.*

83. *Id.* at *9.

84. Certain Wireless Communications Base Stations and Components Thereof, Inv. No. 337-TA-871, 2013 ITC LEXIS 1791, Initial Det. Granting Motion to Terminate the Investigation In Its Entirety (Dec. 12, 2013) (Order No. 35).

B. *InterDigital v. Nokia, et al* (Inv. No. 337-TA-800)

In 2011, InterDigital filed a complaint alleging that Nokia and others infringed several patents⁸⁵ alleged to be essential to two 3G wireless standards (WCDMA and CDMA2000): *In the Matter of Certain Wireless Devices with 3G Capabilities and Components Thereof*, Inv. No. 337-TA-800.⁸⁶ The IPR Policy of several standards organizations were involved, because InterDigital participated in developing the WCDMA standard through its membership in ETSI and participated in developing the CDMA2000 standard through the Telecommunications Industry Association (“TIA”) and approval of CDMA2000 as an international standard by the International Telecommunications Union (“ITU”).⁸⁷

1. Initial Determination

In June 2013, Administrative Law Judge David P. Shaw issued an Initial Determination finding that there was no Section 337 violation, although he rejected the accused infringer’s FRAND-based defenses.⁸⁸ He held that InterDigital’s commitment under the ITU policy meant that it was “willing to negotiate” a license, meaning that InterDigital “must negotiate towards licenses on FRAND terms, making genuine and good faith efforts to reach agreement.”⁸⁹ The ETSI commitment was governed under French law as “*un accord de principe* (agreement in principle)” that “imposes on both negotiating parties a duty

85. U.S. Patent Nos. 7,706,830; 8,009,636; 7,502,406; 7,706,332; 7,970,127; 7,536,013; 7,616,970.

86. *Certain Wireless Devices with 3G Capabilities and Components Thereof*, Inv. No. 337-TA-800, 75 Fed. Reg. 54252, Notice of Institution of Investigation (Aug. 31, 2011).

87. *Certain Wireless Devices with 3G Capabilities and Components Thereof*, Inv. No. 337-TA-800, Initial Det. at 418–19 (June 28, 2013).

88. Initial Determination at 423, 447.

89. *Id.* at 421.

to negotiate in good faith” but “does not, however, impose an obligation actually to conclude a contract.”⁹⁰ Remedies for breach of the ETSI commitment “consist only of damages” and “there is no specific performance” or “remedy consisting of ‘the forced conclusion of a contract.’”⁹¹ Judge Shaw found this similar to U.S. contract law “under which a generalized ‘agreement to agree’ is unenforceable, but parties may enter into binding agreements to negotiate.”⁹²

Judge Shaw found that InterDigital had complied with such standard-setting obligations to negotiate in good faith. He reviewed the history of negotiations between the parties, but that history is not clear from the opinion because the bulk of that discussion has been redacted as confidential and is not publicly available. He had found that the standard-setting commitments at issue did not require a country-by-country license offer, but contemplated offering worldwide licenses.⁹³ He also did not find fault with InterDigital seeking exclusionary relief while the parties were still in negotiation, noting that some negotiations had started years earlier in 2009.⁹⁴ Judge Shaw did not find that InterDigital violated the “non-discriminatory” part of the FRAND obligation. Non-discrimination “does not require uniform treatment across licensees, nor does it require the same terms for every manufacturer or competitor.”⁹⁵ Further, that analysis “requires an examination of the whole of each license agreement, and not just the effective royalty rate.”⁹⁶

Judge Shaw rejected the accused infringer’s assertion that competition law concerns, such as those raised by various

90. *Id.* at 422.

91. *Id.*

92. *Id.*

93. *Id.* at 426, 428 n.94, 432.

94. *Id.* at 427–28.

95. *Id.* at 432.

96. *Id.*

U.S. competition agencies, preclude the ITC from entering exclusionary relief on FRAND-committed patents.⁹⁷ Rather, the ITC acts under its enabling statute that “makes no distinction between patents that have or have not been declared essential to a standard” and the accused infringer’s “have not offered any statutory construction that demonstrates that the Commission per se cannot issue an exclusion order for infringement of a declared-essential patent.”⁹⁸ He also rejected the allegation that InterDigital “negotiated in bad faith” that was premised on an argument that “injunctive relief should be available only for non-essential patents.”⁹⁹

Finally, Judge Shaw rejected the accused infringer’s various equitable defenses of equitable estoppel, promissory estoppel, implied waiver, implied license, or patent misuse.¹⁰⁰ For example, the accused infringer’s equitable estoppel argument was premised on InterDigital’s commitments to ETSI and ITU being “misleading” and “induc[ing] implementers . . . to reasonably rely on those statements and conclude that FRAND licenses would be available.”¹⁰¹ But Judge Shaw found that they failed to produce evidence showing that the accused infringer’s “relied on any specific statements InterDigital made to the SSOs [i.e., standard setting organizations ETSI and ITU]” or that those statements “were, in fact, misleading.”¹⁰² Judge Shaw found no waiver, because InterDigital’s disclosure of the patents to the SSOs was not shown to have “waived its right to assert the patents.”¹⁰³ And he found no implied license, because InterDigital’s declarations to the SSOs did not themselves grant a license,

97. *Id.* at 422–23.

98. *Id.* at 423.

99. *Id.*

100. *Id.* at 435–39.

101. *Id.* at 436.

102. *Id.*

103. *Id.* at 438.

but showed that InterDigital was “merely prepared to grant a license on FRAND/RAND terms” and, even if it were a license, “InterDigital has not received compensation for ongoing royalties from the [accused infringers].”¹⁰⁴ He also rejected the accused infringer’s patent misuse argument that was premised on InterDigital improperly expanding its U.S. patent rights by seeking a worldwide license, finding that seeking a worldwide license was not a bad faith refusal to negotiate and “the evidence shows that this practice is common among global companies.”¹⁰⁵

2. Recommended Determination on Remedy

In July 2013, a month after his Initial Determination finding no Section 337 violation, Judge Shaw issued his Recommended Determination on remedy.¹⁰⁶ At the outset, he states that he had not been authorized by the Commission in this investigation to consider the public interest:

The Commission did not authorize the administrative law judge to take public interest evidence or to provide findings and recommendations concerning the public interest. Thus, in accordance with the usual Commission practice and the applicable Commission Rule, only the Commission can determine the role that public interest factors may play in this investigation.¹⁰⁷

Accordingly, Judge Shaw ruled that, should the Commission find a Section 337 violation has occurred, he recommends a limited exclusion order based on his ruling that rejected the FRAND-related defenses for purposes of liability but without

104. *Id.* at 438–39.

105. *Id.* at 439–40.

106. Certain Wireless Devices with 3G Capabilities and Components Thereof, Inv. No. 337-TA-800, Recommended Det. (July 8, 2013).

107. *Id.* at 1.

further considering whether the “FRAND or other issues may be deemed to be related to public interest.”¹⁰⁸

After Judge Shaw’s decision, on August 3, 2013, the U.S. Trade Representative issued his disavowal of exclusionary relief in the *Samsung v. Apple* investigation where he instructed the ITC in future cases to proactively create a record and make specific factual findings on FRAND issues for purposes of the public interest inquiry.¹⁰⁹

3. Commission Review

In September 2013, the full Commission decided to review Judge Shaw’s Initial Determination in its entirety.¹¹⁰ But the Commission indicated that it was “not interested in receiving written submissions that address the form of remedy and bonding, if any, or the public interest at this time.”¹¹¹ In December 2013, the Commission ruled that no valid patent claim was infringed and reserved ruling on the FRAND-based defenses for efficiency sake pending entry of an Initial Determination in the investigation against LG (LG had been dismissed but then reinstated into this investigation).¹¹² InterDigital then sought to dismiss the investigation as to LG while it appealed the liability ruling as to the other accused infringers, which the Commission granted and reiterated that it would “take no position on the

108. *Id.* at 6.

109. *See* Froman Letter, *supra* notes 70–74.

110. Certain Wireless Devices with 3G Capabilities and Components Thereof, Inv. No. 337-TA-800, Notice of Comm’n Det. (Sept. 4, 2013).

111. *Id.* at 3.

112. Certain Wireless Devices with 3G Capabilities and Components Thereof, Inv. No. 337-TA-800, Notice of Comm’n Det. to Affirm in Part and Modify in Part a Final Initial Det. Finding No Violation of Section 337 By Certain Respondents; Termination of the Investigation as to Certain Respondents; Extension of the Target Date for Completion of the Investigation (Dec. 19, 2013) (“800 Notice of Final Determination”).

FRAND issues” given the liability ruling.¹¹³ In February 2015, the Federal Circuit affirmed the ITC’s determination that the patents were not infringed, thus resolving the case without the full Commission addressing the FRAND issues.¹¹⁴

C. *LSI v. Realtek* (Inv. No. 337-TA-837)

In April 2012, the ITC instituted an investigation based on a complaint filed by LSI Corp. and Agere Systems, Inc. (referred to herein collectively as “LSI”) alleging that Realtek Semiconductor Corporation (“Realtek”) and others infringed several patents, including one patent alleged to be essential to the ITU-T H.264 standard and two patents alleged to be essential to the IEEE 802.11 WiFi standard, where it was undisputed that all three patents were essential to the standards and subject to FRAND commitments.¹¹⁵

1. Intervening District Court Case

In June 2012, during the pendency of the ITC investigation, Realtek filed suit against LSI in district court alleging that LSI had breached its FRAND obligation by filing the ITC complaint seeking an exclusion order and offering an unreasonably high royalty rate. In May 2013, Judge Whyte granted Realtek’s motion for summary judgment and found that LSI breached its

113. Certain Wireless Devices with 3G Capabilities and Components Thereof, Inv. No. 337-TA-800, Notice of Comm’n Det. to Grant Unopposed Motion by Complainants to Withdraw the Complaint as to the Remaining Respondents; Termination of the Investigation at 3 (Feb. 12, 2014).

114. *InterDigital et al v. U.S. International Trade Commission*, No. 2014-1176, 601 Fed. App’x 972, 979; 2015 U.S. App. LEXIS 2602, at *15 (Fed. Cir. Feb. 18, 2015).

115. *Certain Audiovisual Components and Products Containing the Same*, Inv. No. 337-TA-837, Initial Det. at 333, 351 (July 18, 2013).

FRAND obligation by seeking exclusionary relief in the ITC before first offering Realtek a FRAND license.¹¹⁶ Judge Whyte held that there was no dispute in the case that LSI “entered into a binding contract with the IEEE to license [its] declared standard-essential patents . . . on RAND terms, and that Realtek is a third party beneficiary to that contract.”¹¹⁷ He then determined that, “instigating an ITC 337 action naming Realtek as a respondent **prior to** offering a RAND license to Realtek, violated [LSI’s] contractual obligations to the IEEE and to Realtek to license their standard-essential patents under RAND terms.”¹¹⁸ Judge Whyte made clear that “[t]he court’s breach of contract holding is limited to the situation here, where defendants did not even attempt to offer a license, on ‘RAND’ terms or otherwise, until after seeking injunctive relief” and that “the limited issue here [is] whether the initiation of the ITC action **before offering any license** was a breach of defendants’ RAND obligations.”¹¹⁹ He further issued a preliminary injunction to enjoin LSI “from enforcing any exclusion order or injunctive relief by the ITC that they might obtain against Realtek with respect to the . . . declared standard essential patents.”¹²⁰ Some questions existed as to the import of this ruling because an ITC complain-

116. Realtek Semiconductor Corp. v. LSI Corp., et al., Case No. C-12-03451, 946 F. Supp. 2d 998, 2013 WL 2181717 (N.D. Cal. May 20, 2013).

117. *Id.* at 1005.

118. *Id.* (emphasis in original) (citing Microsoft Corp. v. Motorola, Inc., 696 F.3d 872 (9th Cir. 2012)).

119. *Id.* at 1008 (emphasis in original).

120. *Id.* at 1009–1010 (noting that such injunction “shall remain in effect until this court determines defendants’ RAND obligations and defendants have complied therewith.”).

ant generally need not do anything to enforce an exclusion order—they are automatically enforced by U.S. Customs and Border Protection.¹²¹

On June 4, 2013, after Judge Whyte’s decision, the Commission entered its final determination in the *Samsung v. Apple* investigation (Inv. No. 337-TA-794) that rejected Apple’s FRAND-based defenses and issued exclusionary relief.

2. Initial Determination

In July 2013, Administrative Law Judge David P. Shaw issued his Initial Determination finding that the three standard essential patents were not infringed. He ruled that the accused infringers had the “burden to show by a preponderance of the evidence that a RAND defense precludes the Commission from finding a violation of section 337,”¹²² but the accused infringers had not carried their burden here. The accused infringers’ defense was based on LSI’s opening offer being unreasonable, but there was no precedent that an initial offer need be a specific RAND royalty rate and there was precedent that “an initial offer need not be the terms of a final FRAND license because SSOs intend the final license to be accomplished through negotiation.”¹²³ Further, the accused infringers did not introduce any evidence of what would be a RAND license or RAND royalty

121. See, e.g., *RealTek v. LSI: Will ITC Defer to District Court*, LAW360.COM (Aug. 2, 2013, 1:10 PM EDT), <http://www.law360.com/articles/458127/real-tek-v-lsi-will-itc-defer-to-district-court> (questioning whether the ITC “is free to chart its own course” despite Judge Whyte’s decision).

122. *Certain Audiovisual Components and Products Containing the Same*, Inv. No. 337-TA-837, Initial Det. at 351 (July 18, 2013) (citing *Certain Devices, Including Wireless Communications Devices, Portable Music and Data Processing Devices, and Tablet Computers*, Inv. No. 337-TA-794 (“*Wireless Communications Devices*”), Comm’n Op. at 46 (July 5, 2013)).

123. *Id.* at 351–52 (citing *Microsoft v. Motorola*, 864 F. Supp. 2d 1023, 1038 (W.D. Wash. 2012)).

rate for these patents, so there was nothing to compare LSI's offers to: "a finder of fact should usually compare offers with a RAND royalty rate because more than one rate could conceivably be within the range of reasonable and non-discriminatory license terms."¹²⁴ Although the accused infringers referred to the RAND royalty determination by Judge Robart in the *Microsoft v. Motorola* litigation, the decision "did not necessarily set RAND royalty rates for the IEEE and ITU" or "for either 802.11 or H.264 standards themselves."¹²⁵ Rather, that decision was decided within an analytical framework, but the accused infringers did not offer such an analysis here.¹²⁶

Judge Shaw also found that the investigation properly proceeded notwithstanding Judge Whyte's ruling in the parallel district court proceeding that LSI breached its RAND obligation by filing the ITC complaint and enjoined LSI from enforcing any exclusionary relief granted.¹²⁷ As an initial matter, he noted that no party sought to apply collateral estoppel to the ITC investigation based on Judge Whyte's ruling and no party sought to terminate the investigation.¹²⁸ He then determined that, based on the record of the investigation, he should not find that LSI is barred from enforcing the standard essential patents based on the theory that the accused infringers "are third-party beneficiaries of a contract whose terms [LSI has] yet to satisfy."¹²⁹

First, he found that the record in the ITC investigation was different than that before Judge Whyte, showing that LSI made an offer to Realtek and the failure of the parties to agree to licensing terms "cannot be attributed to" LSI.¹³⁰ It is not clear,

124. *Id.* at 352.

125. *Id.*

126. *Id.* at 352–53, 356–57.

127. *Id.* at 359.

128. *Id.*

129. *Id.*

130. *Id.*

however, when and under what terms LSI made an offer to Realtek given the substantial redaction of confidential information from the public version of Judge Shaw's decision.¹³¹

Second, there was no authority to support the accused infringer's contractual theory as precluding a patent holder from even seeking exclusionary relief at the ITC before first making a RAND offer:

Second, there is no indication at this time that the Commission, as a matter of law, has determined to treat RAND obligations as contractual obligations, with respondents as third-party beneficiaries, that must be satisfied before relief may be sought at the Commission. Furthermore, the Commission has not determined whether it has the statutory authority to adopt a policy of requiring patent holders to make an offer with RAND terms before filing a complaint at the Commission; nor has the Commission adopted such a policy.

Further, as in the *Samsung v. Apple* Inv. No. 337-TA-794, the accused infringers had not "presented evidence to define such traditional elements of a contract defense, let alone one that is then extended to third-party beneficiaries" like the accused infringers.¹³²

3. Recommended Determination on Remedy

A few weeks later, on July 31, 2013, Judge Shaw issued his Recommended Determination on relief which decided that, if a violation were found, a limited exclusion order should be entered. In doing so, he stated that he did not take evidence or

131. See *id.* at 342–46 (heavily redacted discussion of LSI and Realtek negotiations).

132. *Id.* at 360.

make any findings on the public interest because the Commission did not authorize him to do so and, thus, “only the Commission can determine the role that public interest factors play in this investigation.”¹³³ Further, the accused infringers did not take a position on the public interest factors either, but reserved the ability to raise their RAND defense as to the public interest on full review by the Commission:

Respondents [accused infringers] state that they “do not and have not taken a position as to whether the Commission should issue remedial orders in view of [LSI’s] declaration to standard-setting organizations that three of the four asserted patents are standard essential.” They further state that “Respondents may, however, take a position when the issue of public interest is before the Commission.” While the Commission may determine that RAND or other issues are related to the public considerations that it must address, this RD [Recommended Determination] does not address such considerations for the reasons stated above. Otherwise, it is noted that specific RAND-related defenses were ruled upon in the ID [Initial Determination].¹³⁴

On August 3, 2013—just a few days after Judge Shaw’s ruling—the U.S Trade Representative issued his disavowal of exclusionary relief in the *Samsung v. Apple* investigation where he instructed the ITC in future cases to proactively create a record and make specific factual findings on FRAND issues for purposes of the public interest inquiry.¹³⁵

133. Certain Audiovisual Components and Products Containing the Same, Inv. No. 337-TA-837, Recommended Det. at 1–2 (July 31, 2013).

134. *Id.* at 2 n.1.

135. See Froman Letter, *supra* notes 70–74.

4. Commission Review

In October 2013, the full Commission issued a Notice that it would review “in its entirety” Judge Shaw’s determinations.¹³⁶ In doing so, the Commission asked the parties to “discuss and cite any record evidence of the standard essential nature” of the standard essential patents at issue.¹³⁷ Further, in light of the U.S. Trade Representative’s instructions when disavowing exclusionary relief in the *Samsung v. Apple* investigation, the Commission sought submissions and additional evidence (including “additional sworn testimony or expert declarations”) in response to the following RAND-related issues concerning the public interest inquiry:

1. Please discuss and cite any record evidence of the allegedly RAND-encumbered nature of the declared standard essential ‘663, ‘958 and ‘867 patents. With regard to the ‘958 patent and the ‘867 patent, what specific contract rights and/or obligations exist between the patentee and the applicable standard-setting organization, i.e., the Institute of Electrical and Electronic Engineers, Inc. (IEEE)? With regard to the ‘663 patent, what specific contract rights and/or obligations exist between the patentee and the applicable standard-setting organization, i.e., the International Telecommunication Union (ITU)?
2. Please summarize the history to date of negotiations between LSI and Funai and between LSI and Realtek concerning any potential license to

136. Certain Audiovisual Components and Products Containing the Same, Inv. No. 337-TA-837, Notice of Comm’n Det. to Review a Final Initial Det. Finding a Violation of Section 337 In Its Entirety (Oct. 17, 2013).

