

# PROFESSIONAL LIABILITY LITIGATION

Professional Liability Litigation Committee, ABA Section of Litigation



VOLUME IV, NUMBER 1, WINTER 2007

## In This Issue

**8 E-Discovery In Legal Malpractice Lawsuits: December 1, 2006, Federal Rule Amendments & the Discovery of Electronically Stored Information From Lawyers and Law Firms**  
By Dina Cox

**16 When Negligence Is Not Enough: Proving Causation in a Litigation Malpractice Case**  
By Kelli Hinson and Carolyn Raines

## THE DELAWARE SUPREME COURT CLARIFIES DIRECTOR DUTIES IN DISNEY

By Peter L. Welsh

### Introduction

On June 8, 2006, the final chapter was written in the decade-long shareholder litigation stemming from the hiring and termination of Michael Ovitz by the Walt Disney Company (“Disney” or the “Company”), and the payment to Ovitz of approximately \$130 million in severance.<sup>1</sup> After nearly ten years of litigation, two motions to dismiss, two appeals, extensive fact and expert discovery, a motion for summary judgment and a trial on the merits, the Delaware courts have found that the Disney directors did not breach their fiduciary duties and did not commit corporate waste as a result of the decisions to agree to, and to pay, lucrative severance under Ovitz’s employment agreement. The Chancery Court held in 2005, following a trial on the merits, that the directors’ decisions are protected by the business judgment rule. And the Delaware Supreme Court has now upheld the Chancery Court’s post-trial decision.<sup>2</sup>

The fact that the Delaware Supreme Court has upheld the Chancery Court’s post-trial decision is unremarkable in itself. The Chancery Court’s decision was well-reasoned and brought some much needed – and long overdue – moderation to the dispute over Ovitz’s severance. What is remarkable about the Supreme Court’s decision is that it restores the all-important distinction between a breach of the fiduciary duty of care, on the one hand, and a breach of the fiduciary duty of good faith, on the other hand. That distinction had been blurred by decisions of the Chancery

[Continued on Page 4](#)

## “BYE, BYE ‘TRIAD’”

By Peter L. Welsh

On November 6, 2006, the Delaware Supreme Court issued an important decision solidifying its holding in *In re Walt Disney Derivative Litigation* and putting to rest any lingering uncertainty surrounding one of the erstwhile “triad” of fiduciary duties – the fiduciary “duty of good faith.”

In *Stone v. Ritter*,<sup>1</sup> the Delaware Supreme Court upheld the Chancery Court’s dismissal, under Rule 23.1, of a complaint alleging breaches by the directors of AmSouth Bancorporation of their so-called *Caremark* oversight duties. Under *Caremark*, directors of a Delaware corporation may be liable for breach of fiduciary duty for a “sustained or systematic” failure to exercise appropriate oversight of the company’s operations and, in particular, of its compliance with the law.<sup>2</sup> In 2004, AmSouth paid some \$50 million in penalties to resolve various investigations into possible violations of the anti-money laundering prohibitions of the Bank Secrecy Act. Shareholders of AmSouth then sued the directors claiming that they should be held personally liable for the penalties and related costs.<sup>3</sup> The Plaintiffs claimed that Section 102(b)(7) could not protect the directors because the directors had allegedly violated their fiduciary duty of good faith and therefore did not qualify for Section 102(b)(7)’s protections. The Chancery Court and the Supreme Court each, in its turn, rejected this claim.

In upholding dismissal by the Chancery Court, the Supreme Court cited on several occasions to its June 2006 decision in the *Disney* case for the proposition that only a knowing or intentional breach of fiduciary duty will take director conduct outside of the protections afforded by Section 102(b)(7):

As evidenced by the language [used in *Caremark*], the *Caremark* standard for so-called ‘oversight’ liability draws heavily upon the concept of director failure to act in good faith. That is consistent with the definition(s) of bad faith recently approved by this Court in its recent *Disney* decision, where we held that a failure to act in good faith requires conduct that is qualitatively different from, and more culpable than, the conduct giving rise to a violation of the fiduciary duty of care (i.e., gross negligence).<sup>4</sup>

In addition, the Supreme Court then clarified the necessary basis for bringing a *Caremark* claim following *Disney* and *Stone*:

[Continued on Page 3](#)

## MESSAGE FROM THE CHAIRS

**WANTED: a few good men and women.** Over the last couple of months, we have focused our attention on how to increase our Committee's overall effectiveness. Ultimately, we concluded that we need to add additional leadership positions to our existing subcommittees and perhaps even add additional subcommittees or other positions. So, we are actively looking for a few good men and women who want to become more involved. We currently have five subcommittees – Accountants Liability, Attorneys Liability, Attorneys Loss Prevention and Ethics, Directors and Officers Liability, and Professional Liability Insurance Coverage. If you have an expertise in one of these areas or if you have expertise in an area that you think we should add as an additional subcommittee, then please send us an email or give us a call.

As you mull this over, we hope you'll enjoy this edition of our newsletter, which has highlighted issues related to the duties of corporate directors. In an article written by Peter Welsh, the chair of our Directors and Officers Liability Subcommittee, we explore the Delaware Supreme Court's recent clarification of the duties owed by directors in the final chapter of the decade-long shareholder litigation stemming from the hiring and termination of Michael Ovitz by the Walt Disney Company and the payment to Ovitz of approximately \$130 million in severance. The Delaware court has restored the all-important distinction between a breach of the fiduciary duty of care, on the one hand, and a breach of the fiduciary duty of good faith, on the other hand, something that had been blurred by earlier decisions. In *Bye, Bye 'Triad'*, Peter also provides an overview of the November 6, 2006, Delaware Supreme Court opinion in *Stone v. Ritter*, which further solidified the court's prior holding in *Disney* and puts to rest any lingering uncertainty surrounding the "duty of good faith."

Also included in this edition is a thoughtful article by Kelli Hinson and Carolyn Raines concerning the many issues practitioners face when dealing with the "case-within-a-case" scenario that often arises in legal malpractice cases. And, for our Young Lawyers who often find themselves on the front lines of discovery, we have included an article by one of our Newsletter Editors, Dina Cox. This article provides an overview of the recent amendments to the Federal Rules and how those amendments will affect the discovery of electronically stored information held by lawyers and law firms.

As always, we are looking for new topics of interest and articles of varying lengths for our newsletter. If you have any suggestions or would like to submit an article for consideration, please contact one of our newsletter editors, Chad Arnette ([carnette@velaw.com](mailto:carnette@velaw.com)) or Dina Cox ([dcox@lewiswagner.com](mailto:dcox@lewiswagner.com)). Similarly, we are open to suggestions for improving our website. If you would like to submit any materials or suggestions concerning either the content or format of the website, please contact one of our web editors, Seth Meisel ([smeisel@hughesluce.com](mailto:smeisel@hughesluce.com)) or Art Justice ([ajjustice@turnerpadget.com](mailto:ajjustice@turnerpadget.com)). And again, please contact us if you have an interest in getting further involved in our Committee.

Co-chairs, Professional Liability Litigation Committee

Carol C. Payne  
Vinson & Elkins L.L.P.  
Dallas, TX  
Phone: (214) 220-7947  
Fax: (214) 999-7947  
E-mail: [cpayne@velaw.com](mailto:cpayne@velaw.com)

Paul M. Koning  
Hughes & Luce L.L.P.  
Dallas, TX  
Phone: (214) 939-5564  
Fax: (214) 939-5849  
E-mail: [koningp@hughesluce.com](mailto:koningp@hughesluce.com)

### EDITORS

**Chad Arnette**  
Vinson & Elkins LLP  
2001 Ross Avenue, Suite 3700  
Dallas, TX 75201  
Phone: (214) 220-7726  
Fax: (214) 999-7726  
E-mail: [carnette@velaw.com](mailto:carnette@velaw.com)

### Dina Cox

Lewis Wagner L.L.P.  
501 Indiana Avenue Suite 200  
Indianapolis, IN 46202  
Phone: (317) 237-0500  
Fax: (317) 630-2790  
E-mail: [dcox@lewiswagner.com](mailto:dcox@lewiswagner.com)

### SUBCOMMITTEE CHAIRS

#### ACCOUNTANTS LIABILITY

**J. B. Heaton, III**  
Bartlit Beck Herman Palenchar & Scott  
54 West Hubbard Street, 3rd Floor  
Chicago, IL 60610  
Phone: (312) 494-4425  
Fax: (312) 494-4440  
E-mail: [jb.heaton@bartlit-beck.com](mailto:jb.heaton@bartlit-beck.com)

#### ATTORNEYS LIABILITY

**Susan Szabo**  
Munger, Tolles & Olson LLP  
355 South Grand Avenue  
35th Floor  
Los Angeles, CA 90071  
Phone: (213) 683-9568  
Fax: (213) 683-4068  
E-mail: [susan.szabo@mto.com](mailto:susan.szabo@mto.com)

#### ATTORNEYS LOSS PREVENTION AND ETHICS

**Jessica B. Rudin**  
Long & Levit LLP  
465 California St., 5th Floor  
San Francisco, CA 94104  
Phone: (415) 397-2222  
Fax: (415) 397-6392  
E-mail: [jrudin@longlevit.com](mailto:jrudin@longlevit.com)

### DIRECTORS AND OFFICERS LIABILITY

**Peter L. Welsh**  
Ropes & Gray  
One International Place  
Boston, MA 02110  
Phone: (617) 951-7865  
Fax: (617) 951-7050  
E-mail: [pwelsh@ropesgray.com](mailto:pwelsh@ropesgray.com)

### PROFESSIONAL LIABILITY INSURANCE COVERAGE

**Serge Adam**  
Monitor Liability Managers  
2850 West Golf Road  
Rolling Meadows, IL 60008  
Phone: (847) 806-6590  
Fax: (847) 806-4017  
E-mail: [sadam@monitorliability.com](mailto:sadam@monitorliability.com)

### COMMITTEE WEBSITE EDITOR

**Seth E. Meisel**  
Hughes & Luce, LLP  
111 Congress Ave., Suite 900  
Austin Texas 78701  
Phone: (512) 482-6940  
Fax: (512) 482-6859  
E-mail: [seth.meisel@hughesluce.com](mailto:seth.meisel@hughesluce.com)

### Arthur E. Justice, Jr.

Turner Padget Graham & Laney  
1831 West Evans Street, 4th Floor  
Florence, South Carolina 29501  
Phone: (843) 656-4412  
Fax: (843) 413-5819  
E-mail: [ajjustice@turnerpadget.com](mailto:ajjustice@turnerpadget.com)

### VISIT OUR WEBSITE:

[www.abanet.org/litigation/committee/professional/home.html](http://www.abanet.org/litigation/committee/professional/home.html)

### JOIN!!

Become a member of the  
Professional Liability Litigation Committee:  
[www.abanet.org/litigation/committees/join.html](http://www.abanet.org/litigation/committees/join.html)

YOUNG LAWYERS,  
CHECK OUT RESOURCES JUST FOR YOU!  
[www.abanet.org/litigation/younglawyers/home.html](http://www.abanet.org/litigation/younglawyers/home.html)

## “BYE, BYE

From Page 1

We hold that *Caremark* articulates the necessary conditions predicate for director oversight liability:

(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.<sup>5</sup>

Finally, in *Stone*, the Supreme Court also laid to rest the doctrinal dispute over whether the obligation to act in good faith is a separate fiduciary duty under Delaware law. It is not: “[A]lthough good faith may be described colloquially as part of the ‘triad’ of fiduciary duties that includes the duties of care and loyalty, the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty.”<sup>6</sup> Instead, the court held, the obligation to act in good faith, properly understood, is subsumed within the duty of loyalty.

