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"Common Sense Legal Reforms Act" Takes Center Stage

Not sure what to think? Read the detailed description below and decide for yourself

by Susan J. Becker, *Associate Editor*

As the popular press has reported, Congress is pursuing extensive and highly controversial civil litigation reforms which, as House Speaker Newt Gingrich and others had pledged, have been approved largely along party lines in the House of Representatives.

Whether the Senate will follow the House's lead during this 104th Congress remains to be seen. The Clinton administration has characterized some of the reforms as "extreme" and "disturbing," but has promised to work with Congress to enact more balanced reforms.

Introduced in the Republicans' "Contract with America," and expanded upon in a series of bills recently considered, thoroughly debated and amended, and eventually passed by the House, Republicans characterize their proposed reforms as vital to curb "the overuse and abuse of the legal system" which they claim costs United States citizens $300 billion a year for "needlessly higher prices for products and services." According to reform advocates—who include several House Democrats—misuse of state and federal courts have "put the legal system out of reach for the average American."

The reforms set forth in the "Attorney Accountability Act of 1995" (H.R. 988), the "Securities Litigation Reform Act" (H.R. 1058), and the "Common Sense Legal Standards Reform Act of 1995" (H.R. 956), affect both substantive and procedural law. As the titles of this legislation suggest, particular emphasis is placed on attorney conduct, products liability, and securities litigation.

The reforms approved by the House that directly impact litigators include a modified "loser-pays" attorneys' fee rule in diversity cases, reinstatement of mandatory sanctions—including a punitive element—for violations of Federal Rule of Civil Procedure 11 and re-attachment of Rule 11 to discovery matters, a uniform federal products liability law, a $250,000 cap on punitive damage awards in all state and federal civil court matters, a limitation of $250,000 for non-economic (i.e. pain and suffering, emotional distress, etc.) damages in medical malpractice cases, and elimination of joint and several liability in all civil litigation which affects interstate commerce.

Many other reforms were proposed but ultimately rejected by the House. These reforms included a requirement that plaintiff provide a written notice to defendant prior to initiation of a civil action, mandatory disclosure to the client of the time and services devoted by the attorney to a contingency fee case, a prohibition against courts entering protective orders to seal the records in cases involving health and safety issues, a rule allowing juries to consider collateral sources of a victim's compensation in assessing damages, and a sunset clause halting the reforms in five years unless the Secretary of Commerce certifies that insurance rates have dropped 10 per cent or more during that time. These proposals may resurface in the Senate.

While many attorneys, judges, legal scholars, and lay persons agree that the stated goals of the House Republicans' reform efforts are laudable, the specific legislation passed by the House has been simultaneously applauded and criticized by individuals and groups representing diverse constituencies. Not surprisingly, attorney sanctions under Federal Rule of Civil Procedure 11 are again at the eye of the storm.

Debra Ballen, Senior Vice President of the Policy Development and Research branch of the American Insurance Association (AIA), was among those who urged the House Subcommittee on Courts and Intellectual Property to strengthen Rule 11 beyond the proposals initially introduced in the House.

"While casual observers might view a federal rules change as largely technical, AIA believes Rule 11 has the potential to be one of the most effective means of curbing frivolous and abusive litigation tactics by plaintiffs and defendants alike," Ballen stated.

Ballen's specific proposals that Rule 11 be restored to its pre-1993 strength by reinstating the requirement of prefiling verification of the facts and elimination of the "safe harbor" provision of Rule 11, adopted in 1993, which permits a party to withdraw an otherwise-sanctionable pleading without penalty, were not approved by the House.

The opposing view of Rule 11 reforms was voiced by DePaul University Law Professor Stephan Landsman, Chicago, to participants at the Section of Litigation's Winter Council/Committee Chairs Meeting.

"What the Common Sense Legal Reforms Act legislation proposes to do is ignore every scrap of evidence about the unsoundness of Rule 11, to reject the advice of every critic of the prior rule, and to overrule the Rules Enabling Act process by restoring many of the most criticized aspects of the prior rule," said Landsman, who is a member of the Section's Task Force on the Justice System. "The empirical evidence suggests that there is no clearer way to increase the caseload of the federal courts, heighten incivility, and undermine effective judicial management" than to again drastically revise Rule 11.

Arguments similar to those advanced by Ballen and Landsman will no doubt be heard by the Senate. Such combative comments have led Speaker Gingrich to admit that the legal reforms section of the Contract with America will be the

toughest to get through Congress. "It's just going to be a brawl," Gingrich predicted.