137. *Id.* at 3–4 (Question 11).

the '663, the '958 and the '867 patents, either alone, in conjunction with each other and/or the '087 patent, and/or in conjunction with non-asserted patents. Please provide copies of, or cite to their location in the record evidence, all offers and communications related to the negotiations including any offer or counteroffer made by Funai and Realtek.

3. Please summarize all licenses to the '663, the '958, and the '867 patents granted by LSI to any entity including evidence of the value of each patent if such patent was licensed as part of a patent portfolio. Please provide copies of, or cite to their location in the record evidence, all agreements wherein LSI grants any entity a license to these patents. Please also provide a comparison of the offers made to Funai and/or Realtek with offers made to these other entities.

4. If applicable, please discuss the industry practice for licensing patents involving technologies similar to the technologies in the '663, the '958, and the '867 patents individually or as part of a patent portfolio.

5. Please identify the forums in which you have sought and/or obtained a determination of a RAND rate for the '663, the '958, and the '867 patents. LSI, Funai and Realtek are each requested to submit specific licensing terms for the '663, the '958, and the '867 patents that each believes are reasonable and non-discriminatory.

6. Please discuss and cite any record evidence of any party attempting to gain undue leverage, or

constructively refusing to negotiate a license, with respect to the '663, the '958, and the '867 patents. Please specify how that evidence is relevant to whether section 337 remedies with respect to such patents would be detrimental to competitive conditions in the U.S. economy and any other statutory public interest factor.¹³⁸

In March 2014, the Commission issued a final determination that found no Section 337 violation had occurred because the patent claims were either not infringed, were invalid or recently expired.¹³⁹ Accordingly, the Commission decided that it would “not reach any RAND or equitable defenses” and “takes no position on the ALJ’s determinations with respect to the respondents’ RAND defenses and equitable defenses.”¹⁴⁰ LSI and Realtek ultimately settled their dispute while Judge Whyte’s district court case was on appeal at the Ninth Circuit.

D. *Amkor v. Carsem* (Inv. No. 337-TA-501)

In December 2003, the ITC instituted an investigation based on patent owner Amkor Technology Inc.’s (“Amkor”) assertion that Carsem Inc. (“Carmsem”) integrated circuit devices infringed U.S. Patent No. 6,433,277 (the ‘277 Patent) alleged to cover the MO-22 standard set by the Joint Electronic Device Engineering Counsel (JEDEC). Carmsem’s defenses included an allegation that equitable or legal estoppel rendered the patents unenforceable based on Amkor’s alleged failure to disclose the ‘277 Patent to JEDEC.

138. *Id.* at 4–5.

139. Certain Audiovisual Components and Products Containing the Same, Inv. No. 337-TA-837, Comm’n Opinion (March 26, 2014).

140. *Id.* at 33–34.

1. Initial Proceedings and Remands

A final Initial Determination (hereinafter 501 Inv. 2004 Final ID) was entered in November 2004 that found there was no valid, infringed claim. On review, the Commission modified the claim construction and remanded back to the ALJ for further consideration. In November 2005, the ALJ issued a remand Initial Determination (“501 Inv. Remand ID”) that found infringement of the ‘277 Patent. But that determination was followed by a delay of several years while the parties attempted to obtain discovery from a foreign third-party, ASAT, related to a prior art defense. In October 2009, after that foreign discovery was obtained, the ALJ issued a Supplemental Determination (“501 Inv. First Supp. ID”) that rejected the defense based on the alleged ASAT prior art.

On review, in July 2010, the Commission disagreed and held that the ASAT invention was prior art and remanded back for further consideration based on that determination. On this second remand, in March 2010, the ALJ issued a Supplemental Initial Determination (“501 Inv. Second Supp. ID”) that held the ASAT prior art invalidated the asserted ‘277 Patent claims. The Commission declined to review that decision, which thus became a final decision. The patent owner Amkor appealed to the Federal Circuit. In August 2012, the Federal Circuit reversed the finding that the ‘277 Patent was invalid and remanded the case back to the Commission.¹⁴¹

On remand, in January 2013, the Commission directed the parties to identify what further proceedings were required to comply with the Federal Circuit’s remand order. In June 2013, the Commission ultimately requested briefing on the economic

141. *Amkor Technology Inc. v. Int’l Trade Comm’n*, 692 F.3d 1250, 1261 (Fed. Cir. 2012).

prong of the domestic industry requirement, remedy, the public interest, and bonding.¹⁴²

On August 3, 2013, the USTR issued his disapproval of the ITC's determination to enter exclusionary relief based on the finding that Apple infringed Samsung's alleged standard essential patents.

2. Commission Review

On April 28, 2014, the Commission issued its decision on remand. The Commission affirmed the ALJ's 501 Inv. First Supp. ID determination that the '277 Patent was not invalid over the ASAT asserted prior art.¹⁴³ The Commission also rejected Carsem's equitable defenses premised on the allegations that Amkor failed to disclose the '277 Patent to JEDEC. The Commission determined that a limited exclusion order was appropriate based on infringement of the '277 Patent.¹⁴⁴

- a) Commission rejects estoppel arguments because patents not shown to be essential to practice the standard.

Carsem argued that, as construed, the '277 Patent is essential to the MO-220 standard that Amkor proposed to JEDEC and, thus, should have been disclosed to JEDEC. Carsem argued that the elements of equitable estoppel were satisfied as follows:

- (1) [Patent holder] Amkor failed to disclose its patent rights to the JC-11.11 committee when it introduced its MO-220 proposal in January 1999 and

142. See 78 Fed. Reg. 35051 (Jun. 11, 2013).

143. Certain Encapsulated Integrated Circuit Devices and Products Containing Same, Inv. No. 337-TA-501, Final Det. at 8 (Apr. 28, 2014) (hereinafter 501 Inv. Final Det.).

144. 501 Inv. Final Det. at 9.

affirmatively misrepresented in the October 1999 [sic] that there were no applicable patents,

(2) [accused infringer] Carsem reasonably relied on [patent holder] Amkor's misleading statements in voting on the original MO-220 proposal and subsequent revisions for this standard and the MO-229 standard, and designing its MLP products to comply with these standards, and

(3) [accused infringer] Carsem is materially prejudiced by [patent holder] Amkor's filing of suit.¹⁴⁵

Relying on the Federal Circuit's *Rambus*¹⁴⁶ decision, the ALJ had held that Carsem must establish by a preponderance of the evidence¹⁴⁷ "that there is a reasonable expectation that the [JEDEC] standard cannot be practiced without a license under the undisclosed [patent] claims."¹⁴⁸ Relying on the *Rambus* decision, the ALJ ruled that the JEDEC disclosure requirement was limited to disclosure of patents whose claims "would cover any [JEDEC] standard and cause those who use the standard to infringe," quoting the following from the *Rambus* decision:

To hold otherwise would contradict the record of evidence and render the JEDEC disclosure unbounded. Under such an amorphous duty, any patent or application having a vague relationship to the standard would have to be disclosed. JEDEC members would be required to disclose

145. 501 Inv. Final Det. at 12.

146. *Rambus Inc. v. Infineon Technologies AG*, 318 F.3d 1081 (Fed. Cir. 2003).

147. The *Rambus* decision was decided under the Virginia fraud "clear and convincing evidence" standard, but the "preponderance of the evidence" standard applied for this equitable defense.

148. 501 Inv. 2004 Final ID at 382 (citing *Rambus Inc. v. Infineon Technologies AG*, 318 F.3d 1081, 1102-03 (Fed. Cir. 2003)).

improvement patents, implementation patents, and patents directed to the testing of standard-compliant devices—even though the standard itself could be practiced without licenses under such patents.

In other words, this duty encompassed any patent or application with claims that a competitor or other JEDEC member reasonably would construe to cover the standardized technology. This does not require a formal infringement analysis. Members are not required to perform a limitation-by-limitation comparison or conduct an equivalent analysis. Rather, the disclosure duty operates when a reasonable competitor would not expect to practice the standard without a license to practice the undisclosed claims. Stated another way, there must be some reasonable expectation that a license is needed to implement the standard. By the same token, the disclosure duty does not arise for a claim that recites individual limitations directed to a feature of the JEDEC standard¹⁴⁹

The ALJ found that accused infringer Carsem had not shown that a license under the '277 Patent was required for Carsem to practice the MO-220 JEDEC standard. The ALJ rejected Carsem's expert testimony because it was premised on claim constructions proposed by Amkor which were not adopted and the expert "does not make reference to particular claim terms in specific patents." The ALJ concluded that Carsem

149. 501 Inv. 2004 Final ID at 382 (quoting *Rambus*, 318 F.3d at 1100–101).

had “failed to show a misleading communication within the meaning of the equitable estoppel test.”¹⁵⁰

After reviewing the foregoing decision of the ALJ, the Commission affirmed the ALJ’s ruling, stating that “the ALJ correctly interpreted the record evidence and properly applied controlling Federal Circuit precedent, and we affirm the ALJ’s determination that the equitable estoppel defense is inapplicable in this investigation.”¹⁵¹

The Commission further found that the equitable estoppel ruling resolved Carmsen’s legal estoppel arguments that patent holder Amkor “is obligated by the JEDEC rules to license the ‘277 patent, which Carsem refers to as a standard-essential patent, on fair, reasonable and non-discriminatory (“FRAND”) terms” but Amkor “refused to offer Carsem a license on FRAND terms consistent with those previously agreed to and offered by Amkor to other actual and prospective licensees.”¹⁵² The Commission ruled that “the legal estoppel defense applies when ‘a patentee has licensed or assigned a right, received consideration, and then sought to derogate from the right granted.’”¹⁵³ In this case, there was no evidence in the record “that [patent holder] Amkor has licensed or assigned the patents to JEDEC or Carsem” or “that Amkor received any consideration for a license from JEDEC or Carsem.”¹⁵⁴ In this case, accused infringer Carsem “failed to prove that Amkor had deceived the standard setting body or that the patents at issue are necessary to practice the standard.”¹⁵⁵ The Commission noted that Amkor’s letter of

150. 501 Inv. 2004 Final ID at 384.

151. 501 Inv. Final Det. at 15.

152. *Id.* at 15–16.

153. *Id.* at 16 (quoting *Wang Labs, Inc. v. Mitsubishi Elecs. Am., Corp.*, 103 F.3d 1571, 1581 (Fed. Cir. 1997)).

154. 501 Inv. Final Det. at 17.

155. *Id.*

assurance to JEDEC “is conditional on its face,” stating that certain patents “may apply to this registration” and that “[i]f the current issued patent or later patents resulting from related applications do apply, Amkor Technology intends to comply with the JEDEC Patent Policy and License under reasonable terms and conditions that are demonstrably free of any unfair discrimination.”¹⁵⁶ In this case, the accused infringer Carsem “failed to prove the ‘277 patent is ‘standard essential.’”¹⁵⁷

- b) Public interest does not preclude exclusionary relief where patent not shown to be essential to practice the standard.

Accused infringer Carsem argued that the ‘277 Patent is essential to a standard and subject to a FRAND commitment such that “[i]mposing an exclusion order barring Carsem’s standardized products from entry into the United States would harm competition and consumers in the United States” and that, “because of the importance of standard setting, an exclusion order would therefore be harmful to competitive conditions and U.S. consumers.”¹⁵⁸ The Commission rejected this argument, because the record showed that the patent “is not essential to the practice of the JEDEC MO-220 and MO-229 standards” and that “[patent holder] Amkor has not breached any obligations to JEDEC.”¹⁵⁹ Accordingly, “an exclusion order would therefore not be harmful to competitive conditions and U.S. consumers.”

156. *Id.* at 18 n.10s (further stating that, “[a]s the ALJ found, the ‘277 patent was not necessary to practice the MO-220 and MO-229 standards and therefore the condition stated in the letter did not materialize.”).

157. *Id.* at 18.

158. 501 Inv. Final Det. at 45–46.

159. *Id.* at 46.

c) Commissioner Aranoff's Footnote 24 on
Public Interest Analysis

Commissioner Aranoff presented additional views in footnote 24 of the opinion concerning whether accused infringer Carsem should be able to relitigate the standard essential patent issues in the public interest analysis even though Carsem had failed to establish such a defense in the liability phase of the investigation.¹⁶⁰ Commissioner Aranoff stated that, under principles of finality, parties wishing to raise certain standard essential patent defenses should do so in the violation phase and not revisit those issues in the public interest phase, stating:

Commissioner Aranoff believes that the Commission's approach . . . should be guided by principles of finality (including waiver and estoppel) and due process. Parties to a section 337 investigation who wish to raise arguments or present evidence concerning (1) whether a patent is standard essential; (2) whether a complainant made and/or fulfilled its obligations pursuant to FRAND commitments; or (3) whether a respondent/implementer was a willing licensee should do so in the violation phase of the investigation by raising one or more FRAND-based affirmative defenses. . . . If the Commission were to find a FRAND-based affirmative defense is proven, the Commission could find no violation of section 337 and would not need to reach the issues of remedy and public interest. When, as in this investigation, the parties have a full and fair opportunity to litigate these three SEP-related issues, the respondent fails to prove a FRAND-based affirmative defense, and

160. 501 Inv. Final Det. at 46–47 n.24.

the Commission finds a violation of section 337, Commissioner Aranoff believes that the Commission should not reconsider the same three issues a second time, in the context of its public interest inquiry.¹⁶¹

Commissioner Aranoff further raised concerns about the propriety of revisiting the facts in the public interest analysis stating that such situations should be “rare”:

If the Commission were to routinely revisit the facts underlying a FRAND affirmative defense in the context of its public interest analysis, this would raise several concerns. Could the Commission, consistent with its obligations under the APA, apply a different burden of proof or consider different evidence on the same issue in the violation and remedy phases of an investigation? Would parties have an incentive to waive arguments or withhold evidence at the violation stage so as to raise them under a less exacting standard in the remedy phase? Are there other affirmative defenses the Commission might reconsider at the remedy stage? (For example, one could argue it is contrary to the public interest to issue a remedy based on infringement of a patent that was obtained through inequitable conduct, even if the affirmative defense of inequitable conduct failed.) Where there may be hypothetical situations that could warrant a second look at facts underlying a FRAND issue that was or could have been liti-

161. *Id.*

gated before the ALJ in the violation phase, Commissioner Aranoff believes that they would be rare and are not present in this investigation.¹⁶²

d) Commissioners Pinkert, Broadbent, and Kieff's Footnote 26 on Public Interest Analysis

Commissioners Pinkert, Broadbent and Kieff provided further views in footnote 26 about a RAND defense in the context of the public interest analysis. They recognized that a RAND obligation may arise from express commitments or commitments implied from a course of conduct, but that did not occur in this case:

For purposes of the analysis of the statutory public interest factors in a case such as this one, Commissioners Pinkert, Broadbent, and Kieff generally recognize that either of the following two scenarios could give rise to a RAND obligation relevant to those factors: (1) where the patent holder has made an express RAND commitment to license or (2) where a RAND commitment to license arises by implication from the course of conduct of the patent holder, such as might result from the patent holder having represented the patent to be essential to an industry standard. The facts here, however, show that the '277 patent is not essential to a JEDEC standard and that the patent holder (Amkor) has not represented it as essential to a JEDEC standard.¹⁶³

The three Commissioners stated that the finding of a RAND obligation simply started the analysis, and the specific

162. *Id.*

163. *Id.* at 49 n.26.

underlying circumstances should be considered to see if the actions of the patent owner or accused infringer were consistent with that obligation, stating:

[e]ven if finding a RAND obligation in this case were warranted, the Commission would stand only at the threshold of the public interest analysis. The Commission would then have to assess the substance of the obligation and whether [patent holder] Amkor’s licensing conduct, considered in light of [accused infringer] Carsem’s conduct, is inconsistent with it. The Commission would also have to evaluate the totality of the evidence, including the evidence of the parties’ conduct, regarding the impact of a Section 337 remedy on the public interest.¹⁶⁴

The three Commissioners indicated (without expressly finding) that this may be a case of “hold-out” by the accused infringer, stating:

[t]he facts, however, demonstrate that [patent holder] Amkor has not acted inconsistently with the alleged obligation. Despite an overture from Amkor, it was Carsem that evidences no interest in pursuing a licensing arrangement with respect to the ‘277 patent. Putting this in terms of contemporary discussions about patent rights and competition, the facts suggest a case of hold-out by the potential licensee rather than one of hold-up by the patent holder.¹⁶⁵

Finally, the three Commissioners emphasized the need to follow procedures in addressing the RAND defense issues,

164. *Id.*

165. *Id.*

though they did not state what exactly that will be (presumably awaiting a case to present the issues in a contested, concrete manner), stating:

in a Section 337 investigation, the Commission is required to make several different types of determinations. In its analysis of whether there is a violation, the Commission must, among other things, consider all legal and equitable defenses. In any analysis of remedy, the Commission must consider the statutory public interest factors. Undergirding all of this are vital procedures that safeguard due process rights and prevent undue prejudice to any party and to the agency itself. These procedures enable each of the various determinations within the investigation to be as ground as possible in a consistent and adequately tested set of facts. They help ensure that all of the relevant facts and arguments are developed on the record in a timely manner and, where appropriate and practicable, in formal adjudication by the ALJ.¹⁶⁶

3. Settlement

Shortly after the Commission's decision, in May 2014, the parties petitioned the Commission to rescind the limited exclusion order based on a settlement that they entered under which the products were now licensed.

E. *InterDigital v. Nokia I* (Inv. No. 337-TA-868)

In February 2013, the ITC instituted an investigation based on InterDigital's complaint that products made by Nokia

166. *Id.*

and others infringed three patents¹⁶⁷ alleged to be essential to 3G or 4G LTE standards: *In the Matter of Certain Wireless Devices with 3G and/or 4G Capabilities and Components Thereof*, Inv. No. 337-TA-868.¹⁶⁸

Several months after this investigation was instituted, the USTR disavowed exclusionary relief in the *Samsung v. Apple* investigation and provided guidance on his expectations from the ITC in future cases dealing with standard essential patents. So, the parties and the ITC had an opportunity to consider early in this investigation the USTR's instructions in conducting discovery, hearing, and decision in this investigation.

1. Initial Determination

In June 2014, Judge Essex issued his Initial Determination and Recommended Determination on Remedy that found that the patents were not infringed, but would recommend exclusionary relief if a Section 337 violation were found.¹⁶⁹ Because he found no valid claim was infringed, "the patents are not essential to the 3G or 4G LTE standard and InterDigital's FRAND obligations are not triggered."¹⁷⁰ He further reviewed the FRAND defenses and found that InterDigital had not breached any standard setting obligation, but the accused infringers appeared to have committed patent hold-out.