<sup>1</sup> C.A. No. 1570-N, 2006 WL 3169168 (Del. Nov. 6, 2006)

<sup>2</sup> *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996).

<sup>3</sup> *Stone*, 2006 WL 3169168, at \*3.

<sup>4</sup> *Id.* at \*5.

<sup>5</sup> *Id.* at \*6.

<sup>6</sup> *Id.*

---

*Peter L. Welsh is an associate in the Boston office of Ropes & Gray LLP practicing in the areas of securities litigation, transactional litigation and director and officer representation. The statements contained in this article do not necessarily represent the views of Ropes & Gray LLP or its clients and are not intended to constitute, and do not constitute, legal advice.*

---

**SUBSCRIBE** to our periodic HTML bulletin,  
**PROFESSIONAL LIABILITY @LERT,**

to stay informed of the  
latest breaking developments.

If you have not received our HTML bulletins  
or you experience any problems

with your subscriptions,

please contact the ABA Service Center

at **800-285-2221**.

---

The views expressed in *Professional Liability Litigation @Lert* are those of the authors and do not necessarily reflect the position of the American Bar Association, the Section of Litigation, or the Professional Liability Litigation Committee. The publication of articles does not constitute an endorsement of opinions or views that may be expressed.

This publication is intended for general information purposes only and does not constitute nor is it intended to constitute legal advice. None of the materials is intended to imply or establish standards of care applicable to any attorney in any particular circumstance.

*Professional Liability Litigation @Lert* is published quarterly by the Professional Liability Litigation Committee of the Section of Litigation, American Bar Association, 321 N. Clark Street, Chicago, IL 60610. Issue: Winter 2007.

Copyright ©2007 by the American Bar Association.

Court and the Supreme Court issued earlier in the case. With its 2006 decision, the Supreme Court has restored the *status quo ante*.<sup>8</sup> As a consequence, it should become more difficult for shareholder plaintiffs to plead claims for a breach of the fiduciary duty of good faith based on what have long been considered merely “honest mistakes of judgment.”<sup>3</sup>

**The Chancery Court’s Factual Findings**

The facts as found by the Chancery Court in its August 2005 post-trial decision, and upheld by the Supreme Court in June of 2006, may be summarized as follows:

In the summer of 1995, Michael Eisner, then chairman and chief executive officer of Disney, sought to hire Michael Ovitz as the Company’s new president. At the time, Ovitz was considered one of the most successful businessmen in Hollywood. He was widely-regarded as an “exceptional corporate executive” and a “highly successful and unique entrepreneur.”<sup>4</sup> Ovitz was also being courted by MCA, a competitor of Disney, with rumors of a lucrative pay package awaiting Ovitz at MCA should he choose to accept.<sup>5</sup> Ovitz was, at the time, the founder, chairman, chief executive and 55% shareholder of the top talent agency in Hollywood, Creative Artists Agency (“CAA”). He was reportedly earning some \$20-25

**“After nearly ten years of litigation . . . the Delaware courts have found that the Disney directors did not breach their fiduciary duties and did not commit corporate waste as a result of the decisions to agree to, and to pay, lucrative severance under Ovitz’s employment agreement.”**

million a year at CAA. Eisner and Disney wanted Ovitz to leave CAA and come to Disney. Yet, “Ovitz made it clear that he would not give up his fifty-five percent interest in CAA without downside protection.”<sup>6</sup> In the ensuing negotiations with Disney, Ovitz drove a hard-bargain, seeking upside potential, in the form of options on approximately five million shares of Disney stock, as well as downside protection, in the form of automatic acceleration of a substantial portion of those options in the event of a “no fault termination.”<sup>7</sup> As such, the Ovitz pay package was, in the words of the Delaware Supreme Court, “specifically structured to compensate Ovitz for walking away from \$150 million to \$200 million of anticipated commissions from CAA over the five-year . . . contract term.”<sup>8</sup>

During the negotiations with Ovitz, Eisner consulted with Sid Bass and Roy Disney, two of the largest individual shareholders of the company, who both supported hiring Ovitz.<sup>9</sup> Eisner and Irwin Russell, the chairman of the compensation committee of the Disney Board, negotiated the terms of Ovitz’s employment agreement and compensation, including Ovitz’s severance in the event of a “no fault” termination, with Russell taking the “lead role” in the negotiations.<sup>10</sup> With the assistance of Raymond Watson, a member of the compensation committee, and with the advice of a

compensation consultant, Russell conducted a financial analysis of Ovitz’s pay package.<sup>11</sup>

On August 13, 1995, Ovitz accepted Disney’s offer to join the Company as its president.

That evening, Ovitz attended a dinner with Eisner, Disney’s chief financial officer, Stephen Bollenbach, and Disney’s general counsel, Sanford Litvack. At the outset of the dinner, Bollenbach and Litvack pointedly informed Ovitz that they would not report to Ovitz and would continue to report to Eisner instead. This encounter, by all accounts, was the start of what would prove to be the rocky and ultimately unsuccessful integration of Ovitz into The Walt Disney Company.<sup>12</sup>

On August 14, 1995, the Company announced Ovitz’s hiring. “The reaction,” of investors to the announcement, noted the Supreme Court, “was extremely positive: Disney was applauded for the decision, and Disney’s stock price rose 4.4% in a single day, thereby increasing Disney’s market capitalization by over \$1 billion.”<sup>13</sup>

On September 26, 1995, the compensation committee met for approximately one hour. Among other matters considered at the meeting was Ovitz’s hiring and proposed compensation. Mr. Watson presented to the committee members concerning Ovitz’s compensation.<sup>14</sup> Following the presentation, the committee approved the terms of Ovitz’s agreement. At a meeting of the board of directors following the compensation committee’s meeting, Director Watson presented to the full board concerning Ovitz’s compensation.<sup>15</sup> Following Watson’s presentation, the board of directors voted unanimously to hire Ovitz. At a subsequent meeting held on October 16, 1995, and following a presentation by Litvack, the compensation committee approved the award, pricing and terms of Ovitz’s stock options.<sup>16</sup>

Although Ovitz performed well at first, Ovitz’s employment with Disney ultimately did not go well. Ovitz had difficulty integrating into the “egalitarian” culture at Disney.<sup>17</sup> The court noted that Ovitz and Disney were a “mismatch of cultures and styles.”<sup>18</sup> By mid 1996, it became apparent that the difficulties Ovitz was having at the Company were less and less likely to be resolved.<sup>19</sup> By the fall of 1996, “directors were discussing that the disconnect between Ovitz and the Company was likely irreparable and that Ovitz would have to be terminated.”<sup>20</sup> In mid-September of 1996, Eisner asked Litvack to communicate to Ovitz that “Eisner no longer wanted Ovitz at Disney and that Ovitz should seriously consider other opportunities,” including an opportunity that Eisner had cultivated for Ovitz at the Sony Corporation.<sup>21</sup>

By the fall of 1996, Eisner hoped to terminate Ovitz for cause and thereby avoid a “no fault termination” under Ovitz’s employment agreement, and therewith the approximately \$130 million severance package that would accrue to Ovitz. Eisner asked the Company’s general counsel, Sanford Litvack, to analyze whether the Company had grounds to terminate Ovitz for cause.<sup>22</sup> Litvack initially concluded that Ovitz could not be terminated for cause and that a “no fault termination” was inevitable.<sup>23</sup> Eisner asked Litvack to look at the question again and more carefully. In response, Litvack reviewed Ovitz’s employment agreement “and reviewed all the facts concerning Ovitz’s performance of which he was aware.”<sup>24</sup> Litvack, who certainly had no allegiance to Ovitz (as demonstrated by his conduct at the August 13, 1995, dinner with Ovitz),<sup>25</sup>

concluded that the question of whether Ovitz could be terminated for cause “was not a close question and, in fact, Litvack described it as a ‘no-brainer.’”<sup>26</sup> Eisner testified that, when Litvack informed him of this conclusion, Eisner “checked with almost anybody that [he] could find that had a legal degree, and there was just no light in that possibility. It was a total dead end from day one.”<sup>27</sup>

On November 26, 1996, an executive session of the Disney board was held, at which Ovitz’s fate was sealed. The board voted to terminate Ovitz without cause. On December 12, 1996, Disney issued a press release announcing Ovitz’s termination.<sup>28</sup>

### Overview of the Litigation

On January 3, 1997, certain Disney shareholders filed a derivative action against the Disney directors alleging breach of fiduciary duty and waste in connection with the negotiation and triggering of Ovitz’s severance. On October 7, 1998, the Chancery Court allowed the defendants’ motions to dismiss the complaint with prejudice on the grounds that the plaintiffs had failed to make demand on the Disney board and that demand was not excused.<sup>29</sup> The Chancery Court held, in particular, that the plaintiffs had not alleged, with particularity, facts creating a reasonable doubt: (i) as to the independence of a majority of the Board; or (ii) that the decisions in question were the product of a valid exercise of the directors’ business judgment.<sup>30</sup> On February 9, 2000, in a lengthy opinion that largely comported with the Chancery Court’s opinion dismissing the case, the Delaware Supreme Court reversed the Chancery Court’s dismissal of the complaint with prejudice and concluded simply that “[b]ecause of the unusual nature of this case and the rulings in this opinion, the interests of justice require that the dismissal ordered in paragraph 1 of the Order of the Court of Chancery shall be without prejudice.”<sup>31</sup>

After the Supreme Court’s reversal of the Chancery Court’s dismissal of the case with prejudice, the plaintiffs conducted limited “books and records” discovery,<sup>32</sup> and thereafter filed an amended complaint. On May 28, 2003, the Chancery Court denied the defendants’ second motion to dismiss. The Chancery Court held, in particular, that the amended complaint sufficiently alleged breaches of the directors’ fiduciary duties in connection with the hiring and termination of Ovitz.<sup>33</sup> The defendants had argued that, at most, the plaintiffs had alleged a breach of the directors’ fiduciary duty of care and that such a claim was subject to dismissal under the exculpation provision in the Disney certificate of incorporation and Del. Gen. Corp. Law § 102(b)(7). The Chancery Court rejected this argument and held that the plaintiffs had alleged more than merely a duty of care claim. As the court explained,

[t]hese facts, if true, do more than portray directors who, in a negligent or grossly negligent manner, merely failed to inform themselves or to deliberate adequately about an issue of material importance to their corporation. Instead, the facts alleged in the new complaint suggest that the defendant directors *consciously and intentionally disregarded their responsibilities*, adopting a “we don’t care about the risks” attitude concerning a material corporate decision. Knowing or deliberate indifference by a director to his or her duty to act faithfully and with appropriate care is conduct, in my opinion, that may not

have been taken honestly and in good faith to advance the best interests of the company.<sup>34</sup>

The Court held that the allegations in the amended complaint stated a claim for breach of the directors’ duty of good faith and that, consequently, such claims were not subject to dismissal under Section 102(b)(7).<sup>35</sup>

The Chancery Court’s 2003 decision paved the way for the eventual trial on the merits. That trial was conducted over 37 days, between October 20, 2004, and January 19, 2005.<sup>36</sup>

In August of 2005, the Chancery Court issued its post-trial decision. In that decision, the court found that the Disney directors did not violate *any* of their fiduciary duties, including their duty of care. The court found, in particular, that the decision to hire Ovitz and dangle an exceptionally lucrative compensation (and potential severance) package was approved by the board and the compensation committee and was reasonable under the circumstances.<sup>37</sup> As for the grant to Ovitz of a “no fault termination,” thereby triggering the automatic vesting of a significant portion of his stock options, the Chancery Court found that “Eisner’s actions in connection with [Ovitz’s] termination are, for the most part, consistent with what is expected of a faithful fiduciary. . . I conclude that the plaintiffs have not demonstrated by a preponderance of the

**“What is remarkable about the Supreme Court’s decision is that it restores the all-important distinction between a breach of the fiduciary duty of care, on the one hand, and a breach of the fiduciary duty of good faith, on the other hand.”**

evidence that Eisner breached his fiduciary duties or acted in bad faith in connection with Ovitz’s termination and receipt of the [no fault termination].”<sup>38</sup> Each of these findings applied likewise to the directors who approved the “no-fault termination” of Ovitz.

