ARNOLD & PORTER LLP

Avoiding the Third Rail: Sanctions in Federal Civil Litigation

Aon Law Firm Conference
October 11, 2012
New Orleans

Sean M. SeLegue

Arnold & Porter LLP
7th Floor
Three Embarcadero Center
San Francisco, CA 94111-4024
tel: 415.471.3169
Sean.SeLegue@aporter.com

I. Introduction.[1]

Federal judges tend to have high expectations of counsel. When counsel fall short of those expectations, they are frequently the subject of sanctions motions brought by an adversary and, infrequently but increasingly, of inquiries by the court itself. When a lawyer or law firm is at risk of sanctions, the stakes can be high. The reputation of the lawyer and his or her firm can be endangered not only by an adverse sanctions ruling but also by critical commentary in a ruling that denies any formal sanctions. The publicity that can result from a sanctions proceeding can itself be damaging. Of course, the direct monetary stakes can be high as well, up to and including six and seven-figure sums that are typically not covered by malpractice insurance.

To avoid these risks, litigators and firm general counsel alike need to know the rules and doctrines that allow for sanctions. This article summarizes the various federal statutes, Rules of Civil Procedure and common law doctrines that shape the power of federal district courts to sanction counsel. When sanctions are sought or threatened against a law firm, knowledge of the rules described in this article take on new importance. Understanding the shape and limits of federal judges' sanctions power is critical to mounting a defense effort. Of course, knowledge of the rules described below is necessary but not sufficient to successful defense of a significant sanctions motion. Resisting an attempt to sanction a firm requires careful and objective marshalling of all relevant facts, along with finesse and candor in presenting the good and the bad facts to the court. Sound and considered judgment, including a willingness to concede error or misstep when appropriate, must be brought to bear on the situation. Today's panel discussion will address those more subtle issues, with this paper providing an overview of the rules and doctrines that permit imposition of sanctions.

[1] The author would like to acknowledge that Diana DiGennaro of Arnold & Porter LLP co-authored an article on sanctions in 2010 that was a useful resource in preparing this article. Christy Hubbard, also of Arnold & Porter LLP, contributed research and editing assistance for this article.

II. Common Sources Of The District Court's Sanction Power Related To Advocacy.

When the advocacy of a lawyer or law firms is criticized for lacking candor, good faith, or a sound basis in law, the federal courts can rely on various rules, summarized below, to impose sanctions. Disputes regarding the rules below typically involve alleged failure to investigate the legal or factual validity of a claim or defense, bad faith tactics designed to run up expense for the opposing party, efforts to delay the day of reckoning on a weak claim, as well as misstatements to the court or opposing party.

A. Rule 11.

Rule 11 requires at least one attorney to sign each pleading, written motion or other paper. Fed. R. Civ. P. 11(a). In doing so, the attorney subjects himself or herself, as well as his or her firm, to sanctions in the event that (1) the paper is presented for any improper purpose; (2) the claims, defenses and other legal contentions in the paper are not warranted by existing law or by a nonfrivolous argument for a change in the law or for establishing new law; (3) the factual contentions lack evidentiary support or are not likely to have evidentiary support after further investigation or discovery; or (4) the denials of factual contentions are not based on evidence, belief or a lack of information. *Id.* 11(b). The District Court may impose "an appropriate sanction" on any attorney, law firm, or party for a violation of Rule 11. *Id.* 11(c)(1).

A motion for sanctions pursuant to Rule 11 "should not be made or threatened for minor, inconsequential violations of the standards prescribed by subdivision (b)." *Committee Notes on Amendments to Federal Rules of Civil Procedure* ("*Committee Notes*"), 146 F.R.D. 401, 590 (1993). "Frivolous filings are those that are both baseless and made without a reasonable and competent inquiry." *Buster v. Greisen*, 104 F.3d 1186, 1190 (9th Cir. 1997) (internal quotation marks omitted), *abrogated on other grounds, Fossen v. Blue Cross & Blue Shield of Mont., Inc.,* 660 F.3d 1102 (9th Cir. 2011); *see also W.* Schwarzer, *et al*., *California Practice Guide: Federal Civil Procedure Before Trial* ¶17:208 (2012). For example, a filing is "frivolous" when a

reasonable inquiry would have revealed that an action was barred by principles of *res judicata* and collateral estoppel. *Buster*, 104 F.3d at 1190.