Judge Essex considered the accused infringers' FRAND position that is based on InterDigital's participation in the European Telecommunication Standards Institute ("ETSI")—

167. U.S. Patent Nos. 7,941,151 ("the '151 Patent"); 7,190,966 ("the '966 Patent") and 7,286,847 ("the '847 Patent").

168. *Certain Wireless Devices With 3G And/Or 4G Capabilities and Components Thereof*, Inv. No. 337-TA-868, 78 Fed. Reg. 8191, Notice of Institution of Investigation (Feb. 5, 2013).

169. *Certain Wireless Devices With 3G And/Or 4G Capabilities and Components Thereof*, Inv. No. 337-TA-868, Initial Det. (June 13, 2014).

170. *Id.* at 108.

specifically the Telecommunications Industry Association (“TIA”) and International Telecommunication Union (“ITU”) subcommittees—giving rise to certain obligations under ETSI’s Intellectual Property Rights (“IPR”) Information Statement and Licensing Declaration under ETSI’s Rules of Procedure from Nov. 30, 2011. Judge Essex noted that these ETSI Rules of Procedure are not themselves a contract under the applicable French law, but rather an agreement in principal, guiding parties in their interactions with ETSI, other members, and third parties.¹⁷¹ He states that the IPR policy’s “first goal . . . is that the IPR owner be ‘adequately and fairly rewarded for the use of their IPRs in the implementation’ of the ETSI standards. Further, a patent owner agrees to license its IPR on FRAND terms only under certain conditions—e.g., the patent owner is “adequately and fairly rewarded” and the patent owner may require a licensee to reciprocate with a FRAND license on its patents covering the standard.¹⁷²

Under the ETSI Rules of Procedure, a patent owner must tell ETSI about patents that might become essential, but the patent owner need not declare or confirm that the patents actually are essential to the standard. Specifically referencing Judge Shaw’s decision in *Inv. No. 337-TA-800*,¹⁷³ Judge Essex notes that not all declared patents actually are essential to the standard, ETSI (like other SSOs) does not itself confirm whether or not a patent is essential to implementing a standard, and declared patents frequently are found not to be essential when challenged.

Judge Essex also considered ETSI Rules of Procedure on dealing with participants that refuse to grant licenses on

171. *Id.* at 108–23.

172. *Id.* at 110–11.

173. *Id.* at 111.

FRAND terms after a standard is published.¹⁷⁴ Those procedures (ETSI Rules of Procedure Section 8.2 Nov. 30, 2011) include alerting ETSI's Director-General who gathers information from the complainant and patent owner, ETSI seeking to change the standard to avoid the patent, and referral to the European Commission. But no accused infringer in this case made use of those procedures.¹⁷⁵ If the accused infringers believed InterDigital violated ETSI's policy, they could have approached ETSI to determine whether there was such a breach and "[i]t would be helpful to this ALJ, and the ITC, if we knew InterDigital had breached its duty to ETSI."¹⁷⁶ Rather, nothing in the ETSI Rules of Procedure prevent a patent owner from using legal means to pressure other parties into negotiations. Further, ETSI does not define FRAND terms and "a FRAND rate is a range of possible values, depending on a number of economic factors."¹⁷⁷

Judge Essex not only faulted the accused infringers for not following the ETSI procedures, but expressed concern that they had demonstrated "patent hold-out" behavior "which is as unsettling to a fair solution as any patent hold up might be,"¹⁷⁸ where the accused infringer starts using the patented technology before getting a license, delays negotiating a license, and then forces the patent owner into litigation where the accused infringer believes its worst case at the end of the day is paying the FRAND royalty it should have been paying all along.¹⁷⁹ Judge Essex ruled that a licensee violates the ETSI IPR rules if it uses the patented technology prior to negotiating a license, because the requirement to negotiate rests on not only the patent owner, but on the standard implementer as well. The accused

174. *Id.* at 112–13.

175. *Id.*

176. *Id.* at 113.

177. *Id.*

178. *Id.* at 114.

179. *Id.* at 113–15.

infringers appear to “pull the words ‘Fair Reasonable and Non-discriminatory’ from the ETSI IPR Rules . . . but have shown no interest in the rules of procedure for settling conflicts, or for obtaining licenses.”¹⁸⁰ For example, the ETSI Rules include a section “4.3 Dispute Resolution” that includes seeking mediation from other ETSI members and, if no agreement, “the national courts of law have the sole authority to resolve IPR disputes.”¹⁸¹ But in this case the accused infringers did not report InterDigital to ETSI or seek a license. Thus, InterDigital had not violated any duty under the ETSI policy and properly had resorted to the laws of the national courts to resolve the dispute.

The accused infringers also failed to show that InterDigital did not negotiate in good faith. Judge Essex discussed the different incentives the parties have in negotiating a FRAND rate. InterDigital solely derives revenue from licensing its patents and may be inclined to grant FRAND licenses because they “allow[] for a profit”; in contrast, respondents benefit from holding out licensing discussions because, with each passing day, “Respondents [accused infringers] have not had to pay anything for a license they were by ETSI policy to obtain prior to adopting the potentially infringing technology.”¹⁸² Acknowledging that the threat of an exclusion order may move a license royalty “in the upper direction on the FRAND scale,” Judge Essex notes “there are hundreds of other economic factors that go into the parties finding a royalty or flat amount both can agree on.”¹⁸³

Judge Essex reviewed the substance of the parties’ negotiations (heavily redacted in the public version) and concludes that, rather than negotiate for a license, “the respondents have attempted to put pressure on InterDigital by using IPR without

180. *Id.* at 116.

181. *Id.*

182. *Id.* at 117.

183. *Id.* at 118.

a license.”¹⁸⁴ Summarizing his findings, ALJ Essex found that InterDigital’s FRAND duty had not been triggered:

The obligation that InterDigital has taken has been fulfilled, and the ETSI agreement anticipates that the parties if necessary will fall back on the national law involved. The Respondents have not taken the steps provided by ETSI to address a failure to license, and so have not done what they ought to do if they believe InterDigital has failed to negotiate in good faith. Finally, they have not followed the ETSI process for procuring a license, and have engaged in holdup by making the products that are alleged to infringe before taking a license. Under these facts there is no FRAND duty.¹⁸⁵

Judge Essex concluded his FRAND analysis by rejecting arguments against exclusion orders for SEPs, which arguments were made by the U.S. Federal Trade Commission (“FTC”) and U.S. Patent & Trademark Office (“PTO”)/U.S. Department of Justice (“DOJ”). The FTC and PTO/DOJ essentially argued that FRAND license negotiations are tainted by the threat of an exclusion order, which creates the risk of patent hold-up that allows the patent owner to secure an excessively high royalty rate on standard-essential patents. But Judge Essex found no evidence that InterDigital had been negotiating in bad faith; rather, “it is the respondents that have taken advantage of the complainant and manufactured, marketed, and profited on goods without taking a license to the IP at issue.”¹⁸⁶ Judge Essex further acknowledged the “hypothetical risk of holdup” in similar situations, but “we have evidence that it is not a threat in this case,

184. *Id.* at 122.

185. *Id.* at 123.

186. *Id.*

or in this industry.”¹⁸⁷ Judge Essex cites standard setting organization TIA’s statement to the FTC that “TIA has never received any complaints regarding such ‘patent hold-up’ and does not agree that ‘patent hold-up’ is plaguing the information and telecommunications technology standard development process.”¹⁸⁸ Judge Essex rejected the accused infringers’ argument that limited exclusion orders should be removed *per se* as a remedy from cases involving FRAND encumbered patents, stating that doing so based on “speculative and unproven position[s] held by other government agency” without specific evidence and findings in each particular case would violate the ITC’s statutory duty and “violate every concept of justice we are tasked to enforce.”¹⁸⁹

Finally, Judge Essex found the accused infringers’ remaining affirmative defenses—equitable estoppel, unclean hands, and patent misuse—to be “moot” given his finding that “Respondents do not infringe a valid patent and that InterDigital’s FRAND obligations are not triggered.”¹⁹⁰

2. Recommendation on Remedy

Judge Essex stated that the Commission authorized him to take evidence and make findings as to the public interest if a Section 337 violation existed and exclusionary relief were entered.¹⁹¹ Judge Essex stated that the threat of an exclusion order may lead to the accused infringers taking a license at a higher rate, but “there has been no proof that such a license would be unfair unreasonable or discriminatory.”¹⁹² Further, Judge Essex expressed concern that the accused infringers failed to

187. *Id.*

188. *Id.* at 124.

189. *Id.* at 126.

190. *Id.*

191. *Id.* at 173 (citing 77 Fed. Reg. 65713 (Oct. 30, 2012)).

192. *Id.* at 175.

acknowledge that the ETSI agreement permits a patent owner to access the national courts and that the accused infringers failed to take steps to adequately compensate the patent owner while using the patented technology:

Respondents ignore the ETSI agreement, paragraph 4.3, that allows a party to use the national courts in a dispute, and states they are willing to take a license. They do not say they will do so as required by the ETSI agreement, that is, to fairly and adequately compensate the IPR owner. While Respondents state a willingness to take a license, they have yet to do so, and are manufacturing handsets in violation of the ETSI agreement. It appears rather than follow the rules of ETSI, Respondents have pulled from the agreement five words, and has fashioned from them a sword to strike down legal remedies and to hold their own duties at bay as long as possible. It makes good business sense, for as long as they hold out, they get the IPR for free, and in the end, they are counting on getting it at either no cost if they prevail in validity or infringement, or the price of a FRAND, the price they would have paid if they had followed the agreement in the first place. The Respondents ignore the other provisions in the ETSI agreement [those duties on their side], and attempt to make it a contract of adhesion, sticking to the IPR owners to their disadvantage, freeing up the potential infringers by controlling their risks. It is not in the public interest to support this.¹⁹³

193. *Id.* at 176–77.

Judge Essex also faulted the accused infringers for not following the procedure in the ETSI agreement where a party dissatisfied in trying to get a RAND license should notify ETSI “so it can mediate the issue.”¹⁹⁴

Based on the foregoing and other factors, such as available alternatives to the excluded products, Judge Essex concluded that the public interest does not support using FRAND to deny an exclusion order and recommended limited exclusionary relief if a Section 337 violation exists in this case.¹⁹⁵

3. Commission Review

In August 2014, the full Commission issued a decision finding no violation based on no infringement and terminated the investigation without reviewing the FRAND issues presented.¹⁹⁶ The Commission decided not to address FRAND and other issues for efficiency reasons given the pending Federal Circuit appeal from the related 337 Investigation No. 800 involving some of the same parties and issues on related patents.¹⁹⁷

F. *GPH v. Toshiba* (Inv. No. 337-TA-884)

In June 2013, the ITC instituted an investigation based on Graphics Properties Holdings, Inc.’s (“GPH”) complaint that products made by Toshiba and others infringed three patents alleged to be essential to the Open Graphics Library

194. *Id.* at 177.

195. *Id.* at 180–81.

196. Certain Wireless Devices With 3G And/Or 4G Capabilities and Components Thereof, Inv. No. 337-TA-868, Comm’n Op. at 13 (Aug. 28, 2014).

197. *Id.* at 13–14.

("OpenGL") standard: *In the Matter of Certain Consumer Electronics with Display and Processing Capabilities*, Inv. No. 337-TA-884.¹⁹⁸

The patents and technology generally relate to devices that use processors for specialized graphics operations and instruction handling in central processing units. A few months after the investigation was instituted, the USTR disavowed exclusionary relief in the *Samsung v. Apple* investigation.

1. Initial Determination

In September 2014, Judge E. James Gildea issued his Initial Determination and Recommended Determination on Remedy and Bond that found that two of three patents were infringed.¹⁹⁹ He rejected Toshiba's claims that GPH had committed to license the patents royalty free or on RAND terms.

Toshiba argued that GPH (operating as SGI at the time) made licensing commitments when it was participating in standards committees related to OpenGL. Toshiba argued that GPH, thus, was equitably estopped from seeking exclusionary relief:

Toshiba says the doctrine of equitable estoppel precludes patent enforcement where (1) a patentee has engaged in conduct that leads another to reasonably infer the patent will not be asserted, (2) the other relies on the misleading conduct, and (3) the reliance would cause material prejudice if assertion were permitted.

According to Toshiba, long before GPH's bankruptcy, GPH, as SGI, made a promise to license the

198. *Certain Consumer Electronics with Display and Processing Capabilities*, Inv. No. 337-TA-884, 78 Fed. Reg. 38072-3, Notice of Institution of Investigation (June 25, 2013).

199. *Certain Consumer Electronics with Display and Processing Capabilities*, Inv. No. 337-TA-613, Initial Det. (Aug. 29, 2014).

asserted patents on RAND terms. Toshiba says it relied on this promise and have since been prejudiced by GPH's failure to adhere to that promise. Toshiba says GPH's business model has changed since it made the promise, but that does not dissolve its obligation to make an offer on RAND terms, something it admits it did not do before filing this investigation.²⁰⁰

Among other things, Toshiba relied on a submission by SGI regarding one of the patents that stated: "We believe this patent contains necessary IP for graphics systems implementing floating point (FP) rasterization and FP frame buffer capabilities. We will not grant the ARB [i.e., the OpenGL standard organization] royalty-free use of this IP for use in OpenGL, but we will discuss licensing on RAND terms."²⁰¹ And SGI made another submission on that patent that stated:

SGI's position is that this is extremely valuable IP. We have not been contemplating either royalty-free licenses, or blanket licenses to groups like Khronos or the ARB [i.e., both OpenGL standard organizations]. We're happy to discuss licensing on a company-to-company basis, of course.²⁰²

Toshiba argued that the standard organization then approved extensions to the OpenGL standard that incorporated GPH's patented technology.

Citing USTR Froman's disavowal of exclusionary relief in the *Samsung v. Apple* 794 Investigation, Toshiba argued that it would now be materially prejudiced if GPH were allowed to seek and obtain an exclusion order "because the pending threat of an exclusion order gives defendants inherent bargaining

200. *Id.* at 372-73.

201. *Id.* at 374.

202. *Id.*

power in any F/RAND licensing negotiation that may now take place.”²⁰³

In response, GPH argued that its statements to the OpenGL standard organizations “establishes that SGI [now GPH] committed to nothing more than a willingness to discuss licensing the ‘327 patent, including, but not limited to, licensing on RAND terms.”²⁰⁴ Because it opted out of the standard organization’s default license, GPH also argued that it had “recommended that OpenGL ARB not incorporate the technology claimed in the ‘327 patent as part of the OpenGL core standard” or that the technology be made “optional” in the standard.²⁰⁵ Further, the ‘158 patent-in-suit was a continuation of the ‘327 patent filed “after SGI/GPH had severed all ties with the relevant SSOs,” and the standard organizations’ agreements did not attach to patents filed after membership was terminated.²⁰⁶ GPH, therefore, argued that Toshiba’s equitable estoppel defense must be rejected because “Toshiba has failed to establish that GPH has engaged in conduct that could reasonably lead Toshiba to believe it was immune from suit.”²⁰⁷

Toshiba also raised a breach of contract defense. Toshiba argued that GPH breached its agreement with the OpenGL standards organizations “when it sued Toshiba before offering a RAND license,” and that Toshiba is a third-party beneficiary of that contract.²⁰⁸ But GPH “did not make any license offer, let alone one on RAND terms before filing this Investigation.”²⁰⁹ GPH argued that, not only has it not breached an agreement, but that “Toshiba well knows from communications between

203. *Id.* at 377.

204. *Id.* at 382.

205. *Id.* at 383–84.

206. *Id.* at 383, 385.

207. *Id.* at 385.

208. *Id.* at 378.

209. *Id.* at 380.

the parties and during the numerous settlement conferences in which the parties engaged, GPH has been ready and willing to discuss licensing terms with Toshiba from the very outset of this Investigation.”²¹⁰

Judge Gildea agreed with GPH on both the equitable estoppel and contract defenses, stating that “GPH amply demonstrate[s] that in fact GPH opted out of RAND and did not, legally or equitably, submit the ‘327 patent to the auspices of any SSO.”²¹¹ Judge Gildea further agreed that no obligation extended to the continuation application either since it “does not appear to have been . . . pending during the time GPH was a member” of the standards organization.²¹² He concluded that nothing precludes GPH from seeking exclusionary relief in this Investigation:

The Administrative Law Judge finds that the evidence with respect to either the ‘327 patent or the ‘158 patent does not show that any contractual relationship exists or existed between GPH and Toshiba, expressed or implied, first party or third party, that impinges on GPH’s right to seek the relief afforded under 19 U.S.C. § 1337 or under 25 U.S.C. § 271(d).²¹³

Toshiba further raised a patent misuse defense. Toshiba argued that GPH made representations to OpenGL standards organizations about willingness to license patents on RAND terms, those communications were misleading and, by breaching those representations, GPH “has wrongfully obtained and exercised monopoly power.”²¹⁴ Toshiba also argued that GPH

210. *Id.* at 387.

211. *Id.* at 390.

212. *Id.* at 391.

213. *Id.* at 392.

214. *Id.* at 380–81.

wrongfully required Toshiba to take a large bundled license of both essential and non-essential patents, and that “GPH is attempting to extract monopoly royalties reflecting the ‘hold-up’ value of avoiding endless litigation involving wave after wave of patents.”²¹⁵

Judge Gildea rejected this patent misuse defense, concluding that GPH made no commitment to license the patents on RAND terms and did not breach any commitment:

Staff says that, as previously, Toshiba has failed to present sufficient evidence to establish that GPH committed to licensing the ‘327 patent on RAND terms; rather, GPH instead stated that it was willing to consider a license on such terms.

The Administrative Law Judge agrees, as previously discussed, and finds that the evidence is devoid of any showing that GPH breached any commitment to any SSO with respect to RAND undertakings or representations.²¹⁶

He also found that “the evidence fails to reveal that GPH acted in bad faith and therefore any legal consequences that may or may not arise from bad faith conduct is irrelevant to the issues in this Investigation.”²¹⁷

Judge Gildea ultimately concluded that the asserted patents were infringed, valid, and enforceable such that there was a 337 violation.²¹⁸ He then considered the recommended remedy in light of the violation. He stated that “Respondents did not present any discussion of remedy in their initial post-hearing

215. *Id.* at 381–82.

216. *Id.* at 394.

217. *Id.* at 395.

218. *Id.* at 440–42.

brief” or on a cease and desist order and ruled that both a limited exclusion order and cease and desist order should be entered.²¹⁹

2. Commission Review

On November 30, 2014, the full Commission gave notice that it would grant partial review of Judge Gildea’s Initial determination.²²⁰ Among other things, “[t]he Commission has . . . determined to review the final ID’s finding that the ‘327 patent is not subject to RAND encumbrances.”²²¹ The Commission asked the parties to brief their positions on several issues, including the RAND issue:

13. Please discuss whether GPH incurred a RAND obligation as to the ‘327 and/or ‘158 patent by reason of GPH’s or SGI’s conduct (1) before any of the standards committees with which GPH or SGI was involved, or (2) in negotiations with potential licensees. In particular, please address: (1) the legal significance of SGI’s purported statement to the OpenGL Architecture Review Board and the Khronos Group Board of Promoters that, as to the ‘327 patent, it will discuss licensing on RAND terms; (2) whether the ‘327 patent is incorporated into an optional extension; (3) if the ‘327 patent is incorporated into an optional extension, is it considered part of the Ratified Specification; and (4) whether the asserted claims of the ‘327 and/or ‘158 patent are “Necessary Claims” or “Necessary Patent Claims.”