The plaintiffs filed a timely appeal.

### The Duty of Care, the Duty of Good Faith and Section 102(b)(7)

On appeal, the Delaware Supreme Court affirmed the Chancery Court on nearly all points. In particular, the court held that the Chancery Court’s finding that the Disney directors had not breached any of their fiduciary duties was not clearly erroneous and would be upheld.<sup>39</sup> Importantly, the court also took the opportunity to clarify the fiduciary duty of good faith and, in particular, how that duty may be distinguished from the fiduciary duty of care. The court made clear that plaintiffs seeking to assert a claim for breach of the duty of good faith must allege more than merely gross negligence, even extreme gross negligence. This is an especially noteworthy feature of the Supreme Court’s opinion.

### Section 102(b)(7)

The distinction between the fiduciary duty of care and the fiduciary duty of good faith is a key factor affecting the risk of personal liability faced by directors of Delaware corporations. The reason is Delaware’s exculpation statute – Del. Gen. Corp. Law § 102(b)(7) – provides that directors of Delaware corporations may be

protected from personal liability for breaches of their fiduciary duty of care, but *not* against breaches of their fiduciary duty of good faith. In particular, Section 102(b)(7) provides that the Certificate of Incorporation of a Delaware corporation may include,

[a] provision eliminating or limiting the personal liability of a director to the corporation or its shareholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of the law.<sup>40</sup>

Most Delaware corporations, including Disney, have adopted the requisite charter provision.

A charter provision adopted pursuant to Section 102(b)(7) is effective to bar all derivative claims – as well as direct shareholder claims – alleging only a breach of the fiduciary duty of care. Section 102(b)(7) applies to derivative claims for breach of fiduciary duty brought by shareholders or creditors of the corporation.<sup>41</sup>

**“[T]he Supreme Court has clarified that, without other conduct or additional factors, the duty of care applies to claims of carelessness or mismanagement, regardless of how egregious the conduct is alleged to be.”**

Furthermore, Section 102(b)(7) is applicable at the pleading stage of litigation and may form a sufficient basis for dismissal with prejudice of a complaint that alleges nothing more than a breach of the fiduciary duty of care.<sup>42</sup> As such, Section 102(b)(7) is a critical protection for directors of Delaware corporations.

### **The 2003 Chancery Court's Decision and Section 102(b)(7)**

The Chancery Court's 2003 decision threatened to weaken much of the protection traditionally provided by Section 102(b)(7). In the *Disney* case, it was held, at an early stage of the case, that the decision to hire Ovitz and to offer him a lucrative severance package, in the event of his termination, was made by a disinterested and independent board of directors.<sup>43</sup> Likewise, the decision to approve a no-fault termination of Ovitz was made by a disinterested and independent board.<sup>44</sup> There was, therefore, no viable claim of disloyalty, nor was there any other actionable claim of a conflict of interest on the part of the Disney board. The entire case hinged, instead, on whether the plaintiff had sufficiently alleged a breach of the fiduciary duty of good faith.<sup>45</sup> In its 2003 decision, the Chancery Court held that the plaintiff had done so.

What is particularly remarkable about the Chancery Court's decision in *Walt Disney III* is that, in holding that the plaintiffs had stated a viable claim for a breach of the fiduciary duty of good faith, the Chancery Court cited to allegations that had long been considered classic duty of care allegations. The court

pointed to, among other things in the amended complaint, the following allegations:

- The compensation committee met “for just one hour” to consider, among other matters, Ovitz’s employment agreement;
- The compensation committee “spent the least amount of time during the meeting discussing Ovitz’s hiring”;
- “[N]o copy of the . . . draft employment agreement was actually given to the committee”;
- The committee members received, instead, an “incomplete” “summary” of the agreement;
- “[T]he committee also lacked the benefit of an expert to guide them through the process”;
- “[N]o presentations, spreadsheets, written analysis, or opinions were given by any expert”;
- The committee approved the retention of Ovitz without receiving the final employment agreement;
- The committee “did not condition their approval on being able to review the final agreement”;
- At the subsequent Board meeting, “no expert was present to advise the board”;
- “Nor were any documents produced to the board for it to review before the meeting regarding the Ovitz contract”;
- “The board did not ask for additional information to be collected or presented regarding Ovitz’s hiring”;
- “According to the minutes, the Old Board did not ask any questions about the details of Ovitz’s salary, stock options or possible termination”;
- “The Old Board also did not consider the consequences of a termination, or the various payout scenarios that existed”; and
- “Nevertheless, at that same meeting, the Old Board decided to appoint Ovitz president of Disney.”<sup>46</sup>

These allegations are highly reminiscent of those made in the classic duty of care case, *Smith v. Van Gorkom*.<sup>47</sup> *Van Gorkom* involved another allegedly hasty and ill-considered high dollar transaction – the sale of the Trans Union Corporation to the Pritzker family. *Van Gorkom*, like *Disney*, contained allegations that an imperious chief executive officer negotiated a transaction while providing little to no information to the company’s board of directors.<sup>48</sup> The CEO then allegedly presented the transaction to the board of directors as a *fait accompli*.<sup>49</sup> The board then allegedly considered the transaction during a relatively short meeting.<sup>50</sup> The Trans Union board also did not retain a financial advisor to assist in assessing the Pritzkers’ offer for the corporation.<sup>51</sup> The transaction was attacked as financially unwise. On these facts, the Delaware Supreme Court held that the directors had not breached their fiduciary duties of loyalty or good faith but that they had breached their fiduciary duty of care in approving the sale of Trans Union, and they could be held personally liable, as a consequence.<sup>52</sup>

Delaware’s Section 102(b)(7) was enacted following the Supreme Court’s decision in *Van Gorkom* and was intended specifically to prevent future *Van Gorkoms*. Yet, the plaintiffs in *Disney* were able to proceed to trial on essentially the same theory as the plaintiffs in *Van Gorkom*. Indeed, in its post-trial decision, the Chancery Court explicitly compared the *Disney* case to *Van Gorkom* and found that the *Disney* case, while similar in many “striking” respects, was actually *less* egregious in numerous

important ways than the circumstances of the transaction in *Van Gorkom*.<sup>53</sup> The Court found that the Disney board was better informed, better prepared and engaged in more meaningful deliberations than the board of Trans Union.<sup>54</sup> Also, the transaction in *Disney* was less material, less sweeping and involved far fewer dollars than the acquisition of the entire Trans Union Corporation by the Pritzkers.<sup>55</sup> Section 102(b)(7) was meant to render cases like *Van Gorkom* – and *a fortiori*, those (like *Disney*) that involve less serious allegations of fiduciary duty breaches – non-actionable. The Disney certificate of incorporation had availed itself of the protections afforded by Section 102(b)(7). Yet, the Disney plaintiffs survived dismissal in spite of the exculpatory charter provision.<sup>56</sup>

### **The Supreme Court Reinforces the Duty of Good Faith**

In its 2003 decision in *Walt Disney III*, the Chancery Court held that the amended complaint stated a claim for a breach of the fiduciary duty of good faith and, therefore, the complaint was not subject to dismissal under Section 102(b)(7). The difficulty with the Chancery Court's 2003 decision is that the conduct alleged appeared, to many, to constitute nothing more than egregious breaches of the duty of care.<sup>57</sup> Indeed, the Chancery Court seemed to allow for bad faith claims based on little – or nothing – more than extreme (and perhaps persistent) carelessness. While there are persuasive doctrinal reasons for eliding the distinction between the duty of care and the duty of good faith, the very real practical problem with doing so is that the more akin the duty of good faith and the duty of care become, the easier it becomes for shareholder or creditor plaintiffs – and especially creditor plaintiffs in the bankruptcy context – to plead around Section 102(b)(7) in what is really nothing more than a duty of care case.<sup>58</sup> In the context of many failed business decisions, it is all too easy for a competent plaintiff's attorney to take conduct that is, in fact, nothing worse than gross negligence – involving nothing more than “honest mistakes of judgment” – and cast it as a “knowing and deliberate indifference to a potential risk of harm to the corporation” – and to do so consistent with Rule 11. Following the Chancery Court's decision in *Walt Disney III*, this is precisely what attorneys representing shareholder plaintiffs and creditors began to do with greater frequency.

In their appeal to the Delaware Supreme Court, the plaintiffs in *Disney* pressed the court to hold explicitly that a particularly strong claim for breach of the fiduciary duty of care – whether styled as a claim for extreme gross negligence or for recklessness – could state a claim under Delaware law for a breach of the duty of good faith and, thereby, avoid an exculpatory charter provision adopted pursuant to Section 102(b)(7). The Supreme Court rejected the plaintiffs' attempt to expand the duty of good faith in this manner and, in doing so, took the opportunity to clarify the duty of good faith under Delaware law. In a passage that one suspects was directed, in part, at the considerable attention that has been paid to the issue since *Walt Disney III* was decided, the Supreme Court noted that,

[i]n this case, appellants assert claims of gross negligence to establish breaches not only of director due care but also of the directors' duty to act in good faith. Although the Chancellor found, and we agree, that the appellants failed to establish gross negligence, to afford guidance we

address the issue of whether gross negligence (including a failure to inform one's self of available material facts), without more, can also constitute bad faith. The answer is clearly no.

From a broad philosophical standpoint, that question is more complex than would appear, if only because (as the Chancellor and others have observed) “issues of good faith are (to a certain degree) inseparably and necessarily intertwined with the duties of care and loyalty. . . .” But, in the pragmatic, conduct-regulating legal realm which calls for more precise conceptual line drawing, the answer is that grossly negligent conduct, without more, does not constitute and cannot constitute a breach of the fiduciary duty to act in good faith. The conduct that is the subject of due care may overlap with the conduct that comes within the rubric of good faith in a psychological sense, but from a legal standpoint those duties are and must remain quite distinct. Both our legislative history and our common law jurisprudence distinguish sharply between the duties to exercise due care and to act in good faith, and highly significant consequences flow from that distinction.<sup>59</sup>

With these relatively brief observations, the Delaware Supreme Court has done much to clarify the uncertainty surrounding the duty of good faith in the wake of the Chancery Court's decision in *Walt Disney III*. Following the Supreme Court's decision in *Walt Disney V*, shareholder and creditor plaintiffs seeking to plead around an exculpatory charter provision adopted pursuant to Delaware's Section 102(b)(7) will face significant hurdles. Above all, they will be required to point to more than merely extremely careless decision-making by corporate directors, although it remains to be seen what such a complaint must allege, in particular.

### **Conclusion**

The Delaware Supreme Court's decision affirming the Chancery Court's post-trial decision in the *Walt Disney Company* shareholder litigation is a welcome clarification of fiduciary duties under Delaware law. In particular, the Supreme Court has done much to resolve the uncertainty around the duty of good faith, generally, and the availability of the protections afforded by Section 102(b)(7) in classic duty of care cases, in particular. In its recent decision, the Supreme Court has clarified that, without other conduct or additional factors, the duty of care applies to claims of carelessness or mismanagement, regardless of how egregious the conduct is alleged to be. As a result, directors of Delaware corporations should, in the future, find themselves better protected against shareholder and creditor claims challenging unsuccessful business decisions.

