ROCKY MOUNTAIN LAW JOURNAL

VOLUME 3

2014

PUBLICATION DATE: JANUARY 12, 2015

ABOUT THE ROCKY MOUNTAIN LAW JOURNAL

CONTENT & OPINIONS

EDITORIAL BOARD AND STAFF EDITORS

EDITOR'S CORNER

ARTICLES

TRUSTED INDIVIDUAL RETIREMENT ACCOUNTS-RISK MANAGEMENT & CLIENT BENEFITS IN THE WAKE OF CLARK v. RAMEKER

BRIAN J. HALSEY, JULIE D. PFAFF & JENNIFER C. HALSEY*...*7-16.

THE "JUST CAUSE" STANDARD: IS AN INVESTIGATION NEEDED?

HARVEY SHRAGE*...*17-34.

BENEFIT CORPORATIONS ARE RAPIDLY EXPANDING TO PROVIDE LEGAL PROTECTION FOR FIRMS SEEKING TO BE SOCIALLY RESPONSIBLE AS WELL AS PROFITABLE

KEVIN P. FARMER*..*35-45.

MAJOR ELECTRONIC DISCOVERY ISSUES FOR 2015

VICKI M. LUOMA, MILTON LUOMA & EMMY J. BUBOLTZ*...*46-60.

SUBMISSION GUIDELINES

About the Rocky Mountain Law Journal

Each of the articles in the *Rocky Mountain Law Journal* was recommended for publication by the staff editors and reviewers using a double, blind review process. The journal continues to attract large numbers of submissions from across the country. It is a relatively newer journal with high aspirations and expectations.

The *Rocky Mountain Law Journal* attracts large numbers of submissions from professors and scholars located across the United States and overseas. The Journal is listed in *Cabell's Directory of Publishing Opportunities in Management*. It is also listed in *Washington & Lee University Law Journals: Submissions & Rankings.*

Copyright to the contents of the articles published herein is retained by the respective authors. Copyright to the design, format, logo and other aspects of this publication is claimed by the *Rocky Mountain Academy of Legal Studies in Business*.

The Academy of Legal Studies in Business (International) (ALSB) is an association of teachers and scholars in the fields of business law, legal environment, and law-related courses outside of professional law schools. The *Rocky Mountain Academy of Legal Studies in Business* is one of twelve regional associations associated with ALSB.

For additional information, visit our online presence at http://www.rockymountainlawjournal.org.

Rocky Mountain Law Journal

ISSN: 2332-5003

Content & Opinions

The opinions expressed in the articles are solely those of their respective authors and do not reflect the opinions of the *Rocky Mountain Academy of Legal Studies in Business*, the *Rocky Mountain Law Journal* itself, the officers, editors and reviewers, or any named college or university. This publication is designed to give accurate and authoritative information with regard to the subject matter. It is distributed with the understanding that neither the publisher nor the editors are engaged in the rendering of legal advice, political opinion, or any other professional service. If legal advice or other expert assistance is required, please seek the services of a competent professional.

EDITORIAL BOARD AND STAFF EDITORS (2014-2015)