219. *Id.*, Recommendation on Remedy, at 1–3.

220. Certain Consumer Electronics with Display and Processing Capabilities, Inv. No. 337-TA-884, Comm’n Notice (Nov. 30, 2014).

221. *Id.* at 4.

14. Please discuss the course of conduct between Toshiba and GPH regarding negotiations on RAND licensing terms.

15. Please discuss whether GPH ever submitted an IP Disclosure Certificate in connection with its participation with Open GL standard under the Khronos Group Membership Agreement.²²²

A few months later, the parties jointly moved to terminate the investigation based on settlement.²²³ The Commission, accordingly, terminated the investigation without comment or decision on the RAND issues presented.²²⁴

G. *InterDigital v. Nokia II* (Inv. No. 337-TA-613)

In September 2007, the ITC instituted this investigation *In the Matter of Certain 3G Mobile Handsets and Components Thereof*, Investigation No. 337-TA-613, which concerns two patents (the '966 and '847 Patents at issue in the *InterDigital v. Nokia I*, Investigation No. 337-TA-868) alleged to cover the 3GPP Wideband Code Division Multiple Access ("WCDMA") standard and subject to declarations submitted by InterDigital to ETSI. The administrative law judge found that neither of the patents was infringed, which was affirmed by the full Commission in 2009. That decision was reversed by the Federal Circuit in 2012 based on a different claim construction and remanded back to the ITC for further proceedings.

In the interim, in 2013, the USTR issued his disavowal of exclusionary relief in the *Samsung v. Apple* (Inv. No. 337-TA-794)

222. *Id.* at 5–6.

223. Certain Consumer Electronics with Display and Processing Capabilities, Inv. No. 337-TA-884, Private Parties' Joint Motion for Termination of Investigation Based on Settlement (Feb. 4, 2015).

224. Certain Consumer Electronics with Display and Processing Capabilities, Inv. No. 337-TA-884, Comm'n Notice to Terminate (Feb. 4, 2015).

investigation and provided instructions to the ITC on what he expects in future investigations involving standard essential patents. Thus, in March 2014, the Commission remanded the investigation to the administrative law judge with instructions to make findings on, among other things, public interest factors, “whether the issue of the standard-essential nature of the patents-in-suit is contested,” and “whether there is patent hold-up or reverse hold-up in this investigation.”

1. Determination on Remand

In April 2015, Judge Theodore Essex provided his determination on remand.²²⁵ Judge Essex recommended exclusionary relief upon finding that Nokia’s smartphones infringed the alleged standard essential patents at issue. Judge Essex found that exclusionary relief would not violate the public interest in this case. Judge Essex determined that no evidence had been presented showing that the particular Nokia smartphones in question “provide any public health and safety benefit other smart phones cannot.”²²⁶ Thus, there was no evidence that a “shortage” of smart phones would ensue if an exclusion order issued.²²⁷

Judge Essex stated that the accused infringers did not address the statutory public interest factors, but instead argued “a new public interest for this case” based on the patent owner’s possible duty to grant licenses on FRAND terms and the possibility of patent hold-up.²²⁸ He ruled that the accused infringers have the burden to prove its defense, including the essentiality of the patents at issue, and they have this burden in both estab-

225. Certain 3G Mobile Handsets and Components Thereof, Inv. No. 337-TA-613, Det. on Remand (Apr. 27, 2015).

226. *Id.* at 31.

227. *Id.* at 30–31.

228. *Id.* at 30.

lishing an affirmative defense and in addressing the public interest inquiry. He rejected the notion of shifting the burden based solely on general policy arguments detached from the facts of the case and the specific FRAND commitment at issue:

[W]e must look at the patentee's actual FRAND commitment. We need not be stampeded into abandoning the rule of law, or burden of proof simply because the respondents shout "FRAND".²²⁹

He found that the accused infringers had not shown that the patents actually were essential to the standard, which showing must be made before InterDigital's FRAND obligation would arise based on the specific commitments at issue here. The accused infringers themselves argued throughout the proceedings that the patents were not infringed and, thus, not essential. Further, the declarations made to the standard setting body did not declare that the patents were essential to the standard, but provided only a commitment to license the patents on FRAND terms if they were essential to the standard and in many cases such patents are found not to be essential.²³⁰ And the mere finding that the patents were infringed did not establish that they were essential to the standard.

Judge Essex found that InterDigital did not act in bad faith in licensing negotiations and there was no evidence of patent hold-up in this case.²³¹ He noted that his prior decision in Inv. No. 337-TA-868 had found that the FRAND commitment to ETSI was not sufficiently definite to be a contract, but nonetheless considered there may be a contractual basis given the current trend in the courts to consider this a contractual issue. Under this approach, the patent owner's licensing offers must be

229. *Id.* at 40.

230. *Id.* at 36–37.

231. *Id.* at 40–42.

“in good faith” but their “initial offers do not have to be on RAND terms so long as a RAND license eventually issues.”²³² Whether a particular offer during negotiations is FRAND or not is not known until the parties themselves reach an agreement or the issue is determined by a court; at that time, a retrospective consideration using the FRAND determination as a measuring stick may indicate whether offers made during negotiations were within a FRAND range. In this case, however, the accused infringers failed to proffer what would constitute a FRAND rate, their witnesses could not identify a FRAND rate, and they testified that it could come in many forms.²³³

Judge Essex also found that InterDigital’s filing of the ITC complaint and pursuing exclusionary relief did not violate the FRAND commitment because they had been and continued to negotiate in good faith, there were many issues to be determined in a FRAND license negotiation beyond a royalty rate, and the ETSI policies at issue expressly contemplate that the patent owner can fall back on national law to resolve disputes in negotiating a FRAND license.²³⁴ Further, ETSI had removed mandatory arbitration provisions from its policies and expressly declined to prohibit injunctive remedies. Thus, again, the focus must be on the actual language of the commitment at issue. And he also noted that many government agencies and others have been scrutinizing standard essential patents recently such that patent hold-up is “unlikely because too many hostile eyes are watching.”²³⁵

Judge Essex also found that Nokia had engaged in patent hold-out and was the type of “unwilling licensee” that the USTR indicated could be subject to exclusionary relief.²³⁶ He reasoned

232. *Id.* at 42.

233. *Id.* at 44–45.

234. *Id.* at 49.

235. *Id.* at 62.

236. *Id.* at 54.

that while Nokia had not committed patent hold-out during the time period when the Initial Determination had found that the patents were not infringed, it did engage in patent hold-out following the Federal Circuit's decision on appeal to reverse the non-infringement finding and supporting claim construction. Following this reversal, the accused infringers were on notice that they infringed and should have sought a license at that time. There was no showing that the patent owner's license offers, which were not accepted, were not offered on FRAND terms and, as discussed, the accused infringers failed to present evidence of what FRAND terms actually would be. The accused infringers' failure to negotiate in a meaningful way and refusal "to take a license" while continuing to sell standard-compliant devices served as evidence of reverse hold-up.²³⁷

Judge Essex took an evidentiary-based approach to patent hold-up to balance the obligations that FRAND licensing places on both innovators and implementers. Judge Essex also concluded that the entry of an exclusion order would not violate InterDigital's offer to license on FRAND terms. If a patent holder breached its ongoing obligation to license on FRAND terms following the entry of an exclusion order, then a breach of contract action in federal district court may provide a viable remedy.

2. Commission Review

In June 2015, the Commission gave notice that it would review Judge Essex's determination. The Commission sought comment from the parties and the public on nine questions focusing on the FRAND issues presented:

4. Please state and explain your position on whether, for purposes of the Commission's consideration of the statutory public interest factors,

237. *Id.* at 52.

InterDigital has in effect asserted that the patents in question are FRAND-encumbered, standard-essential patents.

5. Please state and explain your position on whether InterDigital has offered Respondents licensing terms that reflect the value of its own patents.

6. What portion of the accused devices is allegedly covered by the asserted claims? Do the patents in question relate to relatively minor features of the accused devices?

7. Please state and explain your position on the legal significance of InterDigital's alleged willingness to accept an arbitral determination of FRAND terms with respect to the patents in question.

8. Please state and explain your position on the legal significance of InterDigital's alleged unwillingness to obtain a judicial determination of FRAND terms with respect to the patents in question.

9. Please state and explain your position on whether Respondents have shown themselves willing to take licenses to the patents in question on FRAND terms.

10. Do Respondents' alleged delaying tactics in negotiating with InterDigital provide sufficient evidence of reverse hold-up, regardless of Respondents' offers to license only InterDigital's U.S. patent portfolio?

11. Do Respondents' licensing counteroffers satisfy the requirements of the ETSI IPR Policy?

12. Please state and explain your position on whether the RID [i.e., ALJ Essex's final initial determination on remand] equates patent infringement and reverse hold-up.

The ITC received a number of responses to these questions, including submissions from individual commissioners of the U.S. Federal Trade Commission (FTC) who weighed in through the comment process, speaking for themselves individually and not on behalf of the FTC itself.

The FTC Chairwoman, Edith Ramirez, disagreed with Judge Essex's decision.²³⁸ She stated that standard essential patent owners should not be able to win a ban on imports of infringing products unless the infringer either cannot—or will not—license the patents on FRAND terms. In criticizing the patent hold-up analysis in Judge Essex's decision, Chairwoman Ramirez commented that the ITC should require a standard essential patent holder to prove that the implementer is unwilling or unable to take a FRAND license. She believed that placing the burden on the standard essential patent holder would better ensure that the patent owner followed through on its FRAND licensing commitment and that both parties would negotiate in good faith toward a workable resolution to FRAND issues. In meeting this burden, a standard essential patent owner could demonstrate an implementer's unwillingness to take a FRAND license by showing that the implementer engaged in a constructive refusal to negotiate a FRAND license or refused to pay what had been determined to be FRAND royalties.

238. Certain 3G Mobile Handsets and Components Thereof, Inv. No. 337-TA-613, Response to the Commission's Request for Briefing on Remedy, Bonding and the Public Interest (July 10, 2015).

But FTC Commissioners Ohlhausen and Wright departed substantially from Chairwoman Ramirez, commenting that the ITC should not begin its analysis of disputes involving standard essential patents by imposing on patent owners the burden of proving that accused infringers are unwilling or unable to take licenses on FRAND terms. Rather than assuming that patent hold-up is prevalent when considering whether to preclude an exclusion order on public interest grounds, the ITC should follow an evidence-based approach in line with the approach recommended in Judge Essex's decision. They found that the theory of patent hold-up is not supported by the empirical evidence, stating:

[t]he theory that patent holdup is prevalent predicts that the threat of injunction leads to higher prices, reduced output and lower rates of innovation. These are all testable implications. Contrary to these predictions, the empirical evidence is not consistent with the theory that patent holdup has resulted in a reduction of competition. To the contrary, wireless prices have dropped relative to the overall consumer price index (CPI) since 2005, output has grown exponentially, features and innovation continue at a rapid pace, and competition between mobile device manufacturers has been highly robust with meaningful entry over time.²³⁹

239. Certain 3G Mobile Handsets and Components Thereof, Inv. No. 337-TA-613, Reply Submission on the Public Interest of Federal Trade Commissioners Maureen K. Ohlhausen and Joshua D. Wright (July 20, 2015).

In August 2015, the full Commission issued its determination. The Commission found that Nokia did not infringe InterDigital's patents and did not address the FRAND issues presented.²⁴⁰

H. *Ericsson v. Apple* (Inv. No. 337-TA-953)

In early 2015, Ericsson filed complaints in the ITC as well as several different district courts asserting that Apple infringed Ericsson's patents covering many aspects of Apple's iPhones and iPads. The patents²⁴¹ include alleged standard essential patents related to the 2G and 4G/LTE standards, as well as other patents that relate to other features of Apple devices. In March 2015, the ITC instituted an investigation concerning the alleged standard essential patents: *In the Matter of Certain Wireless Standard Compliant Electronic Devices, Including Communication Devices and Tablet Computers*, Inv. No. 337-TA-953. The ITC expressly authorized the ALJ to take evidence, hear argument, and make findings of fact and recommendations on the statutory public interest factors.

Administrative Law Judge Dee Lord determined that Apple's fourth and sixth affirmative defenses filed in response to the Complaint did not constitute affirmative defenses to a violation of Section 337. In its fourth affirmative defense, Apple contended that the exclusion order and other relief sought by Ericsson did not fall within the public interest because Ericsson had engaged in abusive licensing practices. In its sixth defense, Apple alleged that Ericsson had broken its FRAND obligation by seeking excessive royalties and using the threat of an exclusion order to try and coerce Apple to accept its demands. Judge

240. Certain 3G Mobile Handsets and Components Thereof, Inv. No. 337-TA-613, Remand Det. Finding No Violation of Section 337; Termination of Investigation at 4 (August 28, 2015).

241. U.S. Patent Nos. 8,717,996; 8,660,270; 6,058,359; 6,301,556; 8,102,805; 8,607,130; 8,837,381 and 8,331,476.

Lord ordered the parties to show cause why Apple's fourth and sixth affirmative defenses should not be stricken from Apple's response.²⁴²

Although Apple conceded that its fourth affirmative defense should be stricken, which was more an argument on public interest rather than an affirmative defense, Apple asserted that its sixth affirmative defense should remain. Judge Lord disagreed, finding that Apple's sixth defense failed to plead the elements and supporting facts of an unenforceability defense based on equitable estoppel or waiver:

Apple simply labels its general FRAND allegations as equitable defenses without describing conduct that has been recognized by any court or the Commission as inequitable, much less as constituting an equitable defense to patent infringement. . . . [T]here may be public policy grounds for withholding certain remedies based on Apple's allegations, but that is a distinct issue to be addressed at the appropriate time in this Investigation.²⁴³

To put this ruling in context, below is the entirety of Apple's Sixth Affirmative Defense, which appear more conclusory and policy based rather than a succinct statement of the elements for equitable estoppel or waiver and supporting factual allegations:

242. Certain Wireless Standard Compliant Electronic Devices, Including Communication Devices and Tablet Computers, Inv. No. 337-TA-953, Order to Show Cause Why Apple's Fourth and Sixth Affirmative Defenses Should Not Be Stricken From Its Response, Order No. 15 (July 15, 2015).

243. Certain Wireless Standard Compliant Electronic Devices, Including Communication Devices and Tablet Computers, Inv. No. 337-TA-953, Order Striking Apple's Fourth and Sixth Affirmative Defenses, Order No. 20 at 7 (Aug. 7, 2015).

SIXTH AFFIRMATIVE DEFENSE

(Unenforceability, Equitable Estoppel, and Waiver Based on Standard-Setting Conduct)

33. Upon information and belief, and subject to the discovery of additional evidence, Complainant's [Ericsson's] claims are barred by the doctrines of equitable estoppel and waiver.

34. Ericsson made commitments to license each patent-in-suit on FRAND terms. Standard-setting organizations and their members, and suppliers of products that support standards, rely on such commitments—including Apple, which is a member of standard-setting organizations like ETSI and a supplier of products that support standards promulgated by ETSI and other organizations. For example, Apple develops and supplies products with the expectation and understanding that those entities making FRAND commitments will not seek to disrupt Apple's development and support efforts by using FRAND-committed patents to seek exclusionary remedies. By making FRAND commitments, patent holders waive such remedies, except in the exceptional circumstances where FRAND royalties are not available—including in district court.

35. Ericsson has broken its FRAND commitments and the rules of standard-setting, by seeking excessive royalties and then using the threat of an exclusion order to try to coerce Apple to accept Ericsson's abusive demands. Due to this conduct, Ericsson is equitably estopped from asserting its patents to obtain exclusionary remedies, and Ericsson has also waived its right to assert them in

this fashion. Ericsson's conduct renders the patents-in-suit unenforceable.²⁴⁴

In late 2015, the parties reached a settlement agreement and the investigation was stayed. The investigation ultimately was terminated several months later upon the parties submitting redacted settlement documents.²⁴⁵

I. *Cisco v. Arista* (Inv. No. 337-TA-944)—*De Facto* Standard

In December 2014, Cisco Systems, Inc. ("Cisco") filed a complaint alleging that certain network devices (switches) imported by Arista Networks, Inc. ("Arista") infringed several Cisco patents directed to computer networks. In January 2016, the ITC instituted an investigation concerning the alleged patent infringement: *In the Matter of Certain Network Devices, Related Software and Components Thereof*, Inv. No. 337-TA-944.²⁴⁶ Arista raised several equitable defenses based, in part, on allegations that Cisco had submitted a request for comments document RFC 5517 to the Internet Engineering Task Force ("IETF") and promoted RFC 5517 to the public generally as an "informal standard" for private virtual local area networks ("PVLANS") for which Cisco would not assert its patents or would license on fair, reasonable and non-discriminatory ("FRAND") terms based on Cisco's IPR disclosures to IETF.

244. Certain Wireless Standard Compliant Electronic Devices, Including Communication Devices and Tablet Computers, Inv. No. 337-TA-953, Apples Response to Order to Show Cause at 45–46 (Apr. 30, 2015).

245. Certain Wireless Standard Compliant Electronic Devices, Including Communication Devices and Tablet Computers, Inv. No. 337-TA- 953, Order No. 48: Initial Determination Terminating Investigation Based On Settlement Agreement (May 5, 2016).

246. 80 Fed. Reg. 4314 (Jan. 27, 2015).

1. Initial Determination

In March 2016, Judge Shaw issues his Initial Determination that found that Cisco's patents were infringed and rejected Arista's *de facto* standard defenses, which were based on the equitable theories of equitable estoppel, implied license, waiver, patent misuse, and laches.²⁴⁷

Judge Shaw ruled that the equitable estoppel argument required Arista to "prove by a preponderance of the evidence that (1) Cisco, through misleading conduct, led Arista to reasonably believe that Cisco did not intend to enforce its patents against Arista; (2) Arista relied on that conduct; and (3) due to its reliance, Arista would be materially prejudiced if Cisco were permitted to proceed with its charge of infringement."²⁴⁸ Judge Shaw found that, in generally considering estoppel, there was no misleading conduct by Cisco, because Cisco had taken affirmative steps to assert its patents against others after learning of infringing activities and, in this case, Cisco sued Arista about seven months after learning of Arista's infringement. Judge Shaw also found that Cisco's actions had not led Arista to believe that Cisco would not asserts its patents, stating:

the evidence fails to establish that encouraging adoption of a product in the industry creates any licensing obligation for patents related to that product. Evidence . . . shows that RFC 5517 is not a standard and was never submitted to any standard setting organization for adoption. Specifically, each published version of RFC 5517 states that it is an informational submission and not standards-track. Moreover, Cisco's intellectual property rights disclosure related to RFC 5517 states that a

247. Certain Network Devices, Related Software and Components Thereof, No. 337-TA-944, Initial Det. (Mar. 2, 2016).

248. *Id.* at 263.

license would be required to practice any related patents unless (1) the technology were adopted as an IETF standard, and (2) the patents were necessary to the adoption of the standard. Inasmuch as neither of these conditions were satisfied, Arista could not reasonably believe based on RFC 5517 that Cisco intended to refrain from enforcing its intellectual property rights.²⁴⁹

Judge Shaw also found there was no reasonable reliance by Arista to support an equitable estoppel defense. The basis for his finding is heavily redacted so the details of his finding are not publicly available, but he ultimately concluded that there “was no express or implied communication or relationship between Cisco and Arista that could have led Arista into a false sense of security, and any reliance under the circumstances would be unreasonable.”²⁵⁰

Judge Shaw further found that Arista had not shown prejudice based on a “change of economic position.” Arista argued that it had made substantial investments in the products and developed a substantial use base. But Judge Shaw found there was no evidence that “Arista would have taken different actions had it known about Cisco’s patents, such as decreasing its expenditures with respect to developing the accused products.”²⁵¹

Judge Shaw rejected Arista’s implied license defense. He explained that the main difference between implied license and equitable estoppel is that “implied license looks for an affirmative grant of consent or permission to make, use, or sell: i.e., a license.”²⁵² So Arista was required to show that “Cisco engaged

249. *Id.* at 265.