"Improper purpose" may be in the eye of the beholder, but generally the more meritless a pleading or motion is, the more likely it is that a court will *infer* an improper purpose. A lawyer's experience and expertise can work against him or her in this context. The Ninth Circuit has held that, where an experienced lawyer asserts meritless claims, there is a "strong inference" that the action was brought for an improper purpose. *See, e.g.*, *Huettig & Schromm, Inc. v. Landscape Contractors Council of N. Cal.*, 790 F.2d 1421, 1426-27 (9th Cir. 1986) (finding strong inference of improper purpose where partner and associate at a firm specializing in labor litigation filed an action when each knew or should have known that their client had no cause of action). But even legally viable claims can be litigated in such a way as to warrant sanctions. For instance, *FDIC v. MAXXAM, Inc.*, 523 F.3d 566, 587-91 (5th Cir. 2008), involved sanctions against improper litigation tactics employed during an otherwise proper action. There, the action at bench related to a failed savings and loan, and the claims themselves were not sanctionable. However, the FDIC used the litigation as a means to "harass" the adverse party into a deal concerning redwoods forests that were unrelated to the FDIC's claims. On those facts, the Fifth Circuit affirmed Rule 11 sanctions of approximately $7 million against the FDIC.

A sanction imposed under Rule 11 "must be limited to what suffices to deter repetition of the conduct or comparable conduct by others similarly situated." Fed. R. Civ. P. 11(c)(4); *Committee Notes*, 146 F.R.D. at 587. The purpose of Rule 11 is to *deter* misconduct, not compensate for it, so monetary sanctions ordinarily should be paid into court as a penalty, rather than awarded to the opposing party. *Id.* 11(c)(4). Fee-shifting should be limited to "unusual circumstances," where other sanctions might not have sufficient deterrent effect. *See Committee Notes*, 146 F.R.D. at 588. Sanctions under Rule 11 may include nonmonetary directives, penalties or, if warranted, payment of "all of the reasonable attorney's fees and other expenses directly resulting from the violation." Fed. R. Civ. P. 11(c)(4).

Rule 11 does impose some limits on the court's power. Monetary sanctions for presenting claims, defenses or arguments not warranted by existing law, or by a nonfrivolous argument to change the law, may be imposed *only* against counsel (or against a party acting as his or her own lawyer). *Id.* 11(c)(5). But parties represented by counsel remain subject to "sanctions or remedial orders that may have collateral financial consequences . . . , such as dismissal of a claim, preclusion of a defense, or preparation of amended pleadings." *Committee Notes*, 146 F.R.D. at 589.

Rule 11 also mandates a "safe harbor" period to allow the target of a Rule 11 motion to avoid sanctions by withdrawing or correcting the challenged submission. *Id.* 11(c)(2); *see also In re Pennie & Edmonds LLP*, 323 F.3d 86, 89 (2d Cir. 2003). To comply with the "safe harbor" rule, the moving party must serve the motion but refrain from filing it until at least 21 days (or such other period as the court may set) have passed. If the challenged paper, defense, claim, contention or denial is withdrawn or appropriately corrected within the designated time frame, the motion should not be filed. Fed. R. Civ. P. 11(c)(2). Notwithstanding the 21-day "safe harbor" period, "[i]n most cases . . . counsel should be expected to give informal notice to the other party, whether in person or by a telephone call or letter, of a potential violation before proceeding to prepare and serve a Rule 11 motion." *Committee Notes*, 146 F.R.D. at 591. The safe-harbor provision of Rule 11 provides law firms and their clients with a valuable opportunity to avoid sanctions by using the safe-harbor period to evaluate the alleged basis for sanctions and, if appropriate, to take corrective measures. It can be valuable for counsel who face a Rule 11 motion to get second or third opinions from others in the firm or from outside counsel, because emotions can run high when a lawyer is accused of violating Rule 11.

Rule 11 has other special procedural requirements that must be met to seek sanctions successfully. Requests for sanctions must be made as a separate motion, *i.e.*, not simply by letter or as part of another motion. *Id.* 11(c)(2). If the court considers imposing monetary sanctions *sua sponte*, the court must issue an order to show cause. *Id.* 11(c)(3).