<sup>1</sup> The ten years of litigation is, moreover, a cost that the Disney shareholders and Disney's D&O insurers will be required to bear. See Del. Gen. Corp. Law, § 145(c) (providing for mandatory indemnification for defense costs to the extent that a director is “successful on the merits.”)

<sup>2</sup> *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27 (Del. 2006) (herein “*Walt Disney V*”).

<sup>3</sup> See, e.g., *Cheff v. Mathes*, 199 A.2d 548, 555 (Del. Ch. 1964); see also *Trenwick Am. Litig. Trust v. Ernst & Young, LLP*, 906 A.2d 168, 193 (Del. Ch. 2006) (“But business failure is an ever-present risk. The business judgment rule exists precisely to ensure that directors and managers acting in good faith may pursue risky strategies that seem to promise great profit. If the mere fact that a strategy turned out poorly is in itself sufficient to create an inference that the directors who

# Young Lawyers

## E-DISCOVERY IN LEGAL MALPRACTICE LAWSUITS: DECEMBER 1, 2006 FEDERAL RULE AMENDMENTS & THE DISCOVERY OF ELECTRONICALLY STORED INFORMATION FROM LAWYERS AND LAW FIRMS

By Dina Cox

Recent amendments to the Federal Rules of Civil Procedure make significant revisions to disclosure and discovery rules as they pertain to “electronically stored information.” The rule changes, which were intended to “accommodate discovery directed at information generated by, stored in, retrieved from, and exchanged through, computers,”<sup>1</sup> make clear that litigants and their counsel will no longer be able to ignore electronic discovery issues or skirt electronic discovery obligations.<sup>2</sup> The amended rules emphasize that discovery of electronically stored information (“ESI”) stands on equal footing with discovery of documents and tangible information. Indeed, the Advisory Committee cautions that, even if a discovery request refers only to “documents,” or only to “electronically stored information,” the responding party must produce responsive information no matter what the storage form may be.<sup>3</sup> One commentator has observed: “The upshot of the new Rules is that:

- ESI is discoverable
- Clients must preserve and produce ESI
- Lawyers must understand how to request, protect, review and produce ESI
- The courts have the tools to rectify abusive and obstructive electronic discovery.”<sup>4</sup>

The term “electronically stored information” has a broad, expansive meaning within the context of the amended rules.<sup>5</sup> The term includes “any type of information that is stored electronically.”<sup>6</sup> A common example is electronic communications, such as e-mail. The term includes information stored in any medium, to encompass future developments in computer technology. The term “electronically stored information” is intended to be “broad enough to cover all current types of computer-based information, and flexible enough to encompass future changes and developments.”<sup>7</sup>

This article will summarize the ESI-related federal rule amendments and will highlight practical implications for lawyers defending legal malpractice lawsuits. The article concludes with a suggested list of “best practices” for directing and managing ESI preservation, disclosure, and discovery in the context of lawsuits against lawyers and law firms.

### Summary of ESI-Related Rule Amendments

In devising the rule changes, the Advisory Committee agreed that ESI differs from information recorded on paper in three important ways:

(1) ESI is retained in exponentially greater volume, (2) ESI is dynamic

rather than static, and (3) ESI may be incomprehensible when separated from the system by which it was created.<sup>8</sup> Against this backdrop, five categories of amendments related to ESI become effective December 1, 2006:

- 1) Amendments to Rules 16 and 26(f) to provide early attention to electronic discovery issues;
- 2) Amendments to Rule 26(b)(2) to provide for better management of discovery into electronically stored information that is not reasonably accessible;
- 3) Amendment to Rule 26(b)(5) to outline a procedure for asserting privilege *after* production;
- 4) Amendments to Rules 33, 34 and 45 to clarify their application to electronically stored information; and,
- 5) Amendments to Rule 37 to limit the imposition of sanctions for electronically stored information lost as a result of the routine operation of an electronic information system.

### Early Attention to Electronic Discovery

**Rule 26(f)** directs parties to confer as soon as practicable (and before any scheduling conference is held or a scheduling order is due) to consider the nature and basis of their claims and defenses, the possibilities for a prompt resolution, to make or arrange for their Rule 26(a)(i) initial disclosures, and to develop a proposed discovery plan. This rule was amended to direct parties to discuss the discovery of ESI at their discovery-planning conference, if such discovery is contemplated, and to include the results of such discussion in their report to the court.

The amended Rule 26(f) provides that parties should confer about “any issues relating to preserving discoverable information.” The issue of preservation has particular importance to ESI. Both the volume and dynamic nature of ESI may complicate preservation obligations. The ordinary operation of computer systems involves both the automatic creation and the automatic deletion or overwriting of certain information. Thus, the parties’ discussion “should pay particular attention to the balance between the competing needs to preserve relevant evidence and to continue routine operations critical to ongoing activities.”<sup>9</sup>

The amendment to Rule 26(f) also indicates that the parties’ discovery plan should address “any issues relating to disclosure or discovery of [ESI], including the form or forms in which it should be produced.”

Finally, Amended Rule 26(f) provides that the parties should discuss at their discovery-planning conference, and address in their discovery plan, “any issues relating to claims of privilege or of protection as trial-preparation materials, including – if the parties agree on a procedure to assert such claims *after* production – whether to ask the court to include their agreement in an order.” The rule contemplates that parties may wish to reach an agreement on a procedure for asserting claims of privilege after production. Why? Because certain aspects of ESI exacerbate problems associated with privilege reviews and privilege determinations.

The sheer volume of ESI increases the burden of a privilege review. The informality attendant to the use of e-mail may make privilege determinations difficult, particularly early on in a case. Production may be sought of electronic files that include “hidden” information not apparent to the creator or to readers. For instance, computer programs may retain “embedded data” such as draft

language, editorial comments, or other deleted matter. Computer programs may also include “metadata” – information describing the history, tracking, or management of an electronic file, such as when it was created or last accessed. The agreed procedure for asserting claims of privilege *after* production is suggested in Rule 26(f) as a mechanism to facilitate discovery, decrease the costs and delays associated with extensive privilege reviews, and diminish the risks associated with waiver based upon the inadvertent disclosure of privileged materials.

**Rule 26(a)(i) – Initial Disclosures** – was amended to specifically refer to “electronically stored information” in addition to “documents” and “tangible things” – as items subject to the Rule’s initial disclosure requirements. Accordingly, a party must, without waiting for a discovery request, provide to the other parties a copy or description of all documents, ESI, and tangible things in that party’s possession or control, that the party may use to support its claims or defenses.

**Rule 16** was amended to reflect that a court’s initial scheduling order or case management plan may include “provisions for disclosure or discovery of electronically stored information.”

The order may also include “any agreements the parties reach for asserting claims of privilege or of protection as trial-preparation material after production.” According to the Note to this amended rule, the rule is “designed to alert the court to the possible need to address the handling of discovery of [ESI] early in the litigation if such discovery is expected to occur.”<sup>10</sup>

“The amended rules emphasize that discovery of electronically stored information (ESI) stands on equal footing with discovery of documents and tangible information.”

### Managing Discovery of “Not Reasonably Accessible” ESI

**Rule 26(b)** defines the scope of discovery and limitations upon it. According to the Amended Federal Rules, a party responding to discovery must produce ESI that is relevant, not privileged, and reasonably accessible, subject to the provisions of Rule 26(b)(2)(C) (permitting the court to limit discovery that is unreasonably cumulative or duplicative; obtainable from some other source that is more convenient, less burdensome, or less expensive; or, where the burden or expense of the discovery outweighs its likely benefit in light of the needs of the case, the amount in controversy, the parties’ resources, the importance of the issues at stake, and the importance of the proposed discovery in resolving the issues). According to **Rule 26(b)(2)(B)**, “A party need not provide discovery of [ESI] from sources that the party identifies as not reasonably accessible because of undue burden or cost.”<sup>11</sup>

This rule amendment allows a party to respond to a discovery request by (1) producing responsive ESI from reasonably accessible sources, and (2) identifying by category or type the sources of ESI that were *not* searched (but which might contain relevant information) because of the inaccessibility of the sources in terms of undue burden and cost. The identification of the non-searched sources is intended to enable the opposing party to

decide whether to challenge the designation of the source as “not reasonably accessible.”

In many cases, discovery obtained from accessible sources will be sufficient to meet the needs of the case. In fact, the Note to this Amended Rule states: “[I]n many circumstances the requesting party should obtain and evaluate the information from [reasonably accessible] sources before insisting that the responding party search and produce information contained on sources that are not reasonably accessible.”

If information from reasonably accessible sources does not satisfy the requesting party and the requesting party insists upon discovery from the inaccessible sources, the responding party has the burden to show that the sources are “not reasonably accessible.” The test for “not reasonably accessible” is based upon the burden and cost of locating, restoring, and retrieving potentially responsive information from the sources in which it is stored. The information identified as “not reasonably accessible” must be difficult to access by the producing party for all purposes, not just for a particular lawsuit.

The party contesting the designation of sources as “not reasonably accessible” may need discovery to test the assertion. This discovery may include a sampling of information contained on the inaccessible sources, some inspection of the inaccessible sources, or depositions of knowledgeable witnesses.

If a showing is made that the sources are “not reasonably accessible,” the court may still order the discovery if the requesting party shows good cause. The requesting party has the burden of showing that its need for the discovery outweighs the burdens and costs of locating, retrieving, and producing the information. The decision to require a responding party to search for and produce information that is not reasonably accessible depends on whether the burdens and costs of doing so can be justified in the context of the case. Relevant considerations include: (1) the specificity of the discovery request; (2) the quantity of information available from other more easily accessed sources; (3) the failure to produce relevant information that seems likely to have existed but is no longer available on more easily accessed sources; (4) the likelihood of finding relevant, responsive information that cannot be obtained elsewhere; (5) predictions as to the importance and usefulness of the information; (6) the importance of the issues at stake in the litigation; and, (7) the parties’ resources.<sup>12</sup> In addition, a requesting party’s willingness to share or bear the access costs may be weighed by the court in determining whether there is good cause.

In ordering the discovery, the court may establish conditions, such as limitations on the amount, type or sources of information required to be accessed and produced; or, payment by the requesting party of part or all of the reasonable costs.

### Procedure for Asserting Privilege after Production

**Rule 26(b)(5)** was amended to establish a procedure to assert privilege and work-product protection claims *after* production. The amended rule does not address the substantive question of whether privilege or work-product protection has been waived or forfeited. It merely sets up a procedure to allow the responding party to assert a privilege claim.<sup>13</sup> According to the Advisory Committee, the amended rule “is a nod to the pressures of litigating

with the amount and nature of electronically stored information available in the present age.<sup>714</sup>

### Discovery Rules' Application to ESI

**Rule 33** was amended to clarify how the option to produce business records to respond to an interrogatory operates in the information age. The amended rule states: "Where the answer to an interrogatory may be derived or ascertained from the business records, including [ESI], of the party upon whom the interrogatory has been served . . . , and the burden of deriving or ascertaining the answer is substantially the same for the party serving the interrogatory as for the party served, it is a sufficient answer to such interrogatory to specify the records from which the answer may be derived or ascertained and afford the party serving the interrogatory reasonable opportunity to examine . . . or inspect such records."