250. *Id.* at 266–67.

251. *Id.* at 267.

252. *Id.* at 268.

in language or conduct allowing Arista to properly infer that Cisco consented to the use of Cisco's patents, and that Arista acted upon that consent."²⁵³ But Judge Shaw found that Arista made no such showing, as discussed for the equitable estoppel defense.

For similar reasons, Judge Shaw rejected Arista's waiver defense, which is the "intentional relinquishment or abandonment of a known right."²⁵⁴ Judge Shaw explained the waiver defense in the standards setting context as follows:

To support a finding of implied waiver in the standard setting organization context, the accused must show by clear and convincing evidence that [the patentee's] conduct was so inconsistent with an intent to enforce its rights as to induce a reasonable belief that such right has been relinquished. This can be shown by proving that the patentee breached a duty of disclosure to the standard setting organization.²⁵⁵

In this case, Cisco's IPR disclosure "explicitly states that a licensing obligation arose only if the technology were adopted as a standard, which never occurred."²⁵⁶ Thus, "[a]ny reliance Arista placed on the assumption that PVLAN technology was an industry standard subject to SSO obligations was not reasonable."²⁵⁷

Judge Shaw rejected Arista's patent misuse argument, which requires a showing that the patent owner "impermissibly broaden[ed] the physical or temporal scope of the patent grant

253. *Id.*

254. *Id.*

255. *Id.* (citing *Hynix Semiconductor Inc. v. Rambus, Inc.*, 645 F.3d 1336, 1348 (Fed. Cir. 2011)).

256. *Id.* at 269.

257. *Id.*

and has done so in a manner that has anticompetitive effects.”²⁵⁸ Arista argued that Cisco had done so here “by asserting its patents against Arista without offering” a FRAND license.²⁵⁹ But Judge Shaw found that the evidentiary record shows that “Cisco has no obligation to license its patent on FRAND terms, because it made no such contractual undertaking.”²⁶⁰

Judge Shaw rejected Arista’s laches defense, which required Arista to prove that: “(1) Cisco delayed in bringing an infringement lawsuit for an ‘unreasonable and inexcusable’ length of time from when it knew or reasonably should have known of its infringement claim against the accused infringer [Arista]; and (2) the delay caused ‘material prejudice’ to the defendant [Arista].”²⁶¹ A six year delay raises a presumption of laches, which can be rebutted by showing that the delay was reasonable or the defendant was not prejudiced. The delay period starts when the patent owner has actual or constructive knowledge of the defendant’s infringement. In this case, Cisco sued Arista within seven months of learning of the infringement. Further, as with equitable estoppel, Arista had not shown material prejudice to it by any delay by Cisco.

2. Commission Review

In April 2016, the full Commission decided to review Judge Shaw’s Initial Determination and requested that the parties provide comments on several areas, including those concerning Arista’s *de facto* standard defenses:

10. Please discuss whether the “materially prejudiced” requirement has been satisfied here for purposes of laches and equitable estoppel. . . .

258. *Id.*

259. *Id.*

260. *Id.*

261. *Id.* at 270.

16. With respect to the public interest factors, please discuss the facts in the record pertaining to the following: (1) whether RFC 5517 is a *de facto* industry standard; (2) whether the '592 and '145 patents are essential to an industry standard; (3) whether licensing obligations apply to RFC 5517; (4) whether Cisco complied with any licensing obligations with respect to an industry standard; and (5) whether patent hold-up and/or patent hold-out have been demonstrated in the record of this investigation. Provided an analysis as to how these issues relate to the statutory public interest factors of Section 337(d) and (f), 19 U.S.C. § 1337(d)(f).

17. For purposes of the analysis of the statutory public interest factors, describe in detail the specific course of conduct on the part of Cisco, or other factors, that would support a finding that F/RAND commitments have arisen with respect to the '592 and '145 patents here. How does the RFC 5517 document factor into the analysis since it specifically states that what is described with respect to the '592 and '145 patents is not a standard? Arista argues that Cisco "never offered Arista a chance to license this *de facto* standard used by Cisco's other networking competitors." Describe in detail any attempts that Arista made to license the '591 and '145 patents from Cisco. Please describe Cisco's response to these attempts.²⁶²

262. Certain Network Devices, Related Software and Components Thereof, Inv. No. 337-TA-944, Comm'n Op. at 4-5 (July 26, 2016).

The Commission reviewed Arista's *de facto* standard defenses under its public interest analysis—i.e., whether the public interest precludes granting exclusionary relief—which *de facto* standard defense was the only public interest that Arista raised. Arista admitted that RFC 5517 “is not a *de jure* standard,” but argued that Cisco's actions regarding RFC 5517 “should be found to be a *de facto* standard and that the PVLAN patents are essential.”²⁶³

The Commission noted Cisco testimony indicating that “the intent of RFC 5517 was not to have others adopt PVLAN, but if they did, that they could see how the technology should behave.”²⁶⁴ Further, although Cisco's competitors have PVLAN functionality, there is “no evidence that they adopted or relied on RFC 5517 or the PVLAN patents” and competitors “are not required to practice the PVLAN patents or RFC 5517 because they are not part of a formal standard.”²⁶⁵ Thus, “[t]he mere fact that others in the industry offer PVLAN functionality, without more, does not demonstrate that they practice RFC 5517, the PVLAN patents, or that PVLAN is a *de facto* standard.”²⁶⁶ RFC 5517 is not a *de facto* standard “without further action by Cisco to encourage others to adopt RFC 5517 or evidence that the industry has adopted RFC 5517 as a standard.”²⁶⁷

The Commission also found that there was no evidence that patent hold-up has occurred or “is likely to occur,” stating:

[i]n particular, there is nothing on the record demonstrating the existence of an industry standard or that Cisco has an obligation to offer licenses

263. *Id.* at 58–59.

264. *Id.* at 59.

265. *Id.*

266. *Id.*

267. *Id.*

with respect to the PVLAN patents on a fair, reasonable and non-discriminatory basis. Consequently, there are no public interest concerns barring the issuance of a remedy in this investigation.²⁶⁸

V. LESSONS LEARNED FROM STANDARD ESSENTIAL PATENT INVESTIGATIONS

The ITC investigations involving standard essential patents have shown that the Commission is dedicated to following and staying within its statutory mandate and providing timely decisions based on the specific facts and evidence presented. In managing investigations, parties are better served addressing specific facts, evidence, and arguments rather than putting too much weight on vague policy issues concerning standard essential patents. To that end, below are some lessons learned that litigants should consider in presenting their standard essential patent case to the ITC.

First and foremost, the parties should focus on the specific terms of the standard setting obligation at issue. This includes not only whatever intellectual property rights (IPR) policies a standard setting organization (SSO) had applicable to the patents at issue, but the terms of the specific declaration or letter of assurance that the patent owner submitted to the SSO giving rise to a standard-setting obligation. For example, the ITC has given weight to the language of the IPR policy adopted by an SSO, including procedures a licensee can take if a dispute arises in seeking a FRAND-obligated license and the SSO's recognition that parties may seek recourse to national courts to resolve disputes. The ITC's focus on the language of the IPR policy includes what that IPR policy did not include, such as giving

268. *Id.* at 60.

weight to the SSO's decision not to require mandatory arbitration or not to expressly preclude injunctive relief in the terms of the IPR policy. Further, the ITC has focused on the terms of the patent owners' actual commitment to the SSO, such as language indicating that a license would be offered on FRAND terms if a patent is found to be essential to the standard, rather than offering FRAND terms regardless of whether the patent is essential to the standard. The ITC, therefore, has required the accused infringer to establish that the patent is essential to the standard before it can establish that a FRAND obligation exists in order to be breached by the patent owner in the first instance. The ITC's focus on the actual commitment at issue even requires proof of how that obligation would be interpreted under applicable law where the agreement stated that it is to be construed under the laws of a particular country.

Second, a party seeking to raise FRAND defenses should timely plead detail affirmative defenses in their response to the complaint. The pleading should set forth the elements of the cause of action and facts specific to the instant case that support the cause of action. For example, a general pleading that exclusionary relief should be precluded because of a FRAND commitment may be rejected under the view that there is no *per se* prohibition against seeking exclusionary relief in the ITC merely because an alleged standard essential patent is subject to a FRAND commitment. Rather, the response should state a specific, recognized defense and its elements, such as pleading breach of a contract between the patent owner and standard setting organization in which the alleged infringer is a third-party beneficiary, and provide facts supporting that allegation. The ITC has indicated that such a contract theory may be pursued if supported by underlying facts and indication of the specific factual obligation—e.g., is it an agreement to agree where the patent owner should negotiate in good faith toward a FRAND license. In contrast, the ITC has rejected FRAND-based equitable

defenses where the accused infringer relied on general arguments without pleading specific elements and supporting facts to establish the defense, such as pleading facts showing that the accused infringer relied on the specific FRAND commitment that a patent owner made to an SSO to support an equitable estoppel defense.

Third, a party seeking to raise FRAND defenses should consider providing arguments and evidence of what would constitute a FRAND royalty rate or range of FRAND royalty rates, which can then be used as a measuring stick in showing whether a patent owner's offer in licensing negotiations was made in good faith and consistent with the FRAND obligation. The parties also may consider submitting evidence of the custom and practice in the industry in licensing standard essential patents, such as common terms, portfolio licensing, etc. The parties also should consider negotiations beyond the initial offers, because the ITC has indicated that the FRAND commitment does not necessarily require the initial offer to be FRAND and the course of negotiations may be relevant as to whether either party has been negotiating in good faith toward an ultimate FRAND license. Otherwise, the ITC has put little weight in allegations that an offer was not FRAND where a party has not provided an indication of what would be a FRAND offer in the particular circumstances at issue. Further, the ITC may not put any weight in a bare argument that the patent holder committed patent hold-up and used the threat of exclusionary relief to leverage a high royalty outside of FRAND where there is no specific facts and evidence supporting that assertion tied to that particular case.

Fourth, arguments and evidence of the FRAND commitment most likely will be focused at the outset on the pled affirmative defenses regarding whether there is liability and a Section 337 violation. The parties should consider focusing their plead-

ings, evidence, and arguments toward the ITC's statutory requirements rather than broad policy issues. The ITC appears to be trending toward, at the time an investigation is instituted, authorizing the administrative law judges to also consider facts and evidence and to make determinations on the public interest inquiry as to whether exclusionary relief would have an adverse effect on the public interest. So far that inquiry has generally overlapped the evidence and arguments presented in the FRAND affirmative defense, though there may be some room for further arguments and facts on the public interest that may go beyond the specifically pled elements of the affirmative defense. In considering relevant facts and evidence, the parties may want to consider specific FRAND-related questions that the Commission has sought comments on in recent litigations. But parties also may expect that, even though the Commission may seek information on FRAND-based issues, it may not ultimately address those issues if the investigation can be resolved on other grounds, such as non-infringement that precludes a finding of a Section 337 violation in the first instance.

VI. CONCLUSION

Although standard essential patents with standard-setting commitments have been around for decades, we have seen a recent uptick in these patents being litigated in district courts and the ITC. The USTR's disavowal of exclusionary relief in *Inv. No. 337-TA-794* for a FRAND-committed standard essential patents a couple years ago has led to significantly more attention on how to litigate such patents in the ITC. ITC investigations since that time have provided guidance on the detailed pleading, facts, evidence, and arguments required to address FRAND-based defenses. Although several administrative law judges have provided guidance on these issues, the full Commission itself has yet to provide a review of those decisions to

provide the Commission's view on litigating FRAND-based defenses. So we continue to await such a decision from the Commission as well as how the USTR may react to it if exclusionary relief is granted.

A CLEAR AND PRESENT DANGER: MITIGATING THE DATA SECURITY RISK VENDORS POSE TO BUSINESSES

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“It is abundantly clear that, in many respects, a firm’s level of cybersecurity is only as good as the cybersecurity of its vendors.”

-Benjamin Lawsky, New York State Department of Financial Services Superintendent, Oct. 21, 2014.¹

Target. Home Depot. T-Mobile. What do these high-profile data breaches have in common? They were all vendor² breaches. That is, a third-party service provider served as the vehicle to these organizations’ customer data. Vendors are consistently cited as a primary cause of data breaches, and third-

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1. Letter from Benjamin Lawsky, Former Superintendent of the N.Y. State Dep’t of Fin. Servs., to N.Y. Banks on Cybersecurity (October 21, 2014).

2. As used herein, the term “vendor” shall broadly mean any third party with which an organization has an existing or potential business relationship, recognizing that the typical vendor relationship involves the outsourcing of some function or service to another organization.

party involvement remains the highest *per capita* contributor to the cost of a data breach.³

Just ask Target. Target reported that the hackers who ultimately stole 110 million customer records in 2013 initially broke into Target's system by using credentials lifted from an HVAC vendor.⁴ From this initial access point, the hackers were eventually able to upload their malicious software to Target's point-of-sale systems, and the rest, as they say, is history. Target has reported the cost of dealing with the data breach to total \$200 million to date, reflecting \$290 million of gross expense partially offset by an insurance receivable of \$90 million.⁵

The litany of household-name breaches, along with the evolving regulatory framework governing third-party relationships, emphasize the importance of including vendor management within your enterprise risk management program, and devoting sufficient resources toward combating the cyber risk vendors present to your organization. Simply stated, vendor relationships can no longer be left in the capable hands of Information Technology to manage alone. It has evolved into an enterprise risk, prompting legal, compliance, operational risk,

3. See PONEMON INSTITUTE, 2016 COST OF DATA BREACH STUDY: UNITED STATES, at 9 (2016); PONEMON INSTITUTE, 2015 COST OF DATA BREACH STUDY: UNITED STATES 10 (2015). Thirty-six percent of businesses surveyed by the Ponemon Institute in 2014 reported data breaches caused by third party errors, glitches, or misuse. PONEMON INSTITUTE, 2014 COST OF DATA BREACH STUDY: UNITED STATES 9 (2014).

4. Brian Krebs, *The Target Breach, By the Numbers*, KREBSONSECURITY (May 6, 2014, 12:24 EST), <http://krebsonsecurity.com/2014/05/the-target-breach-by-the-numbers/>; Brian Krebs, *Target Hackers Broke in Via HVAC Company*, KREBSONSECURITY (Feb. 5, 2014, 13:52 EST), <http://krebsonsecurity.com/2014/02/target-hackers-broke-in-via-hvac-company/>.

5. Target Corp., Quarterly Report (Form 10-Q), at 11 (November 25, 2015).

executive management, and other business segments to augment the risk management efforts aimed at third-party service providers.⁶

The risk vendors present to the security of an organization's sensitive data is two-fold: 1) the vendor itself could maintain the data (e.g., the medical transcription service that maintains a covered entity's patient records); or 2) the vendor does not maintain sensitive data, but could provide an access point to that data (e.g., the unidentified vendor whose stolen login credentials were used to gain perimeter access to Home Depot's systems),⁷ creating potential exposure of an entity's customer and employee personal information, financial and proprietary business information, and intellectual property. Benjamin Lawsky, the first superintendent of New York's Department of Financial Services, observed that "third-party firms can provide a backdoor entrance to hackers who are seeking to steal sensitive . . . customer data."⁸ This operational reality counsels in favor of extending vendor risk management to an organization's entire roster of vendors, contrary to the traditional model of only focusing on those vendors who specifically handle cus-

6. See, e.g., National Association of Insurance Commissioners, *Principles for Effective Cybersecurity: Insurance Regulatory Guidance* (2015), http://www.naic.org/documents/committees_ex_cybersecurity_tf_final_principles_for_cybersecurity_guidance.pdf ("Cybersecurity transcends the information technology department and must include all facets of an organization.").

7. The Home Depot, *The Home Depot Reports Findings in Data Breach Investigation* (Nov. 6, 2014), <http://ir.homedepot.com/news-releases/2014/11-06-2014-014517315>.

8. N.Y. State Dept. of Fin. Servs., *NYDFS Report Shows Need to Tighten Cyber Security at Banks' Third-Party Vendors* (April 9, 2015), <http://www.dfs.ny.gov/about/press/pr1504091.htm>.

tomers data. The New York State Department of Financial Services (NYDFS), for example, found that the majority of banks it surveyed performed security risk assessments of their high risk vendors, such as payment processors, but did not conduct the same level of oversight for those vendors categorized as low-risk, such as office suppliers and printing companies, or for professional service providers, such as legal counsel or independent consultants.⁹

Increased regulatory scrutiny in this area further compels a more comprehensive approach to vendor management. The Payment Card Industry Security Standards Council published new guidance on third-party service provider security in August of 2014. The Securities and Exchange Commission's (SEC) Office of Compliance Inspections and Examinations (OCIE) conducted a cybersecurity preparedness examination of more than 100 registered broker-dealers and investment advisors in 2014 that focused in part on third-party risk.¹⁰ This was followed by the OCIE's 2015 Cybersecurity Examination Initiative, which again places vendor management on the short list of topics to receive heightened scrutiny.¹¹ Most recently, on September 13, 2016, the NYDFS proposed new cybersecurity regulations that would obligate financial institutions to, among other things, implement and maintain a written cybersecurity policy that addresses a number of areas, including vendor and

9. N.Y. State Dept. of Fin. Servs., *Update on Cyber Security in the Banking Sector: Third Party Service Providers*, at 3 (2015), available at http://www.dfs.ny.gov/reportpub/dfs_rpt_tpvendor_042015.pdf.

10. UNITED STATES SECURITIES AND EXCHANGE COMMISSION OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS, *CYBERSECURITY EXAMINATION SWEEP SUMMARY*, at 1 (2015), available at <https://www.sec.gov/about/offices/ocie/cybersecurity-examination-sweep-summary.pdf>.