Rule 11 does not apply to disclosures, discovery requests, responses, objections nor motions under Rules 26 through 37. *Id.* 11(d). As explained below, various other sanctions provisions apply to the documents exempted from Rule 11's reach.

B. Local Rules.

Many courts have local rules authorizing the imposition of sanctions, including fee awards, against parties or counsel for failure to comply with the local rules. *See*, *e.g.*, N.D. Cal. L.R. 1-4; E.D. Cal. L.R. 11-110. The court's authority to promulgate rules is derived from its inherent power, the Federal Rules and federal statute. *See Zambrano v. City of Tustin*, 885 F.2d 1473, 1479 (9th Cir. 1989). "Congress provided authority to the federal courts to make local rules for the proper administration of judicial business." *Id*.

The power to impose sanctions under this authority is limited. *See Zambrano,* 885 F.2d at 1480. Sanctions under local rules must be consistent with the Federal Rules and applicable statutes, and necessary for the court "to carry out the conduct of its business." *Id.* (internal quotation marks and quoting citation omitted). Such sanctions must also be consistent with "principles of right and justice" and "proportionate to the offense and commensurate with principles of restraint and dignity in judicial power." *Id.* (internal quotation marks and quoting citation omitted). These principles include "a responsibility to consider the usefulness of more moderate penalties before imposing a monetary sanction." *Id.*

Accordingly, sanctions generally may not be imposed for mere negligence; conduct amounting to "recklessness, gross negligence, repeated--although unintentional--flouting of court rules, or willful misconduct" is required for the imposition of monetary sanctions under local rules. *Zambrano,* 885 F.2d at 1480.

C. 28 U.S.C. §1927.

Under Section 1927, an attorney who "*so multiplies the proceedings in any case unreasonably and vexatiously* may be required by the court to satisfy personally the excess costs, expenses,

and attorneys' fees reasonably incurred because of such conduct." 28 U.S.C. §1927 (emphasis added). Unlike Rule 11 awards, which are limited to the amount necessary to deter and punish violators, Section 1927 exists to allow compensation to the victim of abusive litigation tactics. Sanctions under Section 1927 "are levied to compensate the victims of dilatory practices, not as a means of punishment." *Hamilton v. Boise Cascade Express*, 519 F.3d 1197, 1203 (10th Cir. 2008).

"Multiplying" the proceedings can take a variety of forms. *See, e.g., Hamilton v. Boise Cascade Exp.* (attorney sanctioned under Section 1927 for filing a motion to enforce settlement agreement in which attorney misrepresented opposing counsel's position and thereby unreasonably and vexatiously multiplied proceedings); *Edwards v. Gen. Motors Corp.*, 153 F.3d 242, 246 (5th Cir. 1998) (plaintiff's attorney sanctioned under Section 1927 for refusing to disclose to defendant her decision to abandon prosecution of the case, requiring defendant to continue to defend the case and the court to continue to consider the case's merits). Perspective is everything here, as *Norelus v. Denny's, Inc.*, 628 F.3d 1270 (11th Cir. 2010), demonstrates. In that case, attorneys for a civil rights plaintiff were sanctioned nearly $400,000 when they submitted a 63-page errata sheet setting forth more than 800 changes to the plaintiff's deposition testimony. The majority of the three-judge panel viewed this tactic as a gambit to keep a frivolous case alive. "When the truth was thrust in the [sanctioned attorneys'] faces, they stubbornly ignored it and kept on litigating." *Id.* at 1283. But dissenting Judge Tjoflat had an entirely different interpretation of the facts. Judge Tjoflat noted that the attorneys had not sent the errata sheet to the court reporter to be made part of the record of the deposition but instead had simply sent the errata sheet to defense counsel in correspondence. In Judge Tjoflat's view, plaintiff's counsel owed a duty to inform defense counsel that their client had made statements to them that conflicted with her deposition testimony, and defense counsel erred by not treating the deposition transcript as standing unchanged and proceeding accordingly. "In essence, the [attorneys] did nothing that a reasonable attorney would not have done under the circumstances. They plainly should not be

held responsible for defense counsel's errors that ultimately prolonged this litigation unnecessarily." *Id.* at 1303 (Tjoflat, J., dissenting).