Political compromises are inevitable as the Senate now begins its study of the "Common Sense Legal Reforms" in earnest. But here is a description of the individual features of the reforms as approved by the House:

Attorney Fee-Shifting in Diversity Cases

Severe sanctions may be imposed upon a party who obtains a judgment or final verdict which is less favorable than a settlement offered by her opponent at least 10 days prior to trial. The House's version of the "Attorney Accountability Act" (H.R. 988) amends 28 U.S.C. 1332 to allow an assessment of attorneys' fees and costs against a party who rejected a written offer (or offers) to settle one or more claims for money or property or on any other terms, if the offeree's final award "is not more favorable to the offeree with respect to the claim or claims than the last such offer."

Costs and expenses associated with the claim or claims are assessed from the date of the last offer, presumably (although not expressly stated in the Act) until the date of the final judgment. The Act does not specify whether the offerer is also entitled to reimbursement for expenditures related to the filing and pursuit of the petition for costs and expenses.

The award of attorneys' fees is determined by the market rate and capped at "the actual cost incurred by the offeree" for attorney services relating to the claim or claims on which settlement offers were made. If the offeree has a contingency fee arrangement, then the cap is the "reasonable cost" for an attorney to provide the services to the offeree in a noncontingency setting.

There are several exceptions to the fee-shifting rule. It is not applicable to claims seeking an equitable remedy; where the court, either sua sponte or by motion of a party, finds a claim exempt because it "presents a question of law or fact that is novel and important and that substantially affects nonparties"; or where the court otherwise finds that imposition of a cost and expenses sanction would be "manifestly unjust."

Issues left unanswered by the Act's expense-shifting amendment to 28 U.S.C. 1332 include the appropriateness of, as well as the mechanics for, determining whether a settlement offer of certain property was "more favorable" than the dollar amount awarded on that claim and the particular evidentiary burdens of the offerer and offeree in establishing the fee award. Perhaps the most troublesome aspect is the potential breach of attorney-client privilege and work-product resulting from the revelation of how much time and other resources the offeree's attorney devoted to a particular issue. (This exercise is necessary to set the cap on the offerer's recovery.) The Act also fails to specify what "costs" and "expenses," other than the attorneys' fees, are reimbursable to the offerer pursuant to the legislation.

Mandatory Sanctions Under Rule 11

Heightened scrutiny of attorney conduct is further mandated by proposed section 4 of the Attorney Accountability Act, which reinstates the mandatory imposition of sanctions for violation of Rule 11(c). (This imposition had been rendered discretionary by the 1993 amendments to Rule 11.) In addition to compensating the party for the actual financial injury caused by the offensive conduct, the trial court is directed to impose a punitive sanction sufficient to deter repetition of the conduct by the wrongdoer and others similarly situated. The Act also strikes the language added as subsection "d" of Rule 11 in 1993; with this deletion, Rule 11 again becomes applicable to attorney misconduct related to discovery matters.

Federalized Products Liability

Products liability law will become federalized if the Senate follows the House's plan to substantially overhaul this substantive area of the law traditionally relegated to state legislatures and courts. Enacted pursuant to Congress's power to regulate interstate commerce, H.R. 956 expressly preempts state products liability law on a number of important issues such as limits on punitive damages and joint and several liability; it also restricts, but does not clearly define, the liability of the "product seller" and "manufacturer."

The Act specifically declines to create a federal cause of action for products liability; thus, federal courts will continue to have jurisdiction over products liability lawsuits only where diversity or other ground for federal jurisdiction exists. The Act does, however, extend jurisdiction of the federal courts to all products liability actions for injuries caused in the United States by a product manufactured in a foreign country by a foreign manufacturer.

"Product" means "any object, substance, mixture, or raw material in a gaseous, liquid, or solid state" capable of delivery by itself or combined with other products which is intended for sale for commercial or personal use. It does not include human tissue, blood or organs, nor does it apply to products such as water and electricity when furnished by a utility.

The Act defines "product seller" as one "who, in the course of a business conducted for that purpose, sells, distributes, rents, leases, prepares, blends, packages, labels a product or is otherwise involved in placing a product in the stream of commerce," or one "who installs, repairs, or maintains the harm-causing aspect of a product."

Sellers and lessors of real property, providers of professional services whose involvement with the sale or use of a product was incidental to the services performed on behalf of the claimant, and persons who have acted only in a financial capacity in respect to the sale are expressly excluded from the definition of product sellers.