11. PCI SECURITY STANDARDS COUNCIL, *THIRD-PARTY SECURITY ASSURANCE* (2014), available at https://www.pcisecuritystandards.org/documents/PCI_DSS_V3.0_Third_Party_Security_Assurance.pdf.

third-party service provider management.¹² In an area of law that is rapidly evolving, and as businesses continue to increase the number and complexity of third-party relationships, organizations large and small would be well advised to get out in front of this issue.

The threat vendors pose to businesses is tangible. Fortunately, so are the steps a business can take to mitigate that threat. The key to vendor management—indeed any cybersecurity preparedness program—is deterrence; there is no guarantee that “doing everything right” will absolutely prevent a data breach, but implementing a comprehensive vendor management program is a formidable way to reduce the cyber risk vendor relationships introduce. This paper will examine how the law charges businesses with overseeing their vendors and how businesses are actually managing (or failing to manage) their vendors today, and it will provide practical guidance on how a business can reduce the cyber risk that vendors present.

CALL OF DUTY—WHAT IS REQUIRED OF BUSINESSES?

The exact vendor management practices that an organization must currently follow depend on the regulatory framework for that organization. Even in heavily regulated industries like financial services and healthcare, however, the law with respect to vendor management is not extensive—at least not yet. Most regulations come down in the form of general charges. The Federal Financial Institutions Examination Council’s (FFIEC) regulations implementing the Gramm-Leach-Bliley Act (GLBA) with respect to banks and other FFIEC-regulated financial institutions exemplify the three basic requirements and/or best practices that businesses should follow:

12. N.Y. State Dep’t of Fin. Servs, Proposed 23 NYCRR 500, § 500.03, available at <http://www.dfs.ny.gov/legal/regulations/proposed/rp500t.pdf>.

1. Exercise appropriate due diligence in selecting your service providers;
2. Require your service providers by contract to implement appropriate measures designed to meet the objectives of controlling regulatory guidelines and industry best practices; and
3. Where indicated by your risk assessment, monitor your service providers to confirm that they have satisfied their obligations¹³

These three pillars of vendor management—due diligence, contractual negotiation, and monitoring—are fleshed out below in the “battle plan” for businesses.

The legal obligations in other industries mirror the FFIEC guidelines. For example, the Health Insurance Portability and Accountability Act (HIPAA) provides that “a covered entity may permit a business associate [i.e., vendor] to create, receive, maintain, or transmit electronic protected health information on the covered entity’s behalf only if the covered entity obtains satisfactory assurances, in accordance with § 164.314(a), that the business associate will appropriately safeguard the information.”¹⁴ The U.S. Department of Health and Human Services has promulgated guidance on how to comply with this general charge, providing sample contractual language to be inserted in a covered entity’s contracts with its vendors who handle protected health information.¹⁵

13. Appendix B, Interagency Guidelines Establishing Information Security Standards, 12 C.F.R. § 570, § III(D) (2000).

14. Administrative safeguards, 45 C.F.R. § 164.308(a)(8)(b)(1).

15. U.S. Dep’t of Health & Human Servs., *Sample Business Associate Agreement Provisions* (2013), <http://www.hhs.gov/ocr/privacy/hipaa/understanding/coveredentities/contractprov.html>.

Similarly, the National Association of Insurance Commissioners (NAIC) Standards for Safeguarding Customer Information Model Regulation, adopted by 33 states and the District of Columbia, succinctly captures these general requirements, providing that all licensees shall “[e]xercise[] appropriate due diligence in selecting [their] service providers”; and “[r]equire[] [their] service providers to implement appropriate measures designed to meet the objectives of this regulation, and where indicated by the licensee’s risk assessment, take[] appropriate steps to confirm that [their] service providers have satisfied these obligations.”¹⁶ This sentiment is echoed in the NAIC’s Principles for Effective Cybersecurity: Insurance Regulatory Guidance. (Principle 8: “[T]ake appropriate steps to ensure that third parties and service providers have controls in place to protect personally identifiable information.”)¹⁷ The new proposed NAIC model regulation actually goes one step further, requiring not only that “licensee[s] shall contract only with third-party service providers that are capable of maintaining appropriate safeguards for personal information in the licensee’s possession, custody or control,” but also that “the licensee **shall be responsible** for any failure by such third-party service providers to protect personal information.”¹⁸

16. National Association of Insurance Commissioners, Standards for Safeguarding Customer Information Model Regulation, § 8 (2002), *available at* <http://www.naic.org/store/free/MDL-673.pdf>.

17. National Association of Insurance Commissioners, *Principles for Effective Cybersecurity: Insurance Regulatory Guidance* (2015), http://www.naic.org/documents/committees_ex_cybersecurity_tf_final_principles_for_cybersecurity_guidance.pdf.

18. National Association of Insurance Commissioners, Insurance Data Security Model Law, § 4(F) (2016), *available at* http://www.naic.org/documents/committees_ex_cybersecurity_tf_exposure_mod_draft_clean.pdf (emphasis added).

Non-banking and non-insurance financial institutions likely fall under the catch-all jurisdiction of the Federal Trade Commission (FTC). These financial institutions are subject to the FTC Safeguards Rule implementing the GLBA, which requires businesses to “select service providers that can maintain appropriate safeguards,” “make sure [the] contract requires them to maintain safeguards,” and “oversee their handling of customer information.”¹⁹ Non-financial institutions in less regulated spheres like retail are not subject to specific cybersecurity regulations, but any business engaged in interstate commerce would still be subject to the FTC’s jurisdiction under Section 5 of the FTC Act, which the agency has used to prosecute what it deems to be insufficient data security practices, including lack of proper oversight of vendors.²⁰ Such businesses would, therefore, be well-advised to comply with the FTC Safeguards Rule and corresponding guidance.

The National Institute of Standards and Technology’s Framework for Improving Critical Infrastructure Cybersecurity (NIST Framework), promulgated pursuant to an Executive Order of the White House in February 2014, also includes guideposts for vendor management, and is in fact explicitly intended to “provide[] a common language to communicate requirements among interdependent stakeholders,” including external

19. Federal Trade Commission, *Financial Institutions and Customer Information: Complying with the Safeguards Rule* (2006), <https://www.ftc.gov/tips-advice/business-center/guidance/financial-institutions-customer-information-complying>.

20. See, e.g., Complaint, Nations Title Agency, Inc., FTC File No. 052 3117, No. C-4161, at 4 (F.T.C. June 19, 2006), available at http://www.ftc.gov/sites/default/files/documents/cases/2006/06/0523117nationstitle_complaint.pdf.

service providers.²¹ The NIST Framework targets those organizations within critical infrastructure sectors, but provides a helpful roadmap for any business, advising that cybersecurity roles and responsibilities for third-party stakeholders be established and understood by those entities, and that all external service provider activity be monitored to detect potential cybersecurity events.²²

STATUS REPORT—WHAT ARE BUSINESSES DOING TODAY?

The problem is not that businesses aren't vetting their vendors at all or that they are completely failing to oversee their activities; the general consensus amongst regulators has been that businesses are not doing *enough*. For example, the NYDFS found that 95% of the banking organizations it surveyed conduct specific information security risk assessments of at least their high-risk vendors, and 95% also have information security requirements for third-party vendors.²³ However, that same survey found that fewer than half of the banks required an on-site assessment of their vendors, and 30% did not require their vendors to notify them in the event of a cybersecurity breach.²⁴ In its examination of fifty-seven registered broker-dealers and forty-nine registered investment advisers, the SEC's OCIE reported similar deficiencies in the area of vendor management in 2015, finding, for example, that only 51% of broker-dealers and

21. NATIONAL INSTITUTE OF STANDARDS AND TECHNOLOGY, FRAMEWORK FOR IMPROVING CRITICAL INFRASTRUCTURE CYBERSECURITY, at § 3.3, available at <http://www.nist.gov/cyberframework/upload/cybersecurity-framework-021214.pdf>.

22. *Id.* at DE.CM-6, ID.AM-6, PR.AT-3.

23. N.Y. State Dept. of Fin. Servs., *Update on Cyber Security in the Banking Sector: Third Party Service Providers*, at 2–3 (2015), available at http://www.dfs.ny.gov/reportpub/dfs_rpt_tpvendor_042015.pdf.

24. *Id.* at 3, 5.

13% of advisers maintain policies and procedures related to information security training for vendors authorized to access their networks.²⁵ If organizations in highly regulated sectors are falling short when it comes to vendor management, you can imagine how less regulated organizations may stack up.

In its seminal guidance on this issue, useful for businesses in any industry, the Office of the Comptroller of the Currency (OCC) has observed:

[t]he OCC is concerned that the quality of risk management over third-party relationships may not be keeping pace with the level of risk and complexity of these relationships. The OCC has identified instances in which bank management has:

- failed to properly assess and understand the risks and direct and indirect costs involved in third-party relationships.
- failed to perform adequate due diligence and ongoing monitoring of third-party relationships.
- entered into contracts without assessing the adequacy of a third party's risk management practices.
- entered into contracts that incentivize a third party to take risks that are detrimental to the bank or its customers, in order to maximize the third party's revenues.

25. UNITED STATES SECURITIES AND EXCHANGE COMMISSION OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS, CYBERSECURITY EXAMINATION SWEEP SUMMARY, at 4 (2015), *available at* <https://www.sec.gov/about/of-fices/ocie/cybersecurity-examination-sweep-summary.pdf>.

- engaged in informal third-party relationships without contracts in place.²⁶

All organizations need a comprehensive vendor management program to address the foregoing ubiquitous concepts. However, regulators also recognize that vendor management cannot follow a one-size-fits-all blueprint. For example, the OCC has advised that “[a] bank should adopt risk management processes commensurate with the level of risk and complexity of its third-party relationships.”²⁷ The FTC, which espouses a similar view,²⁸ maintains that its requirements “are designed to be flexible[;] [c]ompanies should implement safeguards appropriate to their own circumstances.”²⁹

So what should you do?

BATTLE PLAN—WHAT SHOULD BUSINESSES DO?

Regardless of the specific legal requirements—or lack thereof—facing your particular business, effective vendor management should be considered a best practice no matter your industry. In the words of the FTC, “safeguarding customer information isn’t just the law. It also makes good business sense.”³⁰

26. OFFICE OF THE COMPTROLLER OF THE CURRENCY, OCC BULLETIN 2013-29, available at <http://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-29.html>.

27. *Id.*

28. A plan to comply with the Safeguards Rule “must be appropriate to the company’s size and complexity, the nature and scope of its activities, and the sensitivity of the customer information it handles.” Federal Trade Commission, *Financial Institutions and Customer Information: Complying with the Safeguards Rule* (2006), <https://www.ftc.gov/tips-advice/business-center/guidance/financial-institutions-customer-information-complying>.

29. *Id.*

30. *Id.*

An effective risk management strategy involves oversight of the vendor throughout the life cycle of the relationship, from due diligence through termination. But, first, a business should conduct an internal risk assessment. Consider: i) taking inventory of where, what kinds, and how much sensitive data lives on and off your company's systems; ii) the access points to your sensitive data; and iii) your company's overall risk appetite. After all, it is hard to appreciate the risk a vendor may present to your data or your systems if you do not have at least a basic understanding of those elements.

Once an internal risk assessment has been performed, your organization will be primed to evaluate vendors. The following considerations, crafted from available regulatory guidance, best practices, and personal experience, cover the most important elements in the vendor management process, though it would be best to make sure you follow all guidance from your primary regulator in this space. This framework can apply equally to the selection and retention of new vendors as well as the review of existing vendors.

Phase 1: Due Diligence

Due diligence in selecting or reviewing vendors should be commensurate with both your organization's risk appetite and the nature of your relationship to the vendor. Consider a tiered approach to vendor management, whereby you categorize each vendor by data security risk to your business. This approach is sometimes referred to as stratification—the placement of vendors with similar risk profiles into tranches of risk. You can then tailor your risk management approach to each tranche. For example, this may inform your thinking about how much cyber liability insurance a vendor may be required to carry.

Below are some action items and considerations when evaluating potential or existing vendors that will help your organization more fully understand the risk presented by a vendor:

- For vendors who will maintain access to your systems, consider the level and frequency of that access (i.e., will they have administrative privileges? If so, they would present a greater security risk).
- For vendors who will be storing or handling sensitive data, consider the type and volume of data you transmit to them.
- Assess the financial soundness and stability of the vendor by reviewing audited financial statements.
- Determine whether the vendor has ever experienced a data breach, and, if so, how the vendor responded and what remedial steps the vendor has taken to prevent a similar breach.
- Request data security customer complaints filed against the vendor.
- Investigate previous data security regulatory enforcement actions and civil litigations.
- Review the vendor's web sites and other marketing materials to assess the adequacy of the vendor's representations regarding data security and privacy.
- Determine whether the vendor has cyber insurance, and, if so, ask to review a copy of the policy. In particular, examine how the sub-limits are structured.
- Evaluate the vendor's information security and incident response programs, including whether they contain the safeguards to protect personal

information you would expect, and how frequently these programs are reviewed and updated.

- Consider the lack of a formal information security program and/or incident response program as a red flag that the vendor is ill-prepared to provide adequate data security.
- Ask for results from the most recent independent security assessment of the vendor, and any documented remediation actions that resulted from the assessment.
 - If available, review Service Organization Control (SOC) reports and any certification for compliance with internal control standards, such as those promulgated by NIST and the International Standards Organization (ISO).
- Ascertain the extent to which the vendor will rely on subcontractors to perform the contemplated services and whether those vendors are storing that information.
- Ask how often employees receive training on data privacy and security.
- Ensure that the vendor conducts thorough background checks on the employees who will have access to your company's sensitive data.
- Consider an on-site visit to the vendor to more fully understand the vendor's operations and capacity.

Phase 2: Contract Negotiation

The traditional template vendor contract must be modified to address the evolving cyber liability landscape. For example, indemnification and limitation of liability language should explicitly address data breaches. Businesses now need to specify what dedicated amount of cyber liability insurance coverage its vendors are expected to carry (and perhaps even the types and amounts of sub-limits that should be maintained). Parties should clearly outline what notification obligations will be discharged following a security incident, to whom, and when.

Those businesses that find themselves in a regulated environment are now able to use the regulatory guidance that demands improved vendor oversight to exact more negotiation leverage. As regulators continue to fashion guidance about what are and are not sound data security practices, the practical effect is that these concepts will be woven into vendor contracts. In other words, the 800-pound gorilla that used to be able to flex its industry muscle to unilaterally dictate major contractual terms may be losing some ground. The stigma of a data breach is certainly helping too. Explicit data security safeguards (physical, administrative, and technical) are appearing with increasing frequency in lieu of a general mandate to follow “industry standards” in order to provide greater accountability. Vendors are being required to undergo audits and other assessments, often at no additional cost to their business partners, to validate the vendor’s data security practices. These have become new contractual norms, in part due to heightened regulatory scrutiny surrounding vendor management.

Here are some particular contract points to consider:

- Clearly define the types of personally identifiable information or other sensitive data that will govern the vendor’s contractual obligations.

- Specify the data security safeguards (e.g., encryption, intrusion detection and prevention systems, firewalls, data segregation) that you expect the vendor to utilize.
- Require compliance with applicable data security and data breach notification laws and regulations.
- Require the vendor to notify you immediately if a data breach is suspected.
- Require that the vendor preserve all logs, files, and documents related to any suspected breach.
- Require the vendor to conduct an internal investigation if it suspects a data breach, and/or to cooperate with any investigation by your organization.
- Clearly establish which party bears the responsibility of notification to any customers impacted by a data breach.
- Require the vendor to conduct regular audits and submit reports to your organization.
 - Include the types and frequency of audit reports your organization is entitled to receive from the vendor (e.g., financial, SSAE 16/SOC 1, SOC 2, and SOC 3 reports, and security reviews).
- Retain your organization's right to conduct its own audits of the vendor, or to engage an independent party to perform such audits.
- Consider requiring the vendor to carry cyber insurance, as well as naming your business as an additional insured.
 - The case law is still evolving on this topic, but a general commercial policy will likely not

cover your business in the event of a data breach by a vendor.

- Memorialize background check and training requirements.
- Establish what role subcontractors will have in the performance of the vendor's services, including access to and storage of sensitive data.
- Include an indemnification provision that would require the vendor to fully defend, indemnify, and hold your organization harmless from any and all third-party claims, first-party losses (which should be defined to include data security incident investigation costs and customer and regulatory notification costs), expenses, and reasonable attorneys' fees that it should incur in the event that the vendor (or one of its subcontractors) sustains a data breach.
- Try to eliminate any limitation of liability that puts a cap on the amount of damages the vendor would have to pay if it sustains a data breach (or at least an exception to the cap if the vendor fails to meet legally, contractually mandated, or industry standard data security requirements).
- Provide for termination of the contract if the vendor fails to implement and maintain sufficient data security practices, and/or if the vendor sustains a data breach.
- Require secure disposal of all of your company's sensitive information maintained by the vendor following the conclusion of the business relationship.

Vendor relationships are often the product of multiyear contracts which must typically come up for renewal before new language and requirements can be negotiated. But consider asking for contractual amendments or addendums that speak to these measures now if your organization has the leverage to do so. It is worth noting that some cyber liability policies require the insured to establish that its in-house or outside counsel has reviewed the governing vendor agreement in order to provide coverage for a data breach that is the byproduct of the vendor's acts or omissions.

Further, the contract negotiation process is an excellent way to conduct further due diligence. If you want to see where a vendor may be weak, pay attention to the contractual provisions it pushes back on.

Phase 3: Monitoring

As with the other phases of vendor management, the nature of any ongoing monitoring should align with the risk profile of the vendor. More extensive monitoring may be necessary for those vendors who pose the greatest risk to your organization. If resources allow, it would be beneficial to have dedicated personnel at your organization responsible for monitoring and periodically evaluating the vendor's data security practices. You could also engage an independent consultant to perform this task. Generally speaking, monitoring should mirror the due diligence actions set forth above. Specifically, you should also consider the following:

- Restrict and monitor the vendor's access to your company's systems—allow only as much access as the vendor needs to complete the services provided by the governing contract.

- Consider putting on a security training program for the vendor's employees who will be accessing your company's systems.
- Ensure that the vendor conducts its own ongoing data security training of its employees.
- Ensure that any access credentials provided to the vendor are not being misused or provided to unauthorized persons.
- Conduct regular on-site data security inspections and audits according to the type and frequency set out in the governing contract.
- Ensure that any data security issues that arise during inspections, audits, or otherwise are properly addressed by the vendor.
- Watch out for any customer complaints, regulatory investigations/enforcement actions, or civil litigation brought against the vendor, even if unrelated to your organization or industry.
- Establish that access, use, and/or storage of your sensitive data has been discontinued following termination of the business relationship. Receive written assurances that your sensitive data has been purged.

CONCLUSION

In an environment where the term “data breach” has entered mainstream media and executive management is being sued for failure to give proper oversight to company cybersecurity practices,³¹ no business, no matter the size, can afford to ignore or minimize the risk that its vendors present. One analyst writing for *Forbes* described a “Cybersecurity Domino Effect”:

31. See, e.g., Complaint, Palkon v. Holmes, Civ. Action No. 2:14-CV-01234 (SRC) (D.N.J. Oct. 20, 2014).

Here's the fundamental truth: We can no longer worry only about our own organization's network security, because so many networks are interconnected and interdependent. A breach in one can easily affect every company in a supply and delivery chain. In fact, we may only be as secure as the least secure partner with whom we connect.³²

Don't let one of your vendors be the weak link in the chain.