A finding that the multiplication of the proceedings was *both* unreasonable and vexatious is required to impose Section 1927 sanctions. *FDIC v. Conner*, 20 F.3d 1376, 1384-85 (5th Cir. 1994) (vacating District Court's Section 1927 sanction where no finding that attorney's actions were vexatious). The federal circuits disagree as to whether bad faith must be found to impose Section 1927 sanctions. *Compare Edwards*, 153 F.3d at 246 (to impose sanctions, court must find "bad faith, improper motive, or reckless disregard of the duty owed to the court") *and Schwartz v. Millon Air, Inc.*, 341 F.3d 1220, 1225 (11th Cir. 2003) ("something more than a lack of merit is required. . . . The statute was designed to sanction attorneys who willfully abuse the judicial process by conduct tantamount to bad faith") (internal citations and quotation marks omitted) *with Hall v. Liberty Life Assurance Co.*, 595 F.3d 270, 275 (6th Cir. 2010) ("A court may sanction an attorney under § 1927 for unreasonably and vexatiously multiplying the proceedings even in the absence of any "conscious impropriety") (citation omitted). In the Sixth Circuit, "[t]he proper inquiry is not whether an attorney acted in bad faith; rather, a court should consider whether "an attorney knows or reasonably should know that a claim pursued is frivolous, or that his or her litigation tactics will needlessly obstruct the litigation of nonfrivolous claims." *Id.* at 275-76 (citation omitted).

Unlike Rule 11 and the court's inherent powers, Section 1927 is specifically limited to misconduct by attorneys; it cannot be used to sanction the client, even if the client is jointly responsible. *Procter & Gamble Co. v. Amway Corp.*, 280 F.3d 519, 525 (5th Cir. 2002) (under Section 1927, "[t]he court can shift fees only to counsel, not to parties"). Nor can Section 1927 be imposed against law firms. *Rentz v. Dynasty Apparel Indus., Inc.*, 556 F.3d 389 (6th Cir. 2009).

D. Exceptional Case Fee Shifting Under 35 U.S.C. §285.

Under 35 U.S.C. §285, "[t]he court in exceptional cases may award reasonable attorney fees to the prevailing party" in patent infringement litigation. "The award of attorney fees under § 285 is within the discretion of the court, and the exceptional nature of the case must be established by clear and convincing evidence." *Cambridge Prods., Ltd. v. Penn Nutrients, Inc.*, 962 F.2d 1048, 1050 (Fed. Cir. 1992) (citation omitted).

The determination of whether a case is exceptional and eligible for fee shifting is a two-step process. *Digeo, Inc. v. Audible, Inc.*, 505 F.3d 1362, 1366-67 (Fed. Cir. 2007). The District Court must (1) determine whether there is clear and convincing evidence that a case is exceptional and if so, then (2) determine in its discretion whether an award of attorneys' fees is justified. *Id.* at 1367. The former is a factual determination reviewed for clear error, while the latter is reviewed for abuse of discretion. *Id.*

"Among the types of conduct which can form a basis for finding a case exceptional are willful infringement, inequitable conduct before the P.T.O., misconduct during litigation, vexatious or unjustified litigation, and frivolous suit." *Hoffmann-La Roche, Inc. v. Invamed, Inc.*, 213 F.3d 1359, 1365 (Fed. Cir. 2000) (quotation marks and citations omitted). Even for the extraordinary case, however, an award of attorneys' fees is not automatic. *Nat'l Presto Indus., Inc. v. W. Bend Co.*, 76 F.3d 1185, 1197 (Fed. Cir. 1996). The District Court in its discretion may also "weigh intangible as well as tangible factors: the degree of culpability of the infringer, the closeness of the question, litigation behavior, and any other factors whereby fee shifting may serve as an instrument of justice." *Id.* "[E]xceptional cases" are normally those of bad faith litigation or those involving fraud or inequitable conduct by the patentee in procuring the patent." *Cambridge*, 962 F.2d at 1050-51.