EDITOR-IN-CHIEF
ADAM EPSTEIN, J.D./M.B.A.
CENTRAL MICHIGAN UNIVERSITY

ASSOCIATE EDITOR
ERIC BLOMFELT, J.D.
METROPOLITAN STATE UNIVERSITY OF DENVER

STAFF EDITORS
PAUL ANDERSON, J.D.
MARQUETTE UNIVERSITY LAW SCHOOL

THOMAS ANTHONY J.D.
CENTRAL MICHIGAN UNIVERSITY

ROBERT BREITENBACH, J.D.
METROPOLITAN STATE UNIVERSITY OF DENVER

J. ROYCE FICHTNER, J.D.
DRAKE UNIVERSITY

JOHN HOLCOMB, J.D.
UNIVERSITY OF DENVER

KATHRYN KISSKA-SCHULZE, J.D., L.L.M.
NORTH CAROLINA AGRICULTURAL & TECHNICAL STATE UNIVERSITY

B. BRITTANY SCANTLAND LALL, J.D.
UNIVERSITY OF DENVER

KONRAD LEE, J.D.
UTAH STATE UNIVERSITY

ELIZABETH MCVICKER, J.D., PH.D.
METROPOLITAN STATE UNIVERSITY OF DENVER

BARBARA OSBORNE, J.D.
UNIVERSITY OF NORTH CAROLINA

DARREN PRUM, J.D./M.B.A.
FLORIDA STATE UNIVERSITY

GREGORY TAPIS, PH.D.
AUGUSTANA COLLEGE

MATTHEW THUE, J.D.
UTAH STATE UNIVERSITY

WHITNEY C. TRAYLOR, J.D.
METROPOLITAN STATE UNIVERSITY OF DENVER

ADVISORY EDITOR
COREY CIOCHETTI, J.D.
UNIVERSITY OF DENVER

EDITOR'S CORNER

What a difference a year makes. We had a record number of submissions this year, the quality of which were outstanding. We had to make tough decisions and we are publishing four. The submissions were from coast-to-coast, and our exposure has picked up among the Academy of Legal Studies in Business (ALSB) community.

We are now listed in both *Cabell's Directory of Publishing Opportunities in Management* and in *Washington & Lee University Law Journals: Submissions & Rankings*. This is a significant achievement. Additionally, our Editorial Board has grown exponentially and even includes members from the law school community and non-business law community as well. Our website is vastly improved as well.

I would like to thank all of you who reviewed for the *Rocky Mountain Law Journal* this year. This includes several new volunteers as well who clearly spent considerable time screening articles and providing comprehensive suggestions to make the articles even better.

For those of you who just came on board, I am looking forward to you next year as we go through the review, acceptance and editorial process once again so that you, too, can provide important input related to article submissions. Certainly, I would also like to thank the Rocky Mountain Academy of Legal Studies in Business conference organizers and committees that continue to support our Journal as it moves forward.

This year's Volume 3 includes four timely and intriguing articles. We begin with Brian J. Halsey, Julie D. Pfaff and Jennifer C. Halsey and their discussion of Trusted Individual Retirement Accounts (TIRAs) in light of the 2014 decision by the U.S. Supreme Court in *Clark v. Rameker*. For the financial and legal practitioner, this has important ramifications with regard to asset protection (or the lack thereof) from creditors under federal bankruptcy law with regard to beneficiaries of individual retirement accounts. The next article by Harvey Shrage explores how courts and arbitrators have interpreted the expression *just cause* in a collective bargaining agreement, a sometimes neglected and not-so-easy task for the employer and employee. Kevin Farmer discusses the relatively new business form known as the benefit corporation and how many states have adopted statutes accordingly for this socially conscious business organization. Finally, Vicki M. Luoma, Milton Luoma and Emmy J. Buboltz explore major electronic discovery issues for the upcoming year, including Technology Assisted Review (TAR), several others, and possible changes to the Federal Rules of Civil Procedure.

So, enjoy Volume 3 and thank you again to all who continue to play a role in making the Rocky Mountain Law Journal a success for years to come.

ADAM EPSTEIN
EDITOR-IN-CHIEF
JANUARY 12, 2015

-ARTICLES-

TRUSTEED INDIVIDUAL RETIREMENT ACCOUNTS – RISK MANAGEMENT & CLIENT BENEFITS IN THE WAKE OF CLARK V. RAMEKER

By

Brian J. Halsey, J.D., LL.M., CISSP*

And

Julie D. Pfaff, J.D., M.A.**

And

Jennifer C. Halsey, M.B.A.***

I. Introduction

The June 2014 Supreme Court decision in *Clark v. Rameker* unanimously held that inherited Individual Retirement Accounts are not protected from creditors under the federal bankruptcy statutes.[1] Consequently, alternative arrangements for the dispositions of Individual Retirement Accounts are increasingly attractive for clients that wish to shelter their assets from their beneficiaries' creditors. This paper discusses the legal, financial, management, and communications challenges imposed by the *Clark*[2] case and advises attorneys and financial advisors: to communicate same to their clients;[3] to be cognizant of highly viable alternatives such as Trusteed Individual Retirement Accounts as a part of a well-managed financial plan;[4] to be prepared to discuss the positive impacts Trusteed Individual Retirement Accounts may have on intra-family and advisor/client relationships;[5] and to be aware of the managerial and financial implications such Trusteed Individual Retirement Accounts may have on the advisor's practice.[6]