32. Ray Rothrock, *Why the Cybersecurity Domino Effect Matters*, FORBES (May 18, 2015, 10:00 AM), <http://www.forbes.com/sites/frontline/2015/05/18/why-the-cybersecurity-domino-effect-matters/#eecad607ee45>.

DEATH BY A THOUSAND CUTS: THE SLOW EROSION OF THE RIGHT TO TRIAL BY JURY IN PATENT CASES

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INTRODUCTION

Juries have decided patent disputes for over two centuries. And yet the right to trial by jury in patent cases is now threatened, as recent developments have diminished the finality of jury verdicts and limited the issues that juries are allowed to decide in patent cases. In particular, commentators and litigants have amplified their concerns that the Federal Circuit is willing to more aggressively reexamine factual determinations made by juries and substitute its judgment on issues of fact for that of the jurors compared to the regional circuit courts of appeals. The *inter partes* review procedure established by Congress in the America Invents Act has effectively transferred most validity disputes from the jury to administrative law judges in the patent office. And district courts now decide issues of damages for future infringement, as well as fact-based disputes about whether a patent includes an “inventive concept” or merely claims

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“well-known, routine, conventional” activities as of the date of the invention. The threat to the right to trial by jury in patent cases is not so much one of outright abolition; rather, the threat is based on recent trends limiting issues that juries decide and lessening the deference traditionally afforded to jury verdicts.

The Supreme Court recognized decades ago in *Beacon Theatres, Inc. v. Westover* that any limitation on the right to trial by jury must be at least done with eyes wide open: “Maintenance of the jury as a fact-finding body is of such importance and occupies so firm a place in our history and jurisprudence that any seeming curtailment of the right to a jury trial should be scrutinized with the utmost care.”¹ This article, therefore, outlines the origins of the Seventh Amendment right to a jury trial and its application in patent cases, and identifies recent developments that are seemingly eroding this fundamental right.

I. The Seventh Amendment’s guarantee of trial by jury provides for the purest form of democracy and has applied to patent infringement cases for over two centuries.

The Seventh Amendment played an important role in this nation’s founding and symbolized the differences between democracy and the British monarchy. It was so fundamental that the Founding Fathers enshrined the right to a jury trial in the Bill of Rights:

In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any

1. *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500, 501 (1959) (quoting *Dimick v. Schiedt*, 293 U.S. 474, 486 (1935)).

Court of the United States, than according to the rules of the common law.²

The right to trial by jury ensured that disputes are resolved by citizens based on their common sense and not by the whim or prejudice of the crown:

Trial by a jury of laymen rather than by the sovereign's judges was important to the founders because juries represent the layman's common sense, the 'passional elements in our nature,' and thus keep the administration of law in accord with the wishes and feelings of the community.³

For many citizens, serving on a jury is the "most significant opportunity to participate in the democratic process."⁴ And the jury system guards against authoritarian rule by performing "the critical governmental functions of guarding the rights of litigants and ensuring the continued acceptance of the laws by all of the people."⁵

This historical right to a jury trial applies with equal force in patent cases. In the seminal case on claim construction, *Markman v. Westview Instruments, Inc.*, the Court reviewed the historical application of the Seventh Amendment to patent trials and concluded that "there is no dispute that infringement cases today must be tried to a jury, as their predecessors were more than

2. U.S. CONST. amend. VII.

3. *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 343 (1979) (Rehnquist, J., dissenting); see also Debra Lyn Bassett, "I Lost at Trial—In the Court of Appeals!": *The Expanding Power of the Federal Appellate Courts to Reexamine Facts*, 38 HOUS. L. REV. 1129, 1131 (Winter 2001) ("One of the primary motivations behind the Declaration of Independence was the Crown's attempt to encroach upon the right to trial by jury.").

4. *Powers v. Ohio*, 499 U.S. 400, 407 (1991).

5. *Edmonson v. Leesville Concrete Co.*, 500 U.S. 614, 618 (1991).

two centuries ago.”⁶ In fact, juries decided patent cases even before the Seventh Amendment was adopted. “In 1790, before the adoption of the Seventh Amendment in 1791, the patent statute in this country provided only for the award of damages in an action at law, with the right to a trial by jury.”⁷

II. The Federal Circuit is more willing to review and reexamine factual determinations made by juries than other circuit courts of appeals.

The Federal Circuit’s reputation for its willingness to substitute its judgment for that of the jury is not new. Over fifteen years ago, for instance, commentators observed that “the bar is expressing concern over the court’s decision-making procedures and its apparent willingness to take over the roles of patent examiner, advocate and trier of fact.”⁸ This concern has become more acute as of late. In the last two years alone, parties have filed at least three petitions for a writ of certiorari with the Supreme Court and a petition for en banc rehearing by the Federal Circuit challenging whether the Federal Circuit has invaded the fact finder’s province in reviewing jury verdicts.⁹ Since 2011,

6. 517 U.S. 370, 376 (1996) (citing *Bramah v. Hardcastle*, 1 Carp. P. C. 168 (K. B. 1789)).

7. *In re Lockwood*, 50 F.3d 966, 976 n.12 (Fed. Cir. 1995) (citing *Root v. Railway Co.*, 105 U.S. 189, 191–92 (1881)).

8. William C. Rooklidge & Matthew F. Weil, *Judicial Hyperactivity: The Federal Circuit’s Discomfort with its Appellate Role*, 15 BERKELEY TECH. L.J. 725, 729 (2000).

9. *Petition for a Writ of Certiorari, ParkerVision Inc. v. Qualcomm Inc.*, No. 15-1092, at Introduction (Feb. 29, 2016) (“Instead of expressly finding facts, the Federal Circuit now applies the standard of review in an outcome-driven, haphazard manner.”); *Petition for a Writ of Certiorari, Alexsam, Inc. v. The Gap, Inc.*, No. 15-736 (Dec. 7, 2015) (“Instead of reviewing evidence which supports the jury’s presumed finding, the Federal Circuit instead looked for evidence that could have supported a different finding,

the Federal Circuit has reversed 19 jury verdicts of patent infringement and validity.¹⁰ In doing so, the Federal Circuit has demonstrated a willingness to reexamine factual determinations made by juries to a greater degree than other circuit courts of appeals.

and drew all inferences in favor of [the movant.]”); Apple’s Combined Petition for Panel Rehearing and Rehearing En Banc, *Apple Inc. v. Samsung Elecs. Co.*, Nos. 2015-1171, -1195, -1994, at 2 (Fed. Cir. Mar. 28, 2016) (arguing that the panel’s “appellate fact finding is contrary to the ‘substantial evidence’ standard and violates Apple’s Seventh Amendment right to have a jury decide the factual question of infringement”); Petition for a Writ of Certiorari, *Commil USA, LLC v. Cisco Sys., Inc.*, No. 15-1446, at 16 (May 27, 2016) (arguing that the Federal Circuit usurped the role of the jury).

10. *Commil USA, LLC v. Cisco Sys., Inc.*, 813 F.3d 994, 997 (Fed. Cir. 2015); *ParkerVision, Inc. v. Qualcomm Inc.*, 621 F. App’x. 1009, 1017 (Fed. Cir. 2015); *Mformation Techs., Inc. v. Research in Motion Ltd.*, 764 F.3d 1392, 1400 (Fed. Cir. 2014); *Phillip M. Adams & Assocs., LLC v. Dell Comput. Corp.*, 519 F. App’x 998, 1005 (Fed. Cir. 2013); *Mirror Worlds, LLC v. Apple Inc.*, 692 F.3d 1351, 1358 (Fed. Cir. 2012); *Cordis Corp. v. Boston Sci. Corp.*, 658 F.3d 1347, 1358 (Fed. Cir. 2011); *Smith & Nephew, Inc. v. Arthrex, Inc.*, 453 F. App’x 977, 981 (Fed. Cir. 2011); *Becton, Dickinson & Co. v. Tyco Healthcare Grp.*, 616 F.3d 1249, 1257–58 (Fed. Cir. 2010); *Calico Brand, Inc. v. Ameritek Imports, Inc.*, 527 F. App’x 987, 994 (Fed. Cir.), *decision clarified on reh’g*, 547 F. App’x 966 (Fed. Cir. 2013); *ABT Sys., LLC v. Emerson Elec. Co.*, 797 F.3d 1350, 1357 (Fed. Cir. 2015); *I/P Engine, Inc. v. AOL Inc.*, 576 F. App’x 982, 992 (Fed. Cir. 2014), *cert. denied*, 136 S. Ct. 54 (2015); *Inventio AG v. Otis Elevator Co.*, 497 F. App’x 37, 43 (Fed. Cir. 2012); *Alexsam, Inc. v. Gap, Inc.*, 621 F. App’x 983, 995 (Fed. Cir. 2015); *Sealant Sys. Int’l, Inc. v. TEK Glob., S.R.L.*, 616 F. App’x 987, 999 (Fed. Cir. 2015); *DDR Holdings, LLC v. Hotels.com, L.P.*, 773 F.3d 1245, 1253 (Fed. Cir. 2014) (same); *ClearValue, Inc. v. Pearl River Polymers, Inc.*, 668 F.3d 1340, 1342 (Fed. Cir. 2012); *ArcelorMittal France v. AK Steel Corp.*, 700 F.3d 1314, 1323 (Fed. Cir. 2012); *Novozymes A/S v. DuPont Nutrition Biosciences APS*, 723 F.3d 1336, 1351 (Fed. Cir. 2013); *Centocor Ortho Biotech, Inc. v. Abbott Labs.*, 636 F.3d 1341, 1353 (Fed. Cir. 2011).

A. The Reexamination Clause of the Seventh Amendment prohibits appellate courts from reexamining factual determinations made by juries.

The Seventh Amendment prescribes the scope of appellate review of jury verdicts. It includes two clauses: the Preservation Clause and the Reexamination Clause. Under the Reexamination Clause, “no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.”¹¹ The Supreme Court has interpreted the Reexamination Clause to allow reviewing courts to vacate a jury’s verdict for insufficient evidence.¹² But it has also explained that in reviewing a motion for a directed verdict, a court of appeals “could *not* itself determine the issues of fact and direct a judgment for the defendant, for this would cut off the plaintiff’s unwaived right to have the issues of fact determined by a jury.”¹³

11. U.S. CONST. amend. VII; *Int’l Terminal Operating Co. v. N.V. Nederl. Amerik Stoom. Maats.*, 393 U.S. 74 (1968) (reversing court of appeals decision because “[u]nder the Seventh Amendment, that issue should have been left to the jury’s determination”).

12. *See, e.g., Baltimore & Carolina Line, Inc. v. Redman*, 295 U.S. 654, 658 (1935). There is, however, disagreement within the Court as to whether the common law even permitted this practice. *See, e.g., Gasperini v. Ctr. for Humanities, Inc.*, 518 U.S. 415, 452 (1996) (Scalia, J., dissenting) (“Cases of this Court reaching back into the early 19th century establish that the Constitution forbids federal appellate courts to ‘reexamine’ a fact found by the jury at trial; and that this prohibition encompasses review of a district court’s refusal to set aside a verdict as contrary to the weight of the evidence.”); *Parsons v. Bedford*, 28 U.S. 433, 448 (U.S. 1830) (“The only modes known to the common law to re-examine such facts, are the granting of a new trial by the court where the issue was tried, or to which the record was properly returnable; or the award of a *venire facias de novo*, by an appellate court, for some error.”).

13. *Baltimore & Carolina Line, Inc. v. Redman*, 295 U.S. 654, 658 (1935) (emphasis added).

Rule 50 codifies this principle.¹⁴ It limits a court's ability to reexamine a jury verdict unless the court "finds that a reasonable jury would not have a legally sufficient evidentiary basis to find for the party."¹⁵ Under Rule 50, a court may not find its own facts. Rather, the court's review is limited to reviewing facts found by the jury, and comparing the jury's factual findings to the evidence submitted.

In *Reeves v. Sanderson Plumbing, Inc.*,¹⁶ the Court set out the rules that would guide lower courts in implementing this standard by outlining what evidence a court must disregard and must not disregard in reviewing a jury verdict governing under Rule 50. Specifically, "although the court should review the record as a whole, it must disregard all evidence favorable to the moving party that the jury is not required to believe."¹⁷ The jury is only required to believe the moving party's evidence when it is "uncontradicted and unimpeached, at least to the extent that the evidence comes from disinterested witnesses."¹⁸ Thus, a moving party's evidence that is contradicted, impeached, *or* offered by an interested witness is insufficient to overturn a jury verdict.¹⁹

B. The Federal Circuit has aggressively reexamined factual findings made by juries as of late.

Four recent cases exemplify the Federal Circuit's willingness to review factual determinations made by juries. The first

14. See *Unitherm Food Sys. Inc. v. Swift-Eckrich, Inc.*, 546 U.S. 394, 402 n.4 (2006) ("Indeed, Rule 50 was drafted with such [Seventh Amendment] concerns in mind.").

15. FED. R. CIV. P. 50(a)(1).

16. 530 U.S. 133 (2000).

17. *Id.* at 151.

18. *Id.*

19. *Id.*

and most recent example is *Commil v. Cisco*. While that case had an unusual procedural posture,²⁰ the Federal Circuit ultimately reviewed and reversed a jury's finding of direct infringement, which served as the basis for the jury's award of \$63.8 million in damages. The Federal Circuit assessed each side's evidence regarding direct infringement.²¹ At trial, Commil offered a technical expert who opined on how Cisco's routers were configured, and concluded that the accused products met the limitations of the claims as construed by the court.²² Cisco chose not to call a technical expert in response.²³ Nor did it challenge Commil's expert under *Daubert*.²⁴ Instead, Cisco relied only on its own in-house engineer to rebut Commil's expert's explanation.²⁵

20. Commil tried its claims to a jury in the Eastern District of Texas twice. At the first trial, the jury found that the patent was valid and that Cisco directly infringed. *Commil USA, LLC v. Cisco Sys.*, No. 2:07-CV-341, 2010 U.S. Dist. LEXIS 144014, at *4 (E.D. Tex. Dec. 29, 2010). The jury awarded Commil \$3.7 million in damages. *Id.* at *4. Due to improper statements made by Cisco's trial attorneys, the district court ordered a new trial on induced infringement and damages. *Id.* at *5–*6. At the second trial, the jury again returned a verdict in Commil's favor, and awarded \$63.8 million in damages. *Commil USA, LLC v. Cisco Sys.*, No. 2:07-CV-341, 2011 U.S. Dist. LEXIS 159236 (E.D. Tex. May 20, 2011). The Federal Circuit reversed the jury verdict of indirect infringement, *Commil USA, LLC v. Cisco Sys.*, 720 F.3d 1361, 1364 (Fed. Cir. 2013), which the Supreme Court vacated, holding that a good faith belief in the invalidity of a patent does not negate intent to induce infringement. *Commil USA, LLC v. Cisco Sys.*, 135 S. Ct. 1920, 1922 (2015). All of this nearly ten-year history occurred before the Federal Circuit reached its decision on direct infringement.

21. See *Commil USA, LLC v. Cisco Sys., Inc.*, 813 F.3d 994, 996-97 (Fed. Cir. 2015).

22. *Id.* at 997.

23. *Id.* at 997.

24. *Id.* at 997.

25. *Id.* at 997.

In a curt, two-page discussion, the Federal Circuit concluded that the evidence did not support the jury's finding of direct infringement.²⁶ The court wrote, "[w]e begin with the running step. . . . Cisco contends that this step is never performed when its system is used, because its system employs a single copy of the protocol to support all the connected devices. *We agree with Cisco.*"²⁷ The court proceeded to credit the testimony of Cisco's fact witness, while disregarding Commil's expert's testimony. In other words, the Federal Circuit reversed the jury's finding of infringement and implicit rejection of Cisco's proffered evidence, and did so by (1) rejecting Commil's evidence on appeal, (2) accepting Cisco's evidence which had been impeached on cross examination, and (3) accepting Cisco's evidence even though it came from a Cisco employee—an interested witness.²⁸ Thus, the Federal Circuit's opinion was based on categories of evidence that *Reeves* required the court to disregard.

A second example is *Cordis Corp. v. Boston Scientific Corporation*, in which the Federal Circuit reexamined whether the jury's determination that an accused stent product included an "undulating" section.²⁹ After determining that the drawing of the stent that both parties "extensively relied" on was "unclear," the Federal Circuit opted to rely on other photographs and engineering drawings, made its own determination about the geometry of the design, and concluded that the stent "lack[s] the change in direction required for literal infringement."³⁰ The Federal Circuit, in turn, disregarded the expert testimony from

26. *Id.* at 996–97.

27. *Id.* (emphasis added).

28. *See id.*

29. 658 F.3d 1347, 1357–59 (Fed. Cir. 2011).

30. *Id.* at 1358.

the patent holder and determined that the accused product did not infringe the asserted claim, like it did in the *Commil* case.³¹

The Federal Circuit also reweighed an expert's opinion in *ABT Systems, LLC v. Emerson Electric Company* when it reversed a jury verdict of no invalidity.³² At issue in *ABT* was whether "at the time of the [patent holder's] invention, a person of ordinary skill would have combined elements from several prior art references."³³ The jury had determined that the accused infringer had failed to prove as much by clear and convincing evidence at trial.³⁴ The Federal Circuit recounted the patent holder's expert testimony and "his view" on the lack of a motivation to combine, but reached a contrary factual finding on appeal. Wrote the court, "[i]n our view, if, at the time of the invention claimed in the '017 patent, a person of ordinary skill had looked at [the] Vogelzang [prior art reference], he or she would have found it nearly obvious from that disclosure itself to set the periodic fan to run as a function of when the heating or cooling cycle ended."³⁵ The Federal Circuit, thus, explicitly substituted its finding of fact for that of the jury's (including with respect to factual determinations of non-obviousness),³⁶ and entered judgment of invalidity for the accused infringer.³⁷

Finally, in *Johns Hopkins v. Datascope Corp.*, the Federal Circuit again disagreed with the expert's testimony about the

31. *Id.* at 1358 ("Indeed, absent the testimony of [the patent holder's] expert regarding troughs and crests, and the corresponding testimony concluding infringement, we find very little evidence to support the jury's verdict that claim 25 was literally infringed." (emphasis added).).

32. 797 F.3d 1350 (Fed. Cir. 2015).

33. *Id.* at 1358.

34. *See id.* at 1354.

35. *Id.* at 1360 (emphasis added).

36. *Id.* at 1361–62.