The Note to Amended Rule 33 underscores "special difficulties" that may arise in substituting access to ESI for an interrogatory answer. A responding party may so substitute "only if the burden of deriving the answer will be substantially the same for either party." The party electing to substitute access to ESI must ensure that the interrogating party can locate and identify it "as readily as can the party served." The interrogating party must also be given a "reasonable opportunity to examine, audit, or inspect" the information.

Thus, depending on the circumstances, the responding party may be required to "provide some combination of technical support, information on application software, or other assistance" to enable the interrogating party to derive or ascertain the answer from the ESI. Such support might include direct access to a party's electronic information system, if that direct access is necessary to afford the requesting party an adequate opportunity to derive or ascertain the interrogatory answer. Because such access may raise sensitive problems of confidentiality or privacy, the responding party may choose to derive or ascertain the answer itself.

**Rule 34** was amended to add "electronically stored information" as a category of items subject to production, in addition to "documents."<sup>15</sup> Amended Rule 34 also provides that a Rule 34 discovery request may request an opportunity to test or sample materials sought, in addition to inspecting and copying them. Inspecting, testing, or sampling certain types of ESI or a party's electronic information system may raise issues of confidentiality or privacy. The Note thus cautions: "The addition of testing and sampling to Rule 34(a) with regard to documents and [ESI] is not meant to create a routine right of direct access to a party's electronic information system, although such access might be justified in some circumstances. Courts should guard against undue intrusiveness resulting from inspection or testing such systems."<sup>16</sup>

Also, procedures for requesting and objecting to the form or forms of producing ESI are established by Amended Rule 34. The request for production may specify (but is not required to specify) the form or forms in which ESI is to be produced. If the request for production specifies the form and the responding party objects, the responding party must include its objection to the requested form or forms in its response to the request for production. If objection is made to the requested form or forms, or if

no form was specified in the request, the responding party must state the form or forms it intends to use. If a dispute over the form of production cannot be resolved, the court may decide the form of production by way of a motion to compel. In ruling on such motion, the court is not limited to the forms of production initially chosen by the requesting party, stated by the responding party, or specified in the amended rule for situations in which there is no court order or party agreement.

Where a request does not specify the form for producing ESI, the responding party may produce the ESI in the form in which it is "ordinarily maintained" or in a form that is "reasonably usable" (in the absence of party agreement or court order). Although a party is not required to produce ESI in the form in which it is ordinarily maintained, the option to produce it in a "reasonably usable" form does not mean that a responding party is free to convert the ESI to a form that makes it more difficult or burdensome for the requesting party to use.<sup>17</sup> Notwithstanding the procedures for specifying the forms of production, Amended Rule 34 explicitly states that, in responding to a request for production of ESI, the responding party may need to "translate" the ESI into "reasonably usable form."

Significantly, "a party need not produce the same electronically stored information in more than one form."

**Rule 45** was amended to make clear that subpoenas to produce documents apply to ESI as well as traditional paper documents. The amended rule also makes clear that a subpoena may not only require production of information for inspection and copying, but also for testing or sampling.<sup>18</sup> Similar to Amended Rule 24, a subpoena may specify the form of production, and the responding entity may object to the specified form. The default forms of production, where none are specified, parallel the default forms of production found in Amended Rule 34(b) (permitting the responding party to produce the ESI in the form in which it is "ordinarily maintained" or in a form that is "reasonably usable"). Similar to Rule 26(b)(2)(B), a person responding to a subpoena need not provide discovery of ESI from sources that the person identifies as not reasonably accessible because undue burden or cost. Moreover, the rule incorporates a procedure for the assertion of claims of privilege *after* production, which procedure is identical to that announced in Amended Rule 26(b)(5).

Any order compelling a response to a Rule 45 subpoena "shall protect" the non-party responding to the subpoena "from significant expense resulting from the inspection, copying, testing, or sampling commanded." In addition, the subpoena may be quashed or modified if it subjects a person to undue burden.

### Limiting Sanctions for Lost ESI

**Rule 37(f)** was drafted to respond to a distinctive feature of electronic information systems, namely: the routine modification, overwriting, and deletion of information that attends normal use. Examples of this feature include programs that recycle storage media kept for brief periods against the possibility of disaster; automatic overwriting of information that has been "deleted"; programs that change metadata to reflect the latest access to particular ESI; programs that automatically discard information that has not been accessed within a defined period or that exists beyond a defined period; and, database programs that automatically create, discard, or update information without specific direction from

or awareness of users. These automatic features are essential to the operation of electronic information systems, which in turn are typically intertwined with and inextricably linked to ongoing business processes. Suspending or interrupting these features can be difficult without creating problems for the larger system, and can also be prohibitively expensive and burdensome. Rule 37(f) recognizes that it is unrealistic and undesirable to expect parties to stop such routine operation of their computer systems as soon as they anticipate litigation.

Rule 37(f) states that, “[a]bsent exceptional circumstances, a court may not impose sanctions under these rules on a party for failing to provide [ESI] lost as a result of the routine, good-faith operation of an electronic information system.” This rule is not intended to provide a shield to parties who intentionally destroy information because of its relationship to litigation. The rule provides protection from sanctions only for the “good faith” routine operation of an electronic information system.

Good faith may require that a party implement a “litigation hold” – intervention to suspend certain features of the routine operation of an information system to prevent loss of information subject to preservation obligations. The steps taken to implement an effective litigation hold bear on good faith. Compliance with any agreements the parties have reached regarding preservation, or with any court orders directing preservation, also bears upon the good faith analysis. It should be noted that, although Rule 26(b)(2) limits the scope of discovery to reasonably accessible sources of ESI, a party may still have a duty to preserve ESI stored on inaccessible sources. Likewise, good faith may require preservation of information on sources that a party believes are not reasonably accessible under Rule 26(b)(2). One factor in determining whether good faith calls for steps to prevent the loss of information on inaccessible sources is “whether the party reasonably believes that the information on such sources is likely to be discoverable and not available from reasonably accessible sources.”<sup>19</sup>

In many cases, a party’s ESI is stored on a system owned by another, such as a vendor in a contractual relationship with the party. The language of Rule 37(f) is intentionally broad enough to apply to the routine, good-faith operation of a third-party’s system. By the same token, a party’s good faith and preservation obligations often require that party to arrange for a “litigation hold” with respect to its ESI stored on a third-party’s system.<sup>20</sup>

### **Application of Amended Rule Requirements to Legal Malpractice Lawsuits: E-Discovery “Best Practices” for the Legal Malpractice Defense Lawyer**

#### ***Equip yourself with the capability to promptly find, preserve, collect, manage, review and duplicate ESI.***

The Amended Rules require that a party include in its initial disclosures an identification of the ESI that the party may use to support its claims or defenses. Parties must not only be prepared to swiftly produce or identify their supporting ESI, but they must also, very early on, “be fluent and forthcoming about their preservation of ESI and any issues relating to its disclosure or discovery.”<sup>21</sup> Thus, it is essential for the legal malpractice defense lawyer to possess the ability to understand and manage ESI. If necessary, attend a course or seminar exclusively related to understanding and managing ESI and e-discovery issues.

Partner with a reputable and reasonably priced local computer forensics and e-discovery expert. This expert can be “on call” to accompany you to early client interviews intended to assess the law firm’s information technology systems. This expert can also assist in the development and implementation of a diligent and reasonable preservation protocol. The expert can assist in formulating thoughtful, focused e-discovery requests directed to the opposing parties. Such an expert can also assist in responding to discovery, investigating and articulating issues such as reasonable accessibility, and conducting searches and testing samples of data retrieved from your law firm client’s information technology systems.

#### ***Treat the law firm or lawyer client the same as any other client unsophisticated in the rules and mechanics of e-discovery.***

Don’t assume that, because your clients are lawyers, they understand e-discovery, the Amended Federal Rules of Civil Procedure, or the firm’s preservation, disclosure, and discovery obligations related to ESI. Few litigants and fewer lawyers currently possess the ability to deal with ESI, particularly lawyers whose practices focus on business transactions as opposed to litigation. Nevertheless, because your client is a lawyer or law firm, the other parties or even the court may unwittingly hold the your client to a heightened “standard of care” in terms of understanding and complying with the ESI-related Federal Rules of Civil Procedure.

#### ***Develop an understanding of the firm’s computer systems at the outset.***

Gaining a thorough understanding of your client’s information technology department, its structure and staff, and its resources and data storage mechanisms and repositories is imperative and should be included in the initial work performed on any new legal malpractice case within the first ninety days of the assignment. This work necessarily includes interviews of the firm’s information technology staff, office manager or firm administrator, key witnesses or players, and sometimes legal assistants and/or paralegals. Take an accounting of the firm’s hardware and software, its networks and servers, and its backup or disaster recovery systems. Identify the in-house persons who are most knowledgeable of the firm’s computer systems. Identify any outside vendors or third-parties who may store the law firm’s electronic information. Consider including an independent, outside IT expert in your investigation to make sure that you ask the right questions, explore all the potential e-discovery exposures, and identify any particular problems or challenges to your ability to ensure compliance with the ESI-related preservation, disclosure and discovery requirements.

#### ***Identify the scope and sources of any potentially relevant ESI early on.***

Because of the preservation, disclosure, and discovery requirements of the Amended Federal Rules which require that e-discovery issues be addressed and discussed in a lawsuit very early on, it is critical to identify the scope and sources of any potentially relevant ESI within the first ninety days of the assignment. This investigation is not only important to ensure compliance with the rigorous e-discovery rules, but it is also important to enable defense counsel to develop his or her own evaluation of the case, to fully understand the facts and

*Continued on Page 12*

circumstances of the underlying attorney-client relationship or matter, and to derive an impression or comfort level with the integrity of the law firm defendant's information technology systems and procedures. With regard to the client-lawyer relationship or matter at issue, where might potentially relevant ESI be stored? On individual PCs, the firm's server(s), backup tapes, e-mail archives? How accessible is the information? How much time, effort and cost will be associated with retrieving the information? Will outside expertise be required? Consider issuing a firm-wide request for potentially relevant information and sources of information. Bear in mind that individual computer users often save relevant information to their individual computer hard drives or e-mail archives and specially created e-mail folders. Consider whether relevant information may be stored on the home computers of the key players.

Your goal is to first identify all potential sources of ESI that may contain relevant or responsive information and second to determine which sources of ESI within the law firm's control should be searched for potentially relevant ESI. Ascertain whether the information is reasonably accessible, including the burden or cost of retrieving and reviewing the information.<sup>22</sup> Discuss with the firm's IT staff or your own expert the various forms in which the ESI might be produced and the pros and cons of the various formats. Discuss measures to preserve the ESI.

Consider the utilization of a two-tiered approach wherein you divide the potentially relevant sources of ESI into two categories: (1) easily accessible sources, and (2) difficult-to-access sources. First sort, retrieve, and review the information that can be gleaned from the reasonably accessible sources. Afterward, determine whether it is necessary to search the difficult-to-access sources. This determination will be based upon a variety of factors such as how and at what cost the difficult-to-access sources may be accessed and whether it is possible to confirm whether any responsive information is in fact on the sources. Moreover, the easily accessed sources may yield all the information that is reasonably useful for the action.