II. The Decision - Clark v. Rameker

Clark v. Rameker was argued March 24, 2014 and decided June 12, 2014.[7] The unequivocal unanimous decision has direct impacts on investors and their legal and financial advisors. Our

---

* Associate Professor of Business Law, West Chester University of Pennsylvania.
** Adjunct Professor of Business Law & Communications, West Chester University of Pennsylvania.
*** Assistant Professor of Management, American Public University.
[1] 134 S.Ct. 2242 (2014).
[2] *Id.*
[3] *See infra* notes 48-57 and accompanying text.
[4] *See infra* notes 58-64 and accompanying text.
[5] *See infra* notes 65-78 and accompanying text.
[6] *See infra* notes 79-80 and accompanying text.
[7] *Clark*, 134 S.Ct. at 2244.

discussion of the *Clark* case focuses on: the underlying bankruptcy statutes; the factual background of the case; the federal circuit splits leading to the Supreme Court decision; and the Supreme Court decision itself.

A. Bankruptcy Statutes

A fundamental principle of the bankruptcy code is that with limited exceptions all of a debtor's property becomes part of the bankruptcy estate subject to distribution by the bankruptcy trustee to the bankrupt's creditors.[8] However, among those exemptions is 11 U.S.C. § 522(b)(3)(C), which exempts certain retirement funds from the bankruptcy estate.[9] This can be tremendously valuable to the bankrupt client/investor because their retirement funds in an IRA, Roth RIA, 401(k), 457 plan, 403(b) or a myriad of other common tax advantaged retirement accounts are protected for the future.[10]

B. Factual Background

The facts are straightforward. In the *Clark* case the Plaintiff, Heidi Heffron-Clark (hereinafter "Clark") was the beneficiary of a traditional IRA established by her mother in 2000.[11] The mother died in 2001, and the roughly $450,000 IRA was transferred to Clark as an inherited IRA.[12]

The Supreme Court discussed the attributes of an inherited IRA. "An inherited IRA is a traditional or Roth IRA that has been inherited after its owner's death."[13]

> Inherited IRAs do not operate like ordinary IRAs. Unlike with a traditional or Roth IRA, an individual may withdraw funds from an inherited IRA at any time, without paying a tax penalty. . . . Indeed, the owner of an inherited IRA not only may but must withdraw its funds: The owner must either withdraw the entire balance in the account within five years of the original owner's death or take minimum distributions on an annual basis. . . . And unlike with a traditional or Roth IRA, the owner of an inherited IRA may never make contributions to the account.[14]

In 2010 Clark and her spouse (also a party to the case) filed for Chapter 7 bankruptcy and classified the now-valued $300,000 inherited IRA as exempt under 11 U.S.C. § 522(b)(3)(C).[15] The respondents objected that Clark's inherited IRA assets were not retirement funds covered by the

---

[8] 11 U.S.C.A. § 541(a)(1) (2014); *see also* Rousey v. Jacoway, 544 U.S. 320, 325 (2005).
[9] U.S.C. § 522(b)(3)(C) (2014); provides that ("retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986."); *see also Clark*, 134 S.Ct. at 2244.
[10] *See* the discussion of retirement accounts at *Clark*, 134 S.Ct. at 2244-45; *see generally* Rousey v. Jacoway, 544 U.S. 320 (2005); *In re* Brucher, 243 F.3d 242 (6th Cir. 2001); *In re* Trawick, 497 B.R. 572 (C.D. Cal. 2013).
[11] *Clark*, 134 S.Ct. at 2245.
[12] *Id.*
[13] *Id.*
[14] *Id.* (Citations Omitted).
[15] *Clark*, 134 S.Ct. at 2245

exemption.[16] The classification of that inherited IRA as exempt or un-exempt property under the bankruptcy code is the crux of the Supreme Court case.[17]

C. Circuit Splits

The Supreme Court granted *certiorari* to resolve a circuit split between *Clark* and *In re Chilton*.[18] In *Chilton* the Fifth Circuit determined that inherited IRA funds constituted retirement funds under 11 U.S.C. § 522(b)(3)(C) and are thus exempt from attachment by the creditors of the bankrupt's estate.[19] The court explained that:

> [t]he plain meaning of the statutory language refers to money that was "set apart" for retirement. Thus, the defining characteristic of "retirement funds" is the purpose they are "set apart" for, not what happens after they are "set apart." Here, there is no question that the funds contained in the debtors' inherited IRA were "set apart" for retirement at the time [the original owner] deposited them into an IRA.[20]

The court further held that inherited IRAs are contained in an "account" that is "exempt from taxation" as that phrase is used in the bankruptcy statutes.[21]

Chilton came to the opposite conclusion from the Seventh Circuit decision in *Clark.*[22] In *Clark* the Circuit Court noted that "[i]nherited IRAs represent an opportunity for current consumption, not a fund of retirement savings."[23] It further explained that at the time of the bankruptcy, "[t]he money in the inherited IRA did not represent *anyone's* retirement funds. They had been [the deceased mother's], but when she died they became no one's retirement funds."[24] The court determined that an inherited IRA only "[r]emains a tax-deferral vehicle until the mandatory distribution is completed, but distribution precedes the owner's retirement."[25]

Thus, prior to the Supreme Court decision in June 2014 it was possible that one bankruptcy court could hold that inherited IRA's were retirement funds exempt from the bankruptcy process, and another, in another circuit, could hold the opposite. Because inherited IRA assets can be substantial the impact on a client contemplating bankruptcy could be very consequential. The situation was ripe for resolution by the Supreme Court.[26] It did so clearly, without dissent or concurrences, and clarified the law nicely for attorney and financial advisors.

---

[16] *Id*.
[17] *Id*. at 2244.
[18] 674 F.3d 486 (2012).
[19] *Id*. at 489.
[20] *Id.*
[21] *Id.* at 490.
[22] In re Clark, 714 F.3d 559 (2013), *aff'd, Clark*, 134 S.Ct. at 2250.
[23] *Id.* at 561.
[24] *Id.*
[25] *Id.*
[26] *See generally* Justin F. Polach, *Are Inherited IRAs Exempt From Creditors In Bankruptcy?*, 99 ILL. B.J. 628, 629 (2011) (discussing the state of case law until 2011. "Until recently, courts seemed assured that an inherited IRA, unlike the original IRA, is not an exempt asset from the debtor's bankruptcy estate. They so held in Oklahoma, California, Alabama, Wisconsin, Texas, and even Illinois. But most recent decisions have gone the other way, finding inherited IRAs exempt from creditors under the bankruptcy code.") (internal citations omitted).

D. The Supreme Court Decision

In its resolution of the circuit split the Supreme Court focused closely on whether or not "[a]s an objective matter [an inherited IRA is an account] set aside for the day when an individual stops working."[27] If that was the case, then the Court would find that the funds were "retirement funds" under 11 U.S.C. § 522(b)(3)(C) and therefore exempt under the bankruptcy code.[28] In its analysis the court focused on three legal characteristics of inherited IRAs that distinguish them from other "retirement funds."[29]

First, the owner of an inherited IRA cannot add funds to the account.[30] This distinguishes inherited IRAs from traditional and Roth IRAs.[31] In the Court's view "[t]he entire purpose of traditional and Roth IRAs is to provide tax incentives for accountholders to contribute regularly and over time to their retirement savings."[32] Those incentives are lacking by definition if the owner is barred from making contributions to his or her retirement within that account.

Second, there are specific withdrawal requirements imposed on the owner of an inherited IRA that are not tied to their retirement plans.[33] The court noted that "[t]he beneficiary of an inherited IRA must either withdraw all of the funds in the IRA within five years after the year of the owner's death or take minimum annual distributions every year."[34] Therefore the inherited IRA commonly is depleted over time "[r]egardless of their holders' proximity to retirement,… hardly a feature one would expect of an account set aside for retirement."[35]

Third, the Supreme Court noted that inherited IRAs are treated far differently from traditional or Roth IRAs.[36] In general, a withdrawal from those accounts prior to age 59 ½ is subject to a 10% tax penalty.[37] This encourages the account holder to leave those funds alone until they reach that age-presumably about the time they would be considering retirement.[38] In contrast, no such restraint is imposed on the holder of an inherited IRA.[39] Those inherited IRA funds can be utilized today, for current needs, without the 10% penalty.[40] That, according to the Court, is not an attribute of retirement funds.[41]