37. *See id.* at 1362.

structure and operation of an accused product, and reversed the jury's finding of infringement.³⁸ The patent holder's expert in this case explained the structure and operation of an accused catheter.³⁹ The jury found infringement, and the district court denied the accused infringer's motion for judgment as a matter of law.⁴⁰ The Federal Circuit ultimately disagreed with the expert's testimony, not on *Daubert* grounds, but because it found portions of the expert's testimony "incredible" based on its assessment of its own application of geometry.⁴¹ The jury's determination of infringement, therefore, was reexamined and reversed.⁴²

This record of reversals has drawn a chorus of dissents. Judge Newman, who has served on the Federal Circuit since 1984, is perhaps the most vocal critic. In *Johns Hopkins*, for instance, Judge Newman emphasized her concern that "it is not our province to reweigh the evidence, when there was substantial evidence by which a reasonable jury could have reached its verdict."⁴³ Chief Judge Prost echoed a similar dissatisfaction in *Mirror Worlds*, explaining that the patent holder "introduced ample evidence to allow a reasonable jury to determine that the required steps were performed," and further that the majority "casually brushes" the patent holder's evidence aside.⁴⁴ Judge Gajarsa expressed his concern that "[t]he majority climbs Jacob's Ladder in search of perfection in the jury verdict, but, by

38. 543 F.3d 1342 (Fed. Cir. 2008).

39. *Id.* at 1346–48, 1350–51.

40. *Id.* at 1344.

41. *Id.* at 1348.

42. *Id.* at 1349.

43. *Johns Hopkins v. Datascope Corp.*, 543 F.3d at 1351 (Newman, J., dissenting).

44. *Mirror Worlds, LLC v. Apple Inc.*, 692 F.3d 1351, 1365 (Fed. Cir. 2012) (Prost, J., dissenting).

substituting its own fact finding for that of the jury, it fails to allow the jury to perform its proper function.”⁴⁵ This trio of judges represents some of the most experienced members on the Federal Circuit.

C. Regional circuit courts of appeals have deferred more to factual findings by juries than the Federal Circuit.

The standard applied by the Federal Circuit stands alone compared to the standard applied by other courts of appeals. Other circuit courts of appeals more faithfully apply the *Reeves* standard and discard evidence from a moving party that is contradicted, impeached, or offered from an interested witness. The following cases are representative, and the analysis in these cases would all lead to a different result in *Commil v. Cisco*, as well as the various other cases in the section above.

The Fifth Circuit’s decision in *Wellogix, Inc. v. Accenture* is a prime example.⁴⁶ In *Wellogix*, the jury returned a \$26.2 million verdict for compensatory damages for Accenture’s trade secret misappropriation, along with a remitted award of \$18.2 million for punitive damages.⁴⁷ The Fifth Circuit deferred to the jury’s factual finding, notwithstanding its skepticism of the jury’s conclusions: “Had we sat in the jury box, we may have decided otherwise. ‘But juries are not bound by what seems inescapable logic to judges.’”⁴⁸ More particularly, *Wellogix* relied on expert testimony to support its claim for trade secret misap-

45. *Becton, Dickinson & Co. v. Tyco Healthcare Grp.*, 616 F.3d 1249, 1265 (Fed. Cir. 2010) (Gajarsa, J., dissenting).

46. 716 F.3d 867 (5th Cir. 2013).

47. *Id.* at 874.

48. *Id.* at 872 (quoting *Morissette v. United States*, 342 U.S. 246, 276 (1952)).

propriation, and Accenture did not offer expert testimony in rebuttal.⁴⁹ When Accenture maintained on appeal that Wellogix's expert testimony was insufficient to establish that Accenture acquired Wellogix's trade secrets, the Fifth Circuit deferred to the wide latitude of experts to offer opinions and concluded that "the jury was reasonable in crediting his testimony."⁵⁰ The court reached the same conclusion when it rejected Accenture's claim that the expert's testimony about Accenture's use of the trade secrets could not support the jury's verdict.⁵¹

The Seventh Circuit's analysis in *Davis v. Wisconsin Department of Corrections* also demonstrates an application that conflicts with the regime adopted by the Federal Circuit in *Com-mil v. Cisco*.⁵² The defendant in *Davis* sought to reverse a jury verdict based on an employment discrimination claim.⁵³ A core issue at trial and on appeal was whether a Department of Corrections memo contained a typographical error.⁵⁴ The defendants' witnesses testified that it did.⁵⁵ The Seventh Circuit refused to "reweigh the evidence or second-guess the jury's credibility determinations."⁵⁶ Specifically, the court applied *Reeves* and explained that the testimony from the defendants' four witnesses is of the sort that is "generally disregard[ed] when reviewing denials of posttrial relief because it is neither uncontradicted (the DOC memo contradicts it) nor d[id] it come from disinterested witnesses."⁵⁷

49. *Id.* at 877–78.

50. *Id.* at 876.

51. *See id.* at 877–78.

52. 445 F.3d 971 (7th Cir. 2006).

53. *See id.* at 972.

54. *Id.* at 975.

55. *Id.*

56. *Id.* at 978.

57. *Id.*

Certainly additional similar cases exist from other circuit courts. These two examples are representative of the conflicting application of *Reeves* among the Courts of Appeals. Had the Federal Circuit deferred to expert witnesses as the Fifth Circuit did in *Wellogix*, or disregarded evidence from the party moving under Rule 50 that was contradicted or from interested witnesses as the Seventh Circuit did in *Davis*, the jury verdicts in the four exemplary Federal Circuit cases above would have been affirmed.

III. The incremental restriction of the right to trial by jury in patent disputes.

The Federal Circuit's review of jury verdicts on liability is not the only way the right to trial by jury is being encroached in patent cases. Recent legislative and judicial developments have also made it more difficult for patent holders to ensure that juries decide their cases. In particular, validity disputes have been shifted from juries to administrative judges; compensatory damages for future infringement in lieu of an injunction are decided by judges, not juries; and, judges resolve factual disputes about what was "well-known, routine, conventional" in deciding whether a patent claims an inventive concept for purposes of subject matter eligibility.

- A. *Inter Partes Review* has shifted disputes over validity between parties from the jury to administrative law judges.

Patent holders can no longer expect to have a jury decide an infringer's defense of invalidity. In 2011, Congress created the *inter partes review* (IPR) procedure in the Leahy-Smith America Invents Act, which affords interested parties—most often accused infringers—the ability to challenge a patent's validity in front of an Article I agency: the Patent and Trial Appeal Board

(PTAB).⁵⁸ The IPR procedure sits in stark contrast to an accused infringer's traditional method of challenging the validity of a patent. A petitioner in the IPR procedure has a lower burden of proof,⁵⁹ can obtain a broader construction of the claims,⁶⁰ and, most critically, is allowed to place factual determinations in the hands of three administrative judges at the PTAB instead of the ladies and gentlemen of the jury.

The results of this new venue for validity disputes have been nothing short of dramatic. The invalidation rate at the PTAB has been so high that the PTAB panels have been referred to as "death squads, killing property rights."⁶¹ The Former Chief Judge at the PTAB embraced such a designation: "If we weren't, in part, doing some 'death squadding,' we would not be doing what the statute calls on us to do."⁶² Such a characterization underscores the fundamental importance of the jury system. Juries have no such agendas; juries are made up of citizens who are called upon to resolve the particular factual disputes in a case between two parties.

58. Pub. L. 112-29, 125 Stat. 284 (2011).

59. Compare 35 U.S.C. § 316(e) (setting burden of proof in IPR proceedings as preponderance of evidence), with *Microsoft Corp. v. i4i Ltd. P'ship*, 564 U.S. 91, 111 (2011) (requiring burden of clear and convincing evidence in district court).

60. Compare 37 C.F.R. § 42.100(b) (applying broadest reasonable construction in IPR proceedings), and *Cuozzo Speed Techs. v. Lee*, U.S., No. 15-446 (June 20, 2016), with *Phillips v. AWH Corp.*, 415 F.3d 1303, 1314 (Fed. Cir. 2005) (construing claims based on their ordinary meaning based primarily on the patent's specification).

61. Peter J. Pitts, *Patent Death Squads vs. Innovation*, WALL ST. J. (June 10, 2015), available at <http://on.wsj.com/1MsqErB>.

62. Ryan Davis, *PTAB's 'Death Squad' Label Not Totally Off-Base*, Chief Says, IPLAW360 (Aug. 14, 2014, 5:47 PM), <http://www.law360.com/arti-cles/567550/ptab-s-death-squad-label-not-totally-off-base-chief-says>.

The creation of the IPR procedure, with its attendant high-kill rate, has effectively shifted disputes from juries in district court to administrative judges at the PTAB. To be sure, the IPR process is not a traditional examination or reexamination that the Patent Office has historically undertaken; an “inter partes review is a trial, adjudicatory in nature and constituting litigation.”⁶³ Indeed, over 80% of all petitions for IPR are associated with co-pending district court litigation.⁶⁴ Thus, patent holders are now effectively denied a right to a jury’s determination of an accused infringer’s invalidity defense.⁶⁵

B. The Federal Circuit has weakened the jury’s traditional role as the arbiter of damages.

This erosion of the jury’s province is also occurring with respect to damages for future infringement. In the wake of the Supreme Court’s decision in *eBay, Inc. v. MercExchange, LLC*,⁶⁶ the Federal Circuit was asked to decide whether a patent holder enjoys a Seventh Amendment right to a jury trial after a district court prescribed an ongoing royalty for future acts of infringement.⁶⁷ The Federal Circuit rejected the patent owner’s Seventh Amendment argument, and summarily concluded that “the fact

63. *ScentAir v. Prolitec*, IPR2013-00179, Paper 9, at 4 (P.T.A.B. April 16, 2013).

64. Matt Cutler, *3 Years of IPR: A Look at the Stats*, IPLAW360 (Oct. 9, 2015, 3:59 PM), <http://www.law360.com/articles/699867/3-years-of-ipr-a-look-at-the-stats>.

65. The Constitutionality of the IPR procedure is at issue in a petition for certiorari at the Supreme Court. *See* Petition for a Writ of Certiorari, *MCM Portfolio, LLC v. Hewlett-Packard Co.*, No. 15-1330.

66. 547 U.S. 388 (2006).

67. *Paice v. Toyota Motor Corp.*, 504 F.3d 1293 (Fed. Cir. 2007), *reh’g en banc denied*.

that monetary relief is at issue in this case does not, standing alone, warrant a jury trial.”⁶⁸

This conclusion appears to conflict with Supreme Court case law. “By the law the jury are judges of the damages.”⁶⁹ The Court explained in *Feltner* that compensatory damages are “traditionally associated with legal relief,” and therefore subject to the Seventh Amendment’s guarantee to trial by jury.⁷⁰ Under *Tull v. United States*, a two-prong test is applied to determine whether the right to trial by jury attaches to a cause of action.⁷¹ First, “a court must compare the action with the analogous action brought in the courts of England during the eighteenth century, prior to the merger of law and equity. Second, a court must look to the remedy sought and determine whether it is legal or equitable in nature.”⁷²

Applying this two part test, it is clear that damages for future patent infringement are compensatory. The first prong is clearly satisfied by findings of damages for patent infringement, as the Court explained that “there is no dispute that infringement cases today must be tried to a jury, as their predecessors were more than two centuries ago.”⁷³ An analysis of the second prong makes clear that compensatory damages for future infringement are legal, not equitable, in nature.⁷⁴ Indeed, *eBay v.*

68. *Id.* at 1316.

69. *Feltner, Jr. v. Columbia Pictures Television, Inc.*, 523 U.S. 340, 352 (1998).

70. *See id.*

71. 481 U.S. 412, 417 (1987).

72. *See id.* (internal citations omitted).

73. *Markman v. Westview Instruments, Inc.*, 517 U.S. 370, 376 (1996) (citing *Bramah v. Hardcastle*, 1 Carp. P. C. 168 (K. B. 1789)).

74. *See generally* Ronald J. Schutz & Patrick M. Arenz, *Unchartered Waters: Determining Ongoing Royalties for Victorious Patent Holders Denied an Injunction*, 11 SEDONA CONF. J. 75 (2010).

MercExchange explained that an injunction is unavailable if a patent holder fails to prove among other things that “remedies available at law, such as monetary damages, are adequate to compensate.”⁷⁵ An award of an ongoing royalty is therefore compensation for future acts of patent infringement. By allocating responsibility for making decisions on such awards in the first instance to the judiciary, the right of patent owners to have a jury decide these issues is being further eroded.

- C. The Federal Circuit’s recent case law on subject matter eligibility has further reduced the province of the jury in patent cases.

The concept of invention should be a quintessential fact issue: the comparison of a new idea with what was known before the conception and reduction to practice of that new idea. Nonetheless, in the wake of the explosion of decisions on subject matter eligibility following *Alice Corporation v. CLS Bank International*,⁷⁶ the Federal Circuit has empowered itself to determine whether a patent claims an “inventive concept” or not. The court has reached these decisions without regard to the jury’s traditional role of deciding fact disputes.

The Supreme Court applies a two-step test to determine patent eligibility.⁷⁷ The second step, most notably, is “a search for an ‘inventive concept’ — *i.e.*, an element or combination of elements that is ‘sufficient to ensure that the patent in practice amounts to significantly more than a patent upon the [ineligible concept] itself.’”⁷⁸ The Court has explained that a patent does not include an inventive concept if it only adds “well-understood,

75. See 547 U.S. 388, 390 (2006).

76. 134 S. Ct. 2347, 2355 (2014).

77. *Id.*

78. *Id.* (quoting *Mayo Collaborative Servs. v. Prometheus Labs., Inc.*, 132 S. Ct. 1289, 1294 (2012)).

routine, conventional” or generic activities.⁷⁹ While not coextensive with novelty, the Court has recognized that the issue of novelty over the prior art—a classic fact question for juries⁸⁰—may overlap with the inventive step inquiry under § 101.⁸¹ Even though § 101 is considered an issue of law, the Federal Circuit has acknowledged that it “may contain underlying issues of fact.”⁸² Nevertheless, the Federal Circuit has implicitly determined that courts—not juries—make the underlying factual determinations about what is an “inventive concept,” and thus, what was “well-understood, routine, conventional” at the time of the claimed invention.

Such a role reversal for the Federal Circuit is new since the *Alice* decision. There is no better example than in the *Ultra-mercical, Inc. v. Hulu, LLC* series of decisions. Before the *Alice* decision, the Federal Circuit explained that fact issues prevented the court from finding a patent ineligible as a matter of law on

79. *Alice*, 134 S. Ct. at 2359.

80. *Med. Instrumentation & Diagnostics Corp. v. Elekta AB*, 344 F.3d 1205, 1221 (Fed. Cir. 2003) (reversing summary judgment because “[t]he question of what a reference teaches and whether it describes every element of a claim is a question for the finder of fact. *Advanced Display Sys. v. Kent State Univ.*, 212 F.3d 1272, 1283 (Fed. Cir. 2000). The district court concluded that the Kall/Kelly reference was ‘ambiguous,’ which suggests to us that the issue of exactly what the reference teaches is something that should have been resolved by the jury. The district court improperly usurped the role of the jury in finding that the reference failed to raise a genuine issue of material fact.”); *Green Edge Enters., LLC v. Rubber Mulch etc., LLC*, 620 F.3d 1287, 1298 (Fed. Cir. 2010) (in an obviousness inquiry, “a jury should determine whether there are differences between the prior art and the claimed invention, among other factual inquiries”).

81. *See Mayo*, 132 S. Ct. at 1304.

82. *See Accenture Global Servs., GmbH v. Guidewire Software, Inc.*, 728 F.3d 1336, 1340–41 (Fed. Cir. 2013).

the pleadings. Former Chief Judge Rader explained that determinations of patentable subject matter almost always involve questions of fact:

If the question is whether “genuine human contribution” is required, and that requires “more than a trivial appendix to the underlying abstract idea,” and were not at the time of filing “routine, well-understood, or conventional,” *factual inquiries likely abound*. Almost by definition, analyzing whether something was “conventional” or “routine” involves analyzing facts. Likewise, any inquiry into the scope of preemption—how much of the field is “tied up” by the claim—by definition will involve historic facts: identifying the “field,” the available alternatives, and preemptive impact of the claims in that field. The presence of *factual issues* coupled with the requirement for clear and convincing evidence normally will render dismissal under Rule 12(b)(6) improper.⁸³

Then the Supreme Court issued its opinion in *Alice*. Even though the Court did not address any issue about the fact-based inquiries involved in its test for an inventive concept, on remand the Federal Circuit reversed its decision in *Ultramercial*, determined those fact issues on its own, and found the patent ineligible to be patented.⁸⁴ The court reached this conclusion even though it recognized that some of the claim limitations “were not previously employed in this art.”⁸⁵ Thus, the court’s decision

83. *Ultramercial, Inc. v. Hulu, LLC (Ultramercial II)*, 722 F.3d 1335, 1339 (Fed. Cir. 2013), *vacated and remanded*, *WildTangent, Inc. v. Ultramercial, LLC*, 134 S. Ct. 2870 (2014) (emphasis added).

84. *Ultramercial, Inc. v. Hulu, LLC (Ultramercial III)*, 772 F.3d 709, 715 (Fed. Cir. 2014).

85. *Id.*

included implicit factual findings on novelty, which a previous panel recognized could not be done. The Federal Circuit has followed this approach many times since.⁸⁶ As a result, courts—not juries—now decide and resolve underlying factual issues pertaining to subject matter eligibility, including whether a patent claims an “inventive concept” or unduly preempts a field.

CONCLUSION

The Supreme Court has warned of the unwavering need to defend the right to trial by jury:

The right of jury trial in civil cases at common law is a basic and fundamental feature of our system of federal jurisprudence which is protected by the Seventh Amendment. A right so fundamental and sacred to the citizen, whether guaranteed by the Constitution or provided by statute, should be jealously guarded by the courts.⁸⁷

And yet that right is not being jealously guarded in patent cases. Instead, the jury trial in patent cases is facing a death by a thousand cuts. Unless this trend is stopped, and courts and parties zealously protect the right to trial by jury, as other constitutional guarantees of other amendments enshrined in the Bill of Rights

86. *See, e.g.,* *Affinity Labs of Tex., LLC v. Amazon.com, Inc.*, 2016 U.S. App. LEXIS 17370 (Fed. Cir. Sep. 23, 2016); *Affinity Labs of Tex. v. DirecTV, LLC*, 2016 U.S. App. LEXIS 17371 (Fed. Cir. Sep. 23, 2016); *Shortridge v. Found. Constr. Payroll Serv., LLC*, No. 2015-1898, 2016 U.S. App. LEXIS 12837 (Fed. Cir. July 13, 2016); *Ultramercial, Inc. v. Hulu, LLC*, 772 F.3d 709 (2015); *Internet Patents Corp. v. Active Network, Inc.*, 790 F.3d 1343, 1344 (Fed. Cir. 2015); *OIP Techs., Inc. v. Amazon.com, Inc.*, 788 F.3d 1359, 1360 (Fed. Cir. 2015); *Content Extraction & Transmission LLC v. Wells Fargo Bank, N.A.*, 776 F.3d 1343, 1347 (Fed. Cir. 2014); *buySAFE, Inc. v. Google, Inc.*, 765 F.3d 1350, 1355 (Fed. Cir. 2014).

87. *Jacob v. City of New York*, 315 U.S. 752, 752–53 (1942).

are protected, the Seventh Amendment guarantee will effectively vanish in patent cases.



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