"Manufacturer" is a person "who is engaged in a business to produce, create, make, or construct any product," or component part thereof, that he has designed or engaged another to design. A product seller can be deemed a manufacturer if, prior to placing the product or component in the stream of commerce, he designs or formulates an aspect of an already-manu-

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"Common Sense Legal Reforms Act" at a Glance

- Allows judicial discretion to award attorneys' fees and other expenses to a party in a diversity case who offered to settle a claim or claims prior to trial for more than the offeree is ultimately awarded by the trier of fact.
- Creates federal law governing all state and federal products liability actions; new law limits the liability of "product sellers," renters and leasing companies to cases where negligence is shown. State law continues to govern many issues not addressed in the federal legislation.
- Shields defendants in products liability actions where the plaintiff was intoxicated by alcohol or drugs at the time of the injury, where the FDA has approved the drug or medical device which caused the injury, where the injury was caused by misuse or alteration of the product, and where a cause of action was filed more than 15 years after the product was delivered to the first purchaser or lessee.
- Rejects joint and several liability of defendants in all civil litigation affecting interstate commerce in favor of the so-called Fair Share, fault-apportioned damage awards.
- Limits punitive damages in all federal and civil state court actions to a maximum of $250,000, and requires a "clear and convincing" showing by the plaintiff of defendant's intentional wrongdoing or at least "conscious, flagrant indifference."
- Sets a $250,000 limit on damage awards for noneconomic damages such as pain and suffering in health care liability litigation.
- Amends Federal Rule of Evidence 702 to exclude scientific testimony by an expert witness unless the witness's opinion is "scientifically valid and reliable" and is more probative than prejudicial.
- Prohibits certain causes of action based on securities fraud from being pursued under RICO.
- Revamps securities litigation to (1) require a showing of intentional misrepresentation or omission on the part of defendant in a 10(b) action; (2) directs the SEC to establish criteria which, if followed, create a "safe harbor" for issuers making forward-looking financial predictions; (3) allows for an award of attorneys' fees and other expenses, including expert witness's fees, to the prevailing party; and (4) incorporates a number of provisions to protect the interests of plaintiff class members.
- Reverses some of the more controversial 1993 amendments to Federal Rule of Civil Procedure 11 by reinstating mandatory imposition of sanctions for attorneys and parties who violate its provisions and re-establishes Rule 11 as controlling on discovery matters.—S.J.B.

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factured product, "produces, creates, makes, or constructs" an aspect of the product, or holds himself out "as a manufacturer to the user of the product."

Product sellers, renters or leasing companies (including automobile rental enterprises) are shielded from liability unless claimant establishes that the defendant "failed to exercise reasonable care with respect to the product" which caused the harm. Liability does not attach to a product seller who has not had reasonable opportunity to inspect the product in a manner which would have revealed the harmful aspect of the product.

The product seller would, however, be liable for harm caused by breach of express warranty and by intentional misconduct as defined by state law. The product seller is also liable as if he were the manufacturer in a jurisdiction where the manufacturer is not subject to service of process or where the court determines the claimant would be unable to enforce a judgment against the manufacturer.

The product liability sections of H.R. 956 do not specify the grounds upon which a manufacturer will be held liable, but does contain a general provision that any issue not governed by the Act "shall be governed by otherwise applicable state or federal law." Current products liability law generally allows a claimant to sue a manufacturer for strict liability as set forth in Restatement (Second) of Torts 402, negligence, and breach of implied or express warranties.

The Act also replaces joint and several liability for noneconomic damages (such as mental distress, loss of consortium, and pain and suffering) with a system in which each defendant "shall be liable only for the amount of noneconomic damages attributable to such defendant in direct proportion to such defendant's proportionate share of fault or responsibility for the claimant's harm as determined by the trier of fact." The House initially approved this "Fair Share" amendment as applicable only to products liability litigation, but amended H.R. 956 prior to passage to eliminate joint and several liability for noneconomic losses in all civil lawsuits that involve interstate commerce.

Representative Barney Frank (D-Mass.) was among those staunchly opposed to the Fair Share provision. "This amendment is about every civil lawsuit, and it says you can't trust the juries and you can't trust the states," Frank opined during the House debate. "This belies the notion that the Contract is about giving power back to the states."

The Act also codifies several defenses to products liability action. It provides a complete defense if "the claimant was intoxicated or was under the influence of intoxicating alcohol or any drug." It bars a cause of action if the complaint is filed more than 15 years after the product was delivered to the first purchaser or lessee. Products which cause chronic illness (i.e., asbestos) or which carry an express warranty longer than 15 years are not shielded by this statute of repose.

The Act further provides at least a partial defense where misuse or alteration of the product proximately caused the claimant's injury. In such cases, the defendant's liability "shall be reduced by the percentage of responsibility for the claimant's harm attributable to misuse or alteration of a product by any person." Unlike many state comparative negligence models, however, the Act does not relieve the defendant from all liability if the "percentage of responsibility" for the harm is greater than 50 percent.

Finally, the Act includes the so-called FDA Defense, which bars punitive damages for harm caused by drugs or medical devices if the injurious product has been approved by the federal Food and Drug Administration. This defense is not available to a defendant who withheld relevant information or provided false data to the agency to obtain FDA approval.