---

27 *Clark*, 134 S.Ct. at 2246.
28 *Id*.
29 *Id*. at 2247.
30 *Id*.; *see also* 26 U.S.C. § 219(d)(4).
31 *Clark*, 134 S.Ct. at 2247.
32 *Id*.
33 *Id*.
34 *Id*. (citing § 408(a)(6); § 401(a)(9)(B); 26 CFR § 1.408-8 (Q-1 and A-1(a) incorporating § 1.401(a)(9)-3 (Q-1 and A-1(a))).
35 *Clark*, 134 S.Ct. at 2247.
36 *Id*.
37 *Id*.
38 *Id*.
39 *Id*.
40 *Id*.
41 *Id*.

The Court noted that because of these three legal characteristics, inherited IRAs are fundamentally distinct from traditional and Roth IRAs.[42] Those accounts (traditional and Roth IRAs) mirror the Bankruptcy Code's interest in shielding assets for the bankrupt's essential needs during retirement.[43] However, the inherited IRA does the opposite. Its legal characteristics do nothing to prevent the new owner "[f]rom using the entire balance of the account on a vacation home or sports car immediately after her bankruptcy proceedings are complete."[44]

The *possibility* that an owner would use an inherited IRA for retirement purposes was not persuasive to the Court.[45] "Were it any other way, money in an ordinary checking account (or, for that matter, an envelope of $20 bills) would also amount to "retirement funds" because it is possible for an owner to use those funds for retirement."[46]

Therefore, based on this reasoning, and as noted *infra*, the Supreme Court in *Clark* unanimously held that inherited Individual Retirement Accounts are not protected from creditors under the exemptions provided in the federal bankruptcy statutes.[47]

E. Clark's Implications for the Client

In the wake of *Clark* attorneys and financial planners are faced with challenges that directly impact their clients' plans. It is the responsibility of both groups of advisors to coordinate.[48]

"An IRA is a "generic" retirement vehicle that can be opened by an individual and contain almost any type of investment. Individuals have great power over an IRA, including the right to liquidate, pledge, or gift the funds."[49] Commonly traditional IRAs and Roth IRAs have named individual beneficiaries. Who those beneficiaries are directly informs *Clark's* ramifications for the client.

If the beneficiary is a surviving spouse, he or she may elect to treat his or her interest in the deceased's IRA as the spouse's own IRA.[50] "The spouse must be the sole beneficiary of the IRA and have an unlimited right to withdraw amounts from the IRA."[51] This is directly relevant as "[t]he result of an election . . . is that the surviving spouse shall then be considered the IRA owner

---

[42] *Id*.
[43] *Id*.
[44] *Id*. at 2248.
[45] *Id*. at 2250.
[46] *Id*.
[47] *Id*.
[48] *See generally* Andrew Huber & Lester Law, *Asset Location: Why Attorneys Should Bridge the Perceived Investment Gap,* 84 Fla. B.J. 46, 48 (2010) (discussing the need for coordination between attorneys and financial planners with regard to tax liability. The principle extends to the need for the two groups to communicate with regard to other potential creditors aside from the government. "The solution to proper asset location begins with robust communication between the client's legal and financial advisors. Specifically, you, as the attorney, can provide guidance on the tax characteristics and implications of the various entities you design for your clients. Additionally, the attorney should become as well-versed as possible in asset allocation methodologies (*e.g.*, pretax and after-tax) that are utilized by particular investment advisors. In short, the attorney is an integral part of the investment planning process.")
[49] In Re: Estate of Sandra L. Neiderhiser, Deceased, 2003 WL 23874020 at *6 (2003).
[50] 26 C.F.R. § 1.408–8, Treas. Reg. § 1.408–8 (A-5.(a)).
[51] *Id*.