#### **Explore all potential sources of ESI on all of the law firm's electronic information systems.**

Be creative when thinking about and exploring the potential sources of relevant ESI. Consider the law firm's (and the opposing parties') electronic communications, including e-mail; hard drives of individual computer users; servers; back-up tapes and other disaster recovery systems and storage media; calendar systems; diary systems; case management or practice management systems; time and billing systems; accounting systems; hand-held technology devices; home computers of individual workers; shared laptops; outside information technology vendors; conflict check databases; client or contact databases; marketing databases; case-related databases; electronic time clocks for firm employees and staff; electronic security access to the law firm building after hours or on weekends and holidays; audio or video recorded meetings or messages; and electronically recorded conferences, meetings or minutes of meetings. Thoroughly exploring the existence of ESI within these aspects of the firm's electronic information systems will

not only help you ensure your client's compliance with the Amended Federal Rules but will allow you to fully understand the facts and circumstances of the underlying attorney-client relationship or matter at issue, to evaluate the case, and to better plan your defense theories and litigation strategies.

#### **Develop, communicate, and implement a preservation protocol.**

It is important to develop and implement a plan to place a "litigation hold" on the potentially relevant sources of discoverable information, including that which is electronically stored, as soon as possible upon receipt of notice of potential or actual litigation.<sup>23</sup> The Amended Rules do not articulate what litigants must do to meet their common law and statutory duties to preserve potentially relevant ESI, but they make clear that the duty to preserve evidence is "very much alive and well in the realm of electronic discovery."<sup>24</sup> It therefore behooves the legal malpractice defense lawyer to ensure that both *accessible* ESI is preserved, as well as ESI that the law firm has designated as *inaccessible*. Efforts to preserve data should be diligent, and they should be documented, to thwart any later effort to impose sanctions for the failure to produce ESI which has been lost as a result of the routine operation of an electronic information system. A finding of good faith may hinge upon the extent to which a party's efforts to preserve the lost data were reasonable and timely. Consider implementation of some of the following preservation strategies:

- Make a "mirror image" of the hard drive of each key player's PC. This will most often require the services of an outside computer forensics or e-discovery expert. Utilizing such an expert, even when you or your law firm client may have in-house IT resources capable of producing the "mirror image" may also help insulate the law firm defendant from claims of inappropriate or inadequate computer forensic protocols and techniques.
- Identify and segregate for preservation all backup tapes generated during the time frame relevant to the litigation.
- Issue a firm-wide notice of the nature and scope of the preservation obligation.
- Make timely "mirror image" copies of all electronic "folders" related to the attorney-client relationship or matter in dispute. Include in your effort electronic "folders" that exist on the firm's server, the hard drives of individual PC users, within the e-mail system, etc.
- Address the retention of any time and billing software data related to the attorney-client relationship or matter in dispute.
- Address the retention of any electronic calendar or practice management software data related to the attorney-client relationship or matter in dispute.
- Address the retention of any conflict-checking or client or contact database information that may be relevant to the attorney-client relationship or matter in dispute. This can be particularly important in legal malpractice cases which include conflict of interest or breach of fiduciary duty allegations.
- Remember to extend the effort to preserve potentially relevant ESI that is stored by outside vendors or third parties on behalf of the law firm client.

**Prepare for and actively participate in the discovery planning conference, initial scheduling orders, or case management plan.**

Be proactive in tackling the relevant e-discovery issues in your legal malpractice case. Do your homework, and do it early.

Be prepared for the discovery-planning conference dictated by Amended Federal Rule 26(f) so that you can define the rules of the game and forestall or eliminate disputes or strategic disadvantages to your client down the road. If the discovery of ESI is contemplated, be prepared to address it at the Rule 26(f) discovery-planning conference. Be prepared to address such details as: (1) the parties' information systems, including the basic structure and organization of the systems, the capabilities of the systems, the sources of all potentially relevant ESI, the accessibility of the ESI, the information systems personnel and staff, and the identities of the most knowledgeable persons; (2) the nature and extent of the contemplated e-discovery; (3) the form or forms in which the various types of ESI are to be produced; (4) commitments as to preservation including the timing, methodology, and scope; and, (5) the possibility of reaching an agreement as to the non-waiver of privilege or the assertion of claims of privilege after production.

**Reach agreement on a procedure for asserting claims of privilege after production.**

Because privilege review and privilege determination may be particularly difficult, expensive, and time-consuming in the ESI discovery context, it may be wise to agree on one of two protocols.

- a. *The "quick peek"*: The parties may agree to the initial provision of requested materials without waiver of any privilege so that the party seeking production may make a preliminary review or initial examination of these materials – known as a "quick peek" – without waiver of any privilege or protection. The requesting party then designates a subset of these materials that it wishes to have actually produced under Rule 34. At that point, the producing party can conduct a detailed privilege review of only the subset of materials actually requested and identified for production.
- b. *"Clawback" agreements*: The parties may agree that production of materials without intent to waive privilege or protection should not be a waiver. If privileged or protected information is inadvertently produced, the producing party may assert the privilege by timely notice and obtain return of the materials without waiver.

Other arrangements may be agreed to. In any event, the parties should report to the court the nature of their agreement and should ask that the court include the agreement in its scheduling or other order. According to the Note to Rule 26(b)(5)(B) (relating to claims of privilege in the context of information produced), "[a]greements reached under Rule 26(f)(4) [re: discovery-planning conference] and orders including such agreements entered under Rule 16(b)(6) [re: scheduling order] may be considered when a court determines whether a waiver has occurred. Such agreements and orders ordinarily control."

**Reach an agreement on the forms of production of ESI. ESI exists and can be produced in a number of forms.**

The forms in which it is kept may not be a form that the requesting party can use or use efficiently or that the responding party wants to use for production. Consider the disadvantages to producing ESI as it is "ordinarily maintained" or in its "native format." Producing ESI in its "native format" may inhibit redacting the information and it may preclude or frustrate Bates-stamping. Additionally, the receiving party may be able to create "documents" from the native format data and present them back to your client as deposition or trial exhibits that are totally unfamiliar to you and your client. Bear in mind that producing information in a form that can be used with software which is in general commercial use often will be considered a "reasonably usable" form.

**Continue to monitor, assess, and manage your law firm client's e-discovery obligations.**

After the hard work is completed, hopefully within the first ninety days of the assignment, don't drop the ball. Continue to monitor and assess your law firm client's implementation and adherence to the perseverance protocol. After reviewing the ESI gleaned from the readily accessible sources, consider the merit and value, if any, of exploring the inaccessible sources of ESI. Make sure initial disclosures are timely supplemented as the evidence supporting your client's claims or defenses evolves. Aggressively and creatively pursue ESI from the opposing parties. Involve computer forensic experts to assess the completeness and soundness of the opposing parties' ESI-related discovery responses and production.

<sup>1</sup> Report of the Civil Rules Advisory Committee, May 27, 2005, [www.uscourts.gov/rules/Reports/CV5-2005.pdf](http://www.uscourts.gov/rules/Reports/CV5-2005.pdf), Rules App. C-18 (hereinafter referred to as Rules App. C-\_\_\_).

<sup>2</sup> The rule amendments "don't so much create new rights as compel lawyers and litigants to deal with the central role computers and the Internet play in business and our lives." Ball, Craig, "Hitting the High Points of the New E-Discovery Rules," LAW PRACTICE TODAY, Oct. 2006, Law Practice Management Section, ABA, [lpn@abanet.org](mailto:lpn@abanet.org).

<sup>3</sup> Rules App. C-65.

<sup>4</sup> Ball, Craig, "Hitting the High Points of the New E-Discovery Rules," LAW PRACTICE TODAY, Oct. 2006, Law Practice Management Section, ABA, [lpn@abanet.org](mailto:lpn@abanet.org).

<sup>5</sup> References to "documents" which appear in discovery rules that were not amended are to be interpreted to include electronically stored information, as circumstances warrant. Note, F.R.C.P. 34(a).

<sup>6</sup> Note, F.R.C.P. 34(a).

<sup>7</sup> *Id.*

<sup>8</sup> Rules App. C-18.

<sup>9</sup> Rules App. C-34.

<sup>10</sup> Rules App. C-27.

<sup>11</sup> According to the Note to this Amended Rule, "A party's identification of sources of [ESI] as not reasonably accessible does not relieve the party of its common law or statutory duties to preserve evidence." Although the Amended Rules do not attempt to define any preservation obligation, a party may be obliged to preserve information stored on sources it has identified as "not reasonably accessible," depending on the circumstances.

<sup>12</sup> See also *Zubulake I*, 217 F.R.D. 309 at 322 (S.D.N.Y. 2003) (articulating a similar seven-factor test for determining who should bear the cost of production).

<sup>13</sup> The amended rule provides: "If information is produced in discovery that is subject to a claim of privilege . . . , the party making the claim may notify any party that

received the information of the claim and the basis for it. After being notified, a party must promptly return, sequester, or destroy the specified information and any copies it has and may not use or disclose the information until the claim is resolved. A receiving party may promptly present the information to the court under seal for a determination of the claim. If the receiving party disclosed the information before being notified, it must take reasonable steps to retrieve it. The producing party must preserve the information until the claim is resolved.”

<sup>14</sup> Rules App. C-54.

<sup>15</sup> According to the Note to this amended rule, even if a request refers only to documents – or to electronically stored information – the responding party must produce responsive information no matter what the storage form may be. Rules App. C-74.

<sup>16</sup> Rules App. C-75.

<sup>17</sup> Producing ESI with the ability to search by electronic means removed or degraded is the e-discovery equivalent of the “document dump,” the production of large amounts of paper with no organization or order. Rules App. C-67. The Note to Amended Rule 34(b) makes clear that a responding party may not convert ESI from the form in which it is ordinarily maintained to a different form that makes it more difficult or burdensome for the requesting party to use. For example, if the responding party ordinarily maintains the information 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.

<sup>18</sup> Because testing and sampling may present particular issues of burden or intrusion for the person served with the subpoena, the “protective provisions” of Rule 45 are to be “enforced with vigilance” when such demands are made.

<sup>19</sup> Note, F.R.C.P. 37(f); Rules App. C-87.

<sup>20</sup> “The party remains obliged to act in good faith to avoid loss of information in routine operations conducted by the outside firm.” Rules App. C-89.

<sup>21</sup> Ball, Craig, “Hitting the High Points of the New E-Discovery Rules,” *LAW PRACTICE TODAY*, Oct. 2006, Law Practice Management Section, ABA, [lp@abanet.org](mailto:lp@abanet.org).

<sup>22</sup> Difficulties in accessing the ESI may arise from a number of different factors. For example, back-up tapes for disaster recovery are often not indexed, organized, or susceptible to electronic searching. Legacy data is that which remains from obsolete systems and is unintelligible on current systems. Data may have been “deleted” previously but still may remain in the computer system in fragmented form, requiring a modern form of forensics to restore and retrieve it. Databases may have been designed to create and store information in certain ways and cannot readily create different kinds or forms of information. It is important for counsel to understand the nature of the access difficulties so that counsel can convincingly articulate the basis for a party’s designation of ESI sources as “not reasonably accessible.”

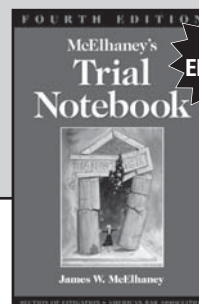
<sup>23</sup> “Preservation of ESI is challenging. Information stored on computers always consists of two or more ‘chunks’ of data, typically a ‘file’ plus information called system ‘metadata’ describing the characteristics of the file and its place within its host environment, e.g., its location, size, name, origins and history. Metadata take many forms and are often important evidence in their own right. However, as some metadata are designed to change in order to track, e.g., access to the file, changes to the file and its relocation, metadata may be quite fluid; accordingly, its preservation demand special handling.” Ball, Craig, “Hitting the High Points of the New E-Discovery Rules,” *LAW PRACTICE TODAY*, Oct. 2006, Law Practice Management Section, ABA, [lp@abanet.org](mailto:lp@abanet.org).