E. Inherent Power Sanctions For Bad Faith Conduct.

A court generally should rely on the statutes and Federal Rules to sanction parties and counsel, 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." *Chambers v. NASCO, Inc.*, 501 U.S. 32, 50 (1991). A "primary aspect" of the court's discretion is "the ability to fashion an appropriate sanction for conduct which abuses the judicial process." *Id.* at 44-45. A court may use its inherent power to impose sanctions on attorneys or parties. *Id.* at 43; *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 766 (1980) ("The power of a court over members of its bar is at least as great as its authority over litigants"). *But see MAXXAM,* 523 F.3d at 593-94 (reversing nearly $57 million sanction against FDIC related to FDIC's pursuit of an administrative proceeding, because the administrative proceeding was not before the court and, as a result, sanctions related to that proceeding were beyond the court's inherent powers).

Notably (and often regrettably for counsel), imposition of inherent-power sanctions requires a finding of bad faith. That requirement was intended on a check on what could otherwise be arbitrary and unrestrained judicial power. "A court must . . . 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." *Chambers*, 501 U.S. at 50; *see also Zambrano*, 885 F.2d at 1478 ("we have routinely insisted upon a finding of bad faith before sanctions may be imposed under the court's inherent power"); *Schmude v. Sheahan*, 420 F.3d 645, 650 (7th Cir. 2005) ("Because these inherent powers are potent, they must be exercised with caution and restraint"). In practice the bad-faith requirement motivates adversaries to ascribe bad faith to counsel because mere negligence is insufficient to justify inherent-power sanctions.

III. Discovery Sanctions.

Numerous sanctions provisions related to discovery are found throughout the Rules, as summarized in this section. Discovery disputes are, of course, common, and sanctions requests in connection with such requests are nearly as common. Most discovery disputes do not warrant attention of a firm's general counsel. Those that do include:

- allegations that the client, while represented by the firm, was not sufficiently diligent in locating and producing information, particularly electronically stored information;
- allegations that the client failed to impose a litigation hold during a period when the firm represented the client on the matter in question;
- allegations that misstatements have been made, or altered evidence produced, in discovery;
- allegations that evidence has been lost, spoiled or destroyed while the client was represented by the firm concerning the matter in issue.

The substantive law concerning counsel's role and responsibility in connection with a client's collection and production of information has been evolving rapidly in light of the overwhelming amount of information now stored electronically. Summarizing that law would itself warrant a substantial paper, but an excellent overview can be found in an opinion that District Judge Shira Scheindlin of New York dubbed "*Zubulake Revisited*" after her influential *Zubulake* series of opinions. *Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Secs.*, 685 F. Supp. 2d 456 (S.D.N.Y. 2010). In her "*Zubulake Revisited*" opinion, Judge Scheindlin provides a detailed discussion of litigation holds and document collection practices, along with a summary of the consequences of missteps in those areas. In addition, the facts Judge Scheindlin describes in *Zubulake Revisited* are a cautionary tale and a good teaching vehicle.

A. Rule 26(g).

Rule 26 governs the duty to disclose and sets forth general provisions regarding discovery, as well as providing the counterpart to Rule 11 in discovery proceedings. Under Rule 26, every discovery disclosure, response and request must be signed and certified by at least one attorney. That attorney may be subject to monetary sanctions for discovery requests, disclosures or responses lacking substantial justification. Fed. R. Civ. P. 26(g).

B. Rule 30(g).

A court may award "reasonable expenses," including attorney fees, against the party noticing a deposition if the deposition does not occur as noticed. Fed. R. Civ. P. 30(g).

C. Rule 37.

Pursuant to Rule 37, a court has authority to impose a full range of sanctions against attorneys or parties for violations of discovery orders or abusive conduct in the course of discovery proceedings. Sanctions may be imposed in the district where a deposition is taken for failure to obey a court order to answer a question. Fed. R. Civ. P. 37(b)(1). Such conduct may be treated as contempt of court. *Id.*

In addition, sanctions for deposition misconduct may also be imposed in the district where an action is pending. The court may impose sanctions for failure to comply with a court order to provide or permit discovery. Fed. R. Civ. P. 37(b)(2). The court may issue "further just orders," including directing that matters encompassed by the order or other designated facts be taken as established; prohibiting the disobedient party from pursuing designated claims, defenses or contentions; striking pleadings in whole or in part; dismissing the action in whole or in part; rendering a default judgment; or treating the conduct as contempt of court. *Id.* 37(b)(2)(A)(i)-(vii). The court may also impose sanctions for not producing a person for examination if ordered to do so under Rule 35(a). *Id.* 37(b)(2)(B). In all cases, instead of, or in addition to, the orders listed above, the court *must* order the disobedient party, its attorney, or

both, to pay the "reasonable expenses, including attorney's fees, caused by the failure," unless there is some justification for the conduct. *Id.* 37(b)(2)(C).