for whose benefit the trust is maintained for all purposes under the Internal Revenue Code."[52] Because the spouse's IRA by definition is *not* an inherited IRA, the *Clark* decision is inoperative. Therefore, the funds within that IRA are subject to the exemptions in 11 U.S.C. § 522(b)(3)(C), which exempts certain "retirement funds" from the bankruptcy estate.[53] The surviving spouse may also elect to treat the deceased spouse's assets as his or her own by initiating a rollover "[i]nto a traditional IRA, or to the extent it is taxable, into a: a. Qualified employer plan; b. Qualified employee annuity plan (section 403(a) plan); c. Tax-sheltered annuity plan (section 403(b) plan); [or] d. Deferred compensation plan of a state or local government (section 457(b) plan)."[54] These rollovers have the same impact[55] and make the assets exempt "retirement funds." [56] The client should be advised accordingly.

If, however, the beneficiaries include any individual aside from the spouse, then *Clark's* holding applies. If at any time after the client's death his or her beneficiaries enter the bankruptcy system, then their inherited IRA, which would have been sheltered if passed wholly to a surviving spouse, is a part of the bankruptcy estate and subject to distribution to creditors.[57] Again, the client should be advised accordingly.

This may not be an overriding issue for many, or most, clients. However, for those clients with spendthrift or unreliable beneficiaries, or clients who merely wish to insure against the unknown, the *Clark* case could be telling as they make their disposition elections for their IRAs. This is so because *Clark* has removed some of the spendthrift advantages from inherited IRAs that are available within other "retirement funds" under the bankruptcy statutes. Due diligence requires the advisor to communicate same to the client.

III. Legal Structure of Trusteed Individual Retirement Accounts

One relatively simple method to avoid this negative treatment of an inherited IRA in bankruptcy is to avoid creating an IRA that has the three legal characteristics of inherited IRAs as discussed in *Clark*.[58] Trusteed Individual Retirement Accounts (hereinafter "TIRAs") are ideal for this purpose.

---

[52] *Id*. at (A-5.(c)).
[53] *See generally supra* notes 27-47 and accompanying text.
[54] Internal Revenue Service, *Retirement Topics-Beneficiary*, http://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Retirement-Topics-Beneficiary (last visited January 5, 2015).
[55] *See* 26 C.F.R. § 1.408–8, Treas. Reg. § 1.408–8 (A-7).
[56] *See generally supra* notes 27-47 and accompanying text.
[57] *Id*.
[58] *See Clark*, 134 S.Ct. at 2247.

TIRAs are established under 26 U.S.C.A. § 408(a).[59] "Ideally, the account owner is able to build in spendthrift protections to protect IRA assets from beneficiary creditors."[60] The account owner can provide, within the account agreement itself, many if not all of the terms for dispositions to later beneficiaries. "To provide maximum protection from creditors, a third-party trustee should be appointed and given broad discretion to distribute or accumulate income and principal."[61] TIRAs avoid the requirement, costs and administrative burden of separate trusts that would otherwise receive the IRA funds.

Because the original account owner (and later the trustee) can control the disposition, they can short circuit the *Clark* analysis. For instance, *Clark* focused in its analysis on the possibility that a beneficiary may use an inherited IRA for current consumption.[62] By prohibiting unauthorized withdrawals except as required to avoid minimum distributions requirements, a competent planner can use a TIRA to protect assets from the beneficiary's creditors. "For instance, trustees under these IRAs are often required to distribute a set minimum to a beneficiary, thus sacrificing creditor protection up to these amounts."[63]

IV. Trusteed Individual Retirement Accounts, Intra-Family & Advisor/Client Relationships

The TIRA offers the client the ultimate control over the disposition of his or her assets and can provide peace of mind that the client's beneficiary's financial needs will be met in a tax-efficient manner. Through the TIRA instrument, clients can control the amount of money distributed to the beneficiaries, to whom the money is distributed, or extend the TIRA's benefits across multiple generations. Moreover, the TIRA can ensure that the client's wishes are carried out even in the event of the client's or a beneficiary's incapacity, as well as protect a beneficiary's inherited assets from attachment by a former spouse in divorce or creditors in a lawsuit. In addition, the trustee is responsible for tax filings, administrative paperwork and the like, thus removing that burden from the client and the beneficiaries. These assurances can offer the client peace of mind while also mitigating the inevitable family disputes that arise around inheritance.