Punitive Damage Awards

Perhaps the most controversial of the reforms passed by the House are limitations on punitive damages contained in H.R. 956. Again flexing its Commerce Clause muscle, the House limited punitive damage awards "in any civil action," in state and federal courts, to cases where a claimant can make a "clear and convincing" showing that the defendant specifically intended the harm or acted in a manner "manifesting a conscious, flagrant indifference to the rights of others."

Even if the claimant meets this burden, punitive damages are limited to three times the amount of the damages for "actual harm" (i.e., excluding noneconomic items), or $250,000, which ever is greater. These limitations are not disclosed to the jury but must be applied by the judge.

Health Care Liability

In addition to the punitive damage limitations discussed above which apply to all civil causes of action, H.R. 956 sets a $250,000 limit for damage awards for noneconomic damages (such as pain and suffering and loss of enjoyment of life) in health care liability litigation. This eleventh-hour amendment was characterized by supporters as an appropriate response to the information gathered during last year's health care reform debate.

Federal Rule of Evidence 702 Alterations

Amendments to Federal Rule of Evidence 702 governing expert witness testimony would also affect—although minimally—products liability, medical malpractice, and other civil cases. As articulated in a section of 988 subtitled "Honesty in Evidence," revised Rule 702 prohibits testimony by any expert witness retained on a contingency fee basis. The Act precludes expert scientific testimony unless the court determines that the expert's opinion "(1) is scientifically valid and reliable; (2) has a valid scientific connection to the fact it is offered to prove; and (3) is sufficiently reliable so that the probative value of such evidence outweighs the dangers specified in rule 403."

This amendment, which is not applicable to criminal proceedings, essentially codifies the interpretation of Rule 702 recently mandated by the U.S. Supreme Court in *Daubert v. Merrell Dow*. The controversy surrounding Rule 702 changes are based more on Congress's efforts to trump the Court's authority as the rule-making body rather than the content of the amendment.

Substantial Changes to Securities Litigation

Finally, H.R. 1058, the "Securities Litigation Reform Act," seeks to substantially reform securities litigation through extensive amendments to the Securities Exchange Act of 1934. The legislation is explicitly crafted to end "strike suits" and "fishing expeditions," and to create a "safe harbor" for those who make predictive statements about an issuer. It also prohibits actions brought under the Racketeer Influenced and Corrupt Organizations Act (RICO) if the racketeering activity complained of involves fraudulent conduct in the purchase or sale of securities. This reform movement enjoyed significant bipartisan support in the Democratic-led 103d Congress.

To prevail on a 10(b) action, plaintiffs will have to plead and prove scienter on the part of the defendant in making or omitting a material fact which misled investors. Plaintiffs must also prove reliance on the defendant's misstatement and that the misstatement actually cause their injuries. Plaintiffs who cannot meet these burdens or otherwise prevail on their claims are subject to a "loser-pays" fee-shifting provision employed at the discretion of the trial court.

In addition to attorneys' fees, the losing party may also have to reimburse her opponent for expert witness fees and the cost of "any study, analysis, report, test, or project which is found by the court to be necessary for the preparation of the party's case." The House legislation also mandates the imposition of attorneys' fees and other expenses on a party who unjustifiably initiates or defends against a motion to compel or a motion seeking a protective order.

H.R. 1058 further directs the Securities and Exchange Commission (SEC) to establish rules and regulations creating "clear and objective guidance" for forward-looking statements concerning the future economic performance of an issuer. The criteria must be sufficient to protect potential investors while also establishing a "safe harbor" provision for issuers who comply with the SEC criteria.

Explicit revisions to the 1934 Act also attempt to derail the careers of "professional plaintiffs" by limiting, except for good cause shown, a person from being a named plaintiff, or from serving as an officer, director or fiduciary of a named plaintiff, in more than five class action suits filed during any three-year period. Upon motion of a party, the court can also determine whether an attorney "who owns or otherwise has a beneficial interest in the securities that are the subject of the litigation" should be disqualified from representing the class due to potential or actual conflict of interest.

Proposed reforms also include court appointment of a plaintiff steering committee for class actions. The committee possesses "all powers normally permitted to an attorney's client in litigation," such as the power to retain or terminate counsel, the authority to reject a settlement offer, and to accept a settlement subject to final court approval. H.R. 1058 also mandates that detailed information be provided to class members considering a settlement offer, including an overview of the potential outcome of the case if not settled and a statement explaining the attorneys' fees that will be sought from any settlement fund.

The Senate Banking, Housing and Urban Affairs Securities Subcommittee is considering a bill (S. 240) similar to H.R. 1058. The Senate and House approaches to securities litigation reforms will be reconciled before the legislation is introduced to the full Senate.

Section members who want to help efforts in this area or who want more information, may call the Co-Chairs of the Section's Federal Legislation Committee, Gail Lione (202) 955-2086 or Mitchell Dolin (202) 662-5210.

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