Rule 37 also authorizes the court to impose sanctions for a party's improper failure to make required disclosures under Rule 26, to supplement an earlier response, or to admit what is requested under Rule 36. *Id.* 37(c)(1)-(2). A party likewise may be sanctioned for a failure to attend its own deposition, serve answers to interrogatories, respond to a request for documents, or participate in framing a discovery plan. *Id.* 37(d), (f). In each of these instances, the court may order the disobedient party to pay reasonable expenses, including attorney's fees, caused by the failure. *Id.* 37(c)(1)(A), (c)(2), (d)(3), (f).

Absent exceptional circumstances, however, "a court may *not* impose sanctions under these rules on a party for failing to provide electronically stored information lost as a result of the routine, good-faith operation of an electronic information system." Fed. R. Civ. P. 37(e) (emphasis added).

IV. Other Sources Of The District Court's Sanction Power.

While the sanctions provisions discussed above are the ones that most commonly become a source of significant disputes, litigators and law firm general counsel should be aware of additional, less commonly relied upon sanctions provisions discussed briefly below.

- **28 U.S.C. §1447(c).**

Removal is a complicated and unforgiving procedure that deserves special attention for many reasons. Among them is the fact that attorneys' fees and costs may be imposed for improper removal of a case from state to federal court. 28 U.S.C. §1447(c) ("An order remanding the case may require payment of just costs and any actual expenses, including attorney fees, incurred as a result of the removal").

- **Fed. R. Civ. P. 16(f).**

Rule 16, which governs pretrial conferences, scheduling and case management, empowers the court to impose sanctions if a party or its attorney (a) fails to appear at a scheduling or other pretrial conference; (b) is "substantially unprepared" to participate in the conference or does not participate in good faith; or (c) fails to obey a scheduling or other pretrial order. Fed. R. Civ. P. 16(f)(1)(A-C). To remedy any of the above, the court may issue any "just orders," including those authorized by Rule 37(b)(2)(A)(ii)-(iii). *Id.* Rule 37 authorizes the court to issue orders "prohibiting the disobedient party from supporting or opposing designated claims or defenses, or from introducing designated matters in evidence" (*id.* 37(b)(2)(A)(ii)), and "striking pleadings in whole or in part." *Id.* 37(b)(2)(A)(iii).

Rule 16 also provides that "[i]nstead of or in addition to any other sanction, the court *must* order the party, its attorney or both to pay the reasonable expenses—including attorney's fees—incurred because of any non-compliance with this rule, unless the noncompliance was substantially justified or other circumstances make an award of expenses unjust." *Id.* 16(f)(2) (emphasis added).

- **Fed. R. Civ. P. 41(b).**

A court may dismiss an action as a sanction for the plaintiff's failure to prosecute the action diligently or otherwise comply with the Federal Rules or any court order. *See* Fed. R. Civ. P. 41(b).

- **Fed. R. Civ. P. 56(h).**

Submission of "bad faith" affidavits in support of or in opposition to a motion for summary judgment may result in the imposition of monetary sanctions or contempt. *See* Fed. R. Civ. P. 56(h).

- **Rules Of Professional Conduct.**

Violations of applicable state rules of professional conduct may result in the imposition of sanctions in federal court. *See, e.g.*, *Midwest Motor Sports v. Arctic Cat Sales, Inc.*, 347 F.3d 693, 697 (8th Cir. 2003) (evidentiary sanction excluding information obtained by counsel in violation of state rule of professional conduct). Most District Courts, via local rule, adopt the state rules of professional conduct of the state in which the District Court sits, but the precise phrasing of these local rules vary, as do procedures and customs for enforcement.