---

[59] 26 U.S.C.A. § 408(a) provides that : "(a) Individual retirement account.--For purposes of this section, the term "individual retirement account" means a trust created or organized in the United States for the exclusive benefit of an individual or his beneficiaries, but only if the written governing instrument creating the trust meets the following requirements: (1) Except in the case of a rollover contribution described in subsection (d)(3) in1 section 402(c), 403(a)(4), 403(b)(8), or 457(e)(16), no contribution will be accepted unless it is in cash, and contributions will not be accepted for the taxable year on behalf of any individual in excess of the amount in effect for such taxable year under section 219(b)(1)(A). (2) The trustee is a bank (as defined in subsection (n)) or such other person who demonstrates to the satisfaction of the Secretary that the manner in which such other person will administer the trust will be consistent with the requirements of this section. (3) No part of the trust funds will be invested in life insurance contracts. (4) The interest of an individual in the balance in his account is nonforfeitable. (5) The assets of the trust will not be commingled with other property except in a common trust fund or common investment fund." (6) Under regulations prescribed by the Secretary, rules similar to the rules of section 401(a)(9) and the incidental death benefit requirements of section 401(a) shall apply to the distribution of the entire interest of an individual for whose benefit the trust is maintained."

[60] Polach, *supra* note 26, at 629.

[61] *Id*. (internal citations omitted).

[62] *See Clark*, 134 S.Ct. at 2247.

[63] Polach, *supra* note 26, at 629.

TIRAs can protect beneficiaries from significant tax liability by limiting beneficiary's withdrawals to only required minimum distributions, or otherwise controlling the withdrawal amount.[64] By managing beneficiary's distributions, the trustee can ensure that the TIRA assets remain tax deferred for as long as possible.[65] It also gives the client – through the trustee – the power to control the disposition of assets long after death, and potentially to stretch the value of the TIRA over multiple generations.[66] To provide further reassurance to the client, the trustee can be granted discretion to make supplementary payments to the beneficiary for health, welfare or education expenses, or upon the beneficiary's attainment of a certain age.[67] All of these tools permit the trustee to make discretionary financial decisions that a beneficiary may not be able to make due to lack of financial discipline or sophistication. Furthermore, when these decisions are made by an institutional trustee-with an arm's length relationship to the beneficiary-the potential for family quarrels is reduced, potentially preserving interpersonal relationships among family members.

In addition to providing long-term control over asset distribution, TIRAs can also help to protect a beneficiary's assets in the event of divorce.[68] A well-written TIRA can specify successor beneficiaries. This is a significant difference from a traditional inherited IRA where, once inherited, the new owner controls beneficiary designation.[69] The opportunity afforded by the TIRA to select specific beneficiaries provides the client with assurance that the client's investments will continue to benefit the family lineage even after life's foibles-death, incapacity, divorce or bankruptcy-inevitably occur.[70] This long-term planning tool can reduce the uncertainty and angst that often accompany family transitions. TIRAs can also contain an incapacity provision.[71] As a client's age and the risk of incapacity increases, this provision can give the client confidence that if they are no longer able to make financial decisions a professional trust committee can act on the client's behalf. [72]

The benefits of the TIRA extend to the client's cost. While a trust instrument can be complex and therefore expensive to establish, a TIRA is generally considerably cheaper and may even reduce attorney liability.[73] Using the pre-prepared, pre-vetted "boilerplate" trust language provided by the trustee firm reduces costs and avoids drafting errors.

---

[64] Julie Jason, *Voices: Julie Jason, on the Benefits of Trusteed IRAs*, WALL ST. J. (July 18, 2013), *available at* http://online.wsj.com/news/articles/SB10001424127887324448104578613991409053454.
[65] *Id.*
[66] *See generally* Kelly Greene, *Trusteed IRAs Can Help Heirs Manage Their Inheritance*, WALL. ST. J. (December 15, 2013), *available at* http://online.wsj.com/news/articles/SB10001424052702303281504579220501897614552.
[67] American Institute of CPAs, *What You Should Know About Trusteed IRAs,* http://www.360financialliteracy.org/Topics/Investor-Education/Beneficiary-Designations/What-you-should-know-about-trusteed-IRAs (last visited January 5, 2015).
[68] Julie Jason, *More Investors Should Consider Trusteed IRAs,* WALL ST. J. (updated February 9, 2014), *available at* http://online.wsj.com/news/articles/SB10001424127887323968704578649770300341976 (last visited January 5, 2015).
[69] John Bock, *Estate Planning: The Trusteed IRA,* (July 26, 2010) http://www.thinkadvisor.com/2010/07/26/estate-planning-the-trusteed-ira (last visited January 5, 2015).
[70] *Id.*
[71] Jason, *supra* note 68.
[72] *Id.*
[73] Greene, *supra* note 66; Bock*, supra* note 69.