<sup>24</sup> Ball, Craig, “Hitting the High Points of the New E-Discovery Rules,” *LAW PRACTICE TODAY*, Oct. 2006, Law Practice Management Section, ABA, [lp@abanet.org](mailto:lp@abanet.org).

*Dina M. Cox is a Partner and Executive Committee member at Lewis Wagner, LLP, in Indianapolis, Indiana. Dina belongs to the*

*firm’s Litigation, Professional Negligence, and Drug & Medical Device practice groups. Dina is an active member of the Professional Liability and Drug & Medical Device Committees of the Defense Research Institute; the American Bar Association’s Standing Committee on Lawyers’ Professional Liability and the Professional Liability Committee of the Litigation Section; the Litigation Section of the Indiana State Bar Association; and, the Trial Tactics Committee of Defense Trial Counsel of Indiana.*

[www.ababooks.org](http://www.ababooks.org)



2005 792 pages  
6 x 9 Paper  
ISBN: 1-59031-503-0  
Product Code: 5310348  
Regular Price: \$64.95  
LT Member Price: \$54.95

McElhaney  
is back – and  
better than ever

A new edition of the ABA’s all-time best-selling book on trial practice. Expanded, updated and revised by the author, this new edition of *Trial Notebook* includes 30 years of James McElhaney’s clear, lively and memorable prose from *Litigation Journal*. Nearly a third larger than the previous edition, the book now includes 90 chapters that

cover everything from discovery through rebuttal and provides you with techniques, tactics and strategies for every stage of trial. James McElhaney knows his subject better than anyone, as a practitioner and as a professor. The result is information, grounded in actual courtroom experience, that you will understand, enjoy and use daily in court. Used again and again by thousands of trial lawyers, *Trial Notebook* is certain to make your trial work more effective. **Bulk discounts available.**

 SECTION of LITIGATION  
AMERICAN BAR ASSOCIATION

AMERICAN BAR ASSOCIATION

Phone: 1-800-285-2221  
Fax: 1-312-988-5568



[www.ababooks.org](http://www.ababooks.org)



Successful litigators understand the importance of lifelong learning. But with research, client meetings, and the everyday work of litigation practice, it can be difficult to find time for professional development. With Litigation Series Teleconferences, discussing the latest issues with nationally known faculty is as easy as picking up the phone.

## Litigation Series TeleConferences

THE CONVENIENT WAY TO STAY CURRENT  
ON TRENDS IN LITIGATION PRACTICE

Join leading lawyers and judges on the second Tuesday of the month for a lively and balanced discussion of hot issues and litigation fundamentals. As a member of the Section, you qualify for special pricing on each program.

#### Recent teleconference topics

- Witness preparation and Rule 615
- Inadvertent document production
- Email management
- Successful oral argument
- Sarbanes-Oxley update
- Class certification

Get connected today at  
[www.abanet.org/litigation/teleconferences/](http://www.abanet.org/litigation/teleconferences/)

## WHEN NEGLIGENCE IS NOT ENOUGH: PROVING CAUSATION IN A LITIGATION MALPRACTICE CASE

By Kelli Hinson and Carolyn Raines

The practice of law, by its very nature, involves adhering to deadlines and making judgment calls, sometimes very tough ones. Accordingly, it is a profession that provides many opportunities for making mistakes. But, as more and more courts are confirming, proving a mistake by a lawyer is not enough to prevail on a claim for legal malpractice, especially when the alleged negligence occurs during the prosecution or defense of another lawsuit.

### The “Trial in a Trial”

A claim for legal malpractice arises in tort and is treated like any other negligence claim. Therefore, the plaintiff must prove the traditional elements of a negligence claim: duty, breach, causation, and damages. When the alleged malpractice involves advice to the client, proving causation may not be difficult. The client, as the key decision maker, may be able to testify that she relied on the attorney’s advice with unfortunate consequences.

If a legal malpractice case arises during the course of litigation, however, in order to show that an attorney’s alleged negligence was the proximate cause of the plaintiff’s damages, the plaintiff must prove that, but for the attorney’s negligence, the plaintiff would have prevailed or obtained a better result in the underlying case. Some states also require proof that the judgment in the underlying case would have been collectible. The need to establish the likely result of the underlying litigation often is referred to as the “suit within a suit” or “case within a case” requirement. “It is this elemental requirement of proving the case within the case that makes a legal malpractice action unique.” In certain cases, it also makes proving causation extremely difficult.

In *Rangel v. Lapin*, for example, the alleged malpractice at issue was the personal injury attorney’s advice to the client that he should sell the car involved in the accident at issue. The client later decided to sue the automobile manufacturer, Honda, claiming that the car had a defective restraint system. But because the client no longer had the car at issue, he was unable to pursue that claim. Instead the client sued his original lawyers for giving him bad advice. The client offered expert testimony from an attorney who had handled similar cases against Honda and who testified that there was “no doubt in his mind” that he could have recovered substantial damages on behalf of the client had the vehicle been preserved. Because the client could not prove the elements of the underlying products liability case (since he was no longer in possession of the car), the appellate court held that the trial court had correctly granted summary judgment in favor of the defendant attorney.

In another Texas malpractice case, *Alexander v. Turtur & Assocs., Inc.*, a client sued a law firm regarding its handling of a complex bankruptcy case. The client had hired the named partner Alexander personally, but Alexander had passed the case off to a new associate, who ultimately tried the case (to a bad result).

The client claimed that causation was obvious, relying on evidence of numerous alleged mistakes made during the trial. The Texas Supreme Court disagreed, noting that “even when negligence is admitted, causation is not presumed.” Because the plaintiff had not offered any expert testimony on the probable outcome of the case in the absence of the alleged mistakes, the Court found that the trial court correctly entered a take-nothing judgment. In a concurring opinion, Justice Hecht expressed doubt as to whether a jury could ever be fairly expected to determine what a judge would have decided in such hypothetical circumstances.

In some circumstances, the result of the underlying case may be determined by essentially trying that case to a jury. In the North Carolina case of *Kearns v. Horsley*, for example, the plaintiff alleged that the defendant attorneys had negligently allowed the statute of limitations to run on her personal injury claim. The trial court ordered a bifurcated proceeding, requiring that the plaintiff literally prove her case within a case by obtaining a jury finding that her original claim would have resulted in a judgment in her favor before she could proceed with her negligence case against the attorneys before a different jury. Because the first jury found no negligence on the part of the would-be defendant in the underlying case, the plaintiff was precluded from pursuing her claim against the attorney defendants.

Courts and commentators have recognized the problems that can be created by requiring a malpractice plaintiff to try her underlying case. First, in a case like *Alexander*, it would be very

**“If a legal malpractice case arises during the course of litigation . . . the plaintiff must prove that, but for the attorney’s negligence, the plaintiff would have prevailed or obtained a better result in the underlying case.”**

difficult, if not impossible, to accurately re-create the original trial such that the effect of different trial strategies could be measured. Also, some have opined that it is unfair to require the client to litigate her case against her own lawyer, who has “superior knowledge about the strengths and weaknesses of the case, including knowledge obtained from the client’s own confidences.” In addition, it may be difficult to conduct adequate discovery into the merits of the underlying case, because the original defendant will not be a party to the malpractice action. Finally, it can be unfair to the defendant attorney that all of the optimistic statements and high-damage estimates he made in the underlying lawsuit may now be used against him as admissions by a party-opponent.

### Emerging Limits

Despite these concerns, many states do require a legal malpractice plaintiff to prove the merit of her case through the “suit within a suit” procedure. But several courts have begun to place limits on, or make exceptions to, the traditional requirements.

Michigan courts, for example, limit the suit within a suit requirement to cases in which: 1) the attorney’s negligence resulted in an adverse judgment on an otherwise successful claim;

2) the attorney's negligence prevents the client from bringing the action (i.e. where the statute of limitations has run); 3) the attorney's failure to appear causes judgment to be entered against the client; or 4) the attorney's negligence prevents an appeal from being perfected. Michigan courts do not apply the "suit within a suit" requirement when the client claims that, absent the attorney's negligence, he would have suffered a smaller verdict than what was rendered. In limiting the applicability of the "suit within a suit" requirement, Michigan courts reason that "[r]equiring the plaintiff in all cases to show that he would have prevailed completely in the former action as a condition precedent to recovery in a subsequent malpractice action is a harsh requirement that would preclude otherwise meritorious claims."

The New Jersey Supreme Court also has recognized the need for alternative approaches to proving causation and a "willingness to accept such alternatives when the situation demands." Accordingly, New Jersey courts allow plaintiffs to prove causation through use of a "suit within a suit" or "any reasonable modification thereof," or by presenting expert testimony regarding "what as a matter of reasonable probability would have transpired at the original trial" absent the malpractice. The proper approach for legal malpractice cases in New Jersey "will depend upon the facts, the legal theories, the impediments to one or more modes of trial, and, where two or more approaches are legitimate, to plaintiff's preference."

Ohio courts also recognize exceptions to the general rule that a plaintiff in a legal malpractice action must prove that absent the attorney's negligence she would have been successful at trial. In a case where the plaintiffs' claims stemmed from the failure of their attorneys to disclose legal consequences surrounding plea bargains and settlement agreements, the Ohio Supreme Court stated that "we cannot endorse a blanket proposition that requires a plaintiff to prove, in every instance, that he or she would have been successful in the underlying matter. Such a requirement would be unjust, making any recovery virtually impossible for those who truly have a meritorious legal malpractice claim." Although the court made an exception because it found that plaintiffs had sustained damages

**"Courts and commentators have recognized the problems that can be created by requiring a malpractice plaintiff to try her underlying case."**

despite their failure to show probable success in the original action, the court also noted that "the requirement of causation often dictates that the merits of the malpractice action depend upon the merits of the underlying case."

As demonstrated by cases like the ones discussed above, the courts are continuing to struggle to find the fairest and most efficient way to establish causation in litigation malpractice cases. Given the complexity of the issues and the difficulties of proof involved, it is a debate that likely will continue for some time.

<sup>1</sup> See, e.g., *Alexander v. Turtur & Assocs., Inc.*, 146 S.W.3d 113, 117 (Tex. 2004); *Osornio v. Weingarten*, 21 Cal.Rptr.3d 246, 254 (Cal. Ct. App. 2004); *Steffen v. Gray, Harris & Robinson, P.A.*, 283 F. Supp. 2d 1272, 1281 (M.D. Fla. 2003); *Allianz Ins. Co. v. Lerner*, 416 F.3d 109, 118 (2d Cir. 2005) (applying New York law). The required elements vary slightly among the different jurisdictions.

<sup>2</sup> *Alexander*, 146 S.W.3d at 119; see, e.g., *Delp v. Douglas*, 948 S.W.2d 483, 495 (Tex. App.—Fort Worth 1997), rev'd on other grounds, 987 S.W.2d 879 (Tex. 1999).

<sup>3</sup> See, e.g., *Allianz Ins.*, 416 F.3d at 118.

<sup>4</sup> See, e.g., *Garretson v. Miller*, 121 Cal.Rptr.2d 317, 321 (Cal. Ct. App. 2002); *Kearns v. Horsley*, 552 S.E.2d 1, 3 (N.C. Ct. App. 2001).

<sup>5</sup> *Rangel v. Lapin*, 177 S.W.3d 17, 22 (Tex. App. 2005, pet. denied); *Steffen*, 283 F. Supp. 2d at 1281.

<sup>6</sup> *Poole v. W.C.A.B. (Warehouse Club, Inc.)*, 810 A.2d 1182, 1184 (Pa. 2002).

<sup>7</sup> 177 S.W.3d 22, 25.

<sup>8</sup> 146 S.W.3d 119, 122.

<sup>9</sup> *Id.*

<sup>10</sup> 522 S.E.2d at 7-9.

<sup>11</sup> See *Garcia v. Kozlov, Seaton, Romanini & Brooks, P.C.*, 845 A.2d 602, 612 (N.J. 2004); *Thomas v. Bethea*, 718 A.2d 1187, 1197, 1201 (Ma. 1998) (both citing to numerous secondary sources).

<sup>12</sup> *Thomas*, 718 A.2d at 1201.

<sup>13</sup> *McClarty v. Gudenau*, 173 B.R. 586, 601-02 (E.D. Mich. 1994).

<sup>14</sup> *Id.* (quoting *Basic Food, Inc. v. Grant*, 310 N.W.2d 26, 30 (Mich. Ct. App. 1981)).

<sup>15</sup> *Garcia*, 845 A.2d at 612.

<sup>16</sup> *Id.* at 604, 613-14.

<sup>17</sup> *Montgomery v. Everett*, 600 N.W.2d 256, 258 (Ohio Ct. App. 1991); *Vahila v. Hall*, 674 N.E.2d 1164, 1170 (Ohio 1997).

<sup>18</sup> *Vahila*, 175 N.E.2d at 1170.

---

*The authors are partners at Carrington, Coleman, Sloman & Blumenthal, L.L.P. in Dallas, Texas, and practice in the area of complex commercial litigation. Ms. Hinson has extensive experience in matters involving medical and legal malpractice and director and officer liability. Ms. Raines has particular experience with director and officer liability and securities matters.*

---

approved it breached their fiduciary duties, the business judgment rule will have been denuded of much of its utility.”)

<sup>4</sup> *In re Walt Disney Co. Deriv. Litig.*, 907 A.2d 693, 704 (Del. Ch. 2005) (herein “*Walt Disney IV*”).

<sup>5</sup> *Id.* at 701. Though not addressed in the Chancery Court’s decision, MCA had reportedly offered Ovitz a package valued at some \$250 million. See David Leiberman, “The Wizard of Hollywood’s Move to MCA Could Upend Tinsletown,” *USA Today*, 1B (June 2, 1995).

<sup>6</sup> *Walt Disney IV*, 907 A.2d at 702.

<sup>7</sup> *Id.*

<sup>8</sup> *Walt Disney V*, 906 A.2d at 58; see also *Walt Disney IV*, 907 A.2d at 705 (“Two days later, Crystal faxed his memorandum to Russell. In the memo, Crystal concludes that the [Ovitz Employment Agreement] would provide Ovitz with approximately \$23.6 million per year for the first five years, or \$23.9 million a year, over a seven-year period, if Disney and Ovitz exercised the two-year renewal option.” Those sums, Crystal opined, would approximate Ovitz’s current annual compensation at CAA.)

<sup>9</sup> *Walt Disney IV*, 907 A.2d at 702.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* at 704-05.

<sup>12</sup> *Id.* at 706-07.

<sup>13</sup> *Walt Disney V*, 906 A.2d at 40.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at 41.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at 42.

<sup>18</sup> *Id.*; *Walt Disney IV*, 907 A.2d at 713.

<sup>19</sup> *Walt Disney V*, 906 A.2d at 42.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* at 43.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> *Id.* at 43-44.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 45.

<sup>29</sup> *In re Walt Disney Co. Deriv. Litig.*, 731 A.2d 342 (Del. Ch. 1998) (“*Walt Disney I*”).

<sup>30</sup> *Walt Disney I*, 731 A.2d at 364-65; see also *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984).

<sup>31</sup> *Brehm v. Eisner*, 746 A.2d 244, 267 (Del. 2000) (herein “*Walt Disney II*”).

<sup>32</sup> See Del. Gen. Corp. Law § 220.

<sup>33</sup> See *In re Walt Disney Deriv. Litig.*, 825 A.2d 275, 289 (Del. Ch. 2003) (herein “*Walt Disney III*”).

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> *Walt Disney V*, 906 A.2d at 34.

<sup>37</sup> *Walt Disney IV*, 907 A.2d at 753 n.447.

<sup>38</sup> *Walt Disney V*, 906 A.2d at 73.

<sup>39</sup> *Id.* at 60-61.

<sup>40</sup> Del. Gen. Corp. Law § 102(b)(7).

<sup>41</sup> *Production Resources Group, LLC v. NCT Group, Inc.*, 863 A.2d 772 (Del. Ch. 2004).

<sup>42</sup> *Malpiede v. Townson*, 780 A.2d 1075 (Del. 2001) (Rule 12(b)(6) motion granted under the business judgment rule and Delaware’s exculpation statute); *In re Lukens Inc. S’holders Litig.*, 757 A.2d 720 (Del. Ch. 1999) (same); *In re Frederick’s of Hollywood, Inc. S’holders Litig.*, No. C.A. 15944, 2000 WL 130630 (Del. Ch. Jan. 31, 2000) (same); *Nebenzahl v. Miller*, No. CIV. A. 13206, 1996 WL 494913, at \*2-3 (Del. Ch. Aug. 29, 1996) (same); *In re Wheelabrator Techs. Inc. S’holder Litig.*, C.A. No. 11495, 1992 WL 212595 (Del. Ch. Sept. 1, 1992) (same).

<sup>43</sup> Although the plaintiff had initially attempted to allege that “a majority of the board was beholden to Eisner,” this claim was initially rejected by the Chancery Court in *Disney I* and that finding was upheld by the Supreme Court in *Disney II*. See *Walt Disney II*, 756 A.2d at 258. That finding was never seriously questioned thereafter.

<sup>44</sup> *Id.*

<sup>45</sup> *Walt Disney V*, 906 A.2d at 52. (“Because no duty of loyalty claim was asserted against the Disney defendants, the only way to rebut the business judgment rule’s presumptions would be to show that the Disney defendants had either breached their duty of care or had not acted in good faith.”)

<sup>46</sup> *Walt Disney III*, 825 A.2d at 280-81.

<sup>47</sup> *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

<sup>48</sup> *Id.* at 874.

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* at 876-77.

<sup>52</sup> *Id.*

<sup>53</sup> *Walt Disney IV*, 907 A.2d at 767-68.

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> *Walt Disney III*, 825 A.2d at 280-81.

<sup>57</sup> See, e.g., Robert Baker, “In re Walt Disney: What It Means to the Definition of Good Faith, Exculpatory Clauses, and the Nature of Executive Compensation,” 4 FL. ST. U. BUS. REV. 261, 269 (2004-2005) (“It seems that the Disney decision blurs the line between this elevated recklessness standard for good faith and the traditional gross negligence standard for duty of care breaches.”); Matthew Berry, “Does Delaware’s Section 102(b)(7) Protect Reckless Directors from Personal Liability? Only if Delaware Courts Act in Good Faith,” 79 WASH. L. REV. 1125 (“Contrary to the *Van Gorkom* court’s decision, the *Disney* Chancery Court suggested that directors’ reckless conduct breaches the duty of good faith.”); Tara Dunn, “The Developing Theory of Good Faith in Director Conduct: Are Delaware Courts Ready to Force Directors to Go Out of Pocket After *Disney IV*?” 83 DENV. U. L. REV. 531 (2005) (“[I]n *Disney II*, the Chancery Court found plaintiffs’ well-pleaded claim based on the duty of care to fairly raise the question of whether *Disney* directors acted in good faith.”)

<sup>58</sup> See, e.g., *Off. Comm. of Unsecured Creditors of Integrated Health Svcs., Inc. v. Elkins*, No. Civ. A. 20228-NC, 2004 WL 1949290, at \*12 (Del. Ch. Aug. 24, 2004) (“Again, the Complaint alleges Compensation Committee approval and Board ratification of an Elkins request without any ‘consideration, deliberation, or advice from any expert.’ Because I must accept this allegation as true on a motion to dismiss, I deny the Motions to Dismiss as to this claim.”)

<sup>59</sup> *Walt Disney V*, 906 A.2d at 64-65 (citations omitted).

---

*Peter L. Welsh is an associate in the Boston office of Ropes & Gray LLP practicing in the areas of securities litigation, transactional litigation and director and officer representation. The statements contained in this article do not necessarily represent the views of Ropes & Gray LLP or its clients and are not intended to constitute, and do not constitute, legal advice.*

---



Successful litigators understand the importance of lifelong learning. But with research, client meetings, and the everyday work of litigation practice, it can be difficult to find time for professional development. With Litigation Series Teleconferences, discussing the latest issues with nationally known faculty is as easy as picking up the phone.

## Litigation Series TeleConferences

THE CONVENIENT WAY TO STAY CURRENT  
ON TRENDS IN LITIGATION PRACTICE

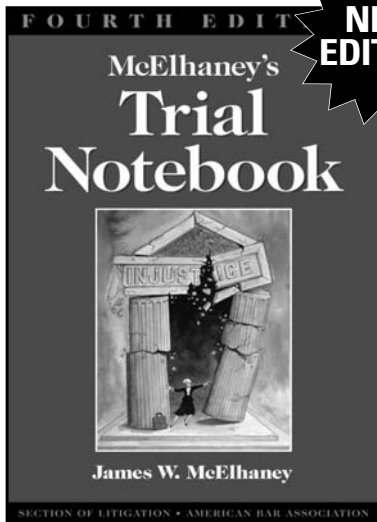
Join leading lawyers and judges on the second Tuesday of the month for a lively and balanced discussion of hot issues and litigation fundamentals. As a member of the Section, you qualify for special pricing on each program.

#### Recent teleconference topics

- Witness preparation and Rule 615
- Inadvertent document production
- Email management
- Successful oral argument
- Sarbanes-Oxley update
- Class certification

Get connected today at  
[www.abanet.org/litigation/teleconferences/](http://www.abanet.org/litigation/teleconferences/)

# McElhaney is back – and better than ever



**NEW  
EDITION**

A new edition of the ABA's all-time best-selling book on trial practice.

Expanded, updated and revised by the author, this new edition of *Trial Notebook* includes 30 years of James McElhaney's clear, lively and memorable prose from *Litigation Journal*. Nearly a third larger than the previous edition, the book now includes 90 chapters that cover everything from discovery through rebuttal and provides you with techniques, tactics and strategies for every stage of trial. James McElhaney knows his subject better than anyone, as a practitioner and as a professor. The result is information, grounded in actual courtroom experience, that you will understand, enjoy and use daily in court. Used again and again by thousands of trial lawyers, *Trial Notebook* is certain to make your trial work more effective.

**Bulk discounts available.**

2005 • 792 pages • 6 x 9 • paper  
ISBN: 1-59031-503-0 • Product Code: 5310348  
\$54.95 Litigation member price • \$64.95 Regular price

 SECTION of LITIGATION  
AMERICAN BAR ASSOCIATION

To order, call the ABA Service Center  
at 1-800-285-2221  
or visit our website at [www.ababooks.org](http://www.ababooks.org)

  
Defending Liberty  
Pursuing Justice

  
Defending Liberty  
Pursuing Justice

American Bar Association  
321 N. Clark Street  
Chicago, IL 60610

 SECTION of  
LITIGATION  
AMERICAN BAR ASSOCIATION

LITIGATION PRACTICE SOLUTIONS  
Sponsor of the ABA Section of Litigation

 LexisNexis®

NONPROFIT  
ORGANIZATION  
U.S. POSTAGE  
PAID  
AMERICAN BAR  
ASSOCIATION