The downside, however, to this lesser-used planning tool is that "there are not many firms willing to act as trustee, which makes the portability of these accounts a short-term concern…"[74] An additional risk is that trust tax rates in some circumstances may be higher than individual income tax rates-which means the beneficiary's tax liability could in certain circumstances be greater.[75] Further, experts warn that "[t]he IRS could decide that [an inexpertly drawn custom trust] doesn't qualify as a 'see-through' or 'conduit' trust, meaning [the client's] heirs wouldn't qualify to take stretched-out withdrawals-even though [the client] may have set up the trust in the first place to make sure they did just that."[76] To guard against this risk, experts suggest naming people as beneficiaries instead of an institution or charity and instructing the preparer to set up a "conduit" or "see-through" trust.[77] Again, professionally pre-prepared, pre-vetted "boilerplate" trust language provided by the trustee firm sidesteps these problems.

Generally, these potential pitfalls can be successfully addressed by a qualified financial planner or attorney, rendering the TIRA not only a useful vehicle by which to direct inheritance, but also a positive tool to manage the difficult family issues that surround inheritance.

V. Trusteed Individual Retirement Accounts & Advisors' Business Models

While TIRAs offer a number of unique, cognizable client benefits, there are potential drawbacks to the legal and financial professional. First, many financial practitioners do not offer TIRAs. This situation places the financial advisor in the undesirable position of referring the client to another advisor and losing the opportunity to manage the asset.[78] As a result, some advisors may be reluctant to discuss this option with their clients and therefore risk losing the client's on-going business.[79] Legal professionals also stand to lose revenue if they move clients to a TIRA, as they will not have the opportunity to draft the more complex (and therefore more lucrative) trust instrument[80] or to help administer the same upon the client's passing.

VI. Conclusion

The June 2014 Supreme Court decision in *Clark*[81] that strips creditor protection from inherited IRAs has implications for advisors and clients that plan for the ultimate disposition of an IRA. A financial planner or attorney is obligated to discuss alternative arrangements for clients to shelter their assets from their beneficiaries' creditors in light of *Clark*. Despite the potential loss of revenue to the financial planner or attorney, those alternatives should include Trusteed Individual Retirement Accounts because of their ease of drafting, their relatively low cost, the increased and

---

[74] Bock*, supra* note 69.
[75] Greene, *supra* note 66.
[76] *Id.*
[77] *Id.* (citing Natalie Choate, an estate planning attorney, who states that "Trusts that fail to qualify typically include those with beneficiaries who aren't people, such as the estate, a charity or another trust. Since those entities don't have life expectancies, stretched-out withdrawals would not be allowed for any of the other beneficiaries involved.")
[78] Jason, *supra* note 68.
[79] *Id.*
[80] Charles Sharpe, Christopher Holtby & Nicole Cassidy, *The Trusteed IRA: One Tested Method to Maintain Assets Under Management Through Generations*, http://www.riabiz.com/a/4782114834743296/the-trusteed-ira-one-tested-method-to-maintain-assets-under-management-through-the-generations (last visited January 5, 2015).
[81] *See supra* notes 27-47 and accompanying text.

extended control afforded to the client, the creditor protections extended to the beneficiaries, the simplification of the paperwork burden, and the potential to reduce inter-family disputes.

THE "JUST CAUSE" STANDARD: IS AN INVESTIGATION NEEDED?

By

Harvey M. Shrage*

Introduction

Through the collective bargaining process employers and unions have usually agreed to require that employers have just cause to discipline employees.[1] Generally, the collective bargaining agreement will not define the meaning of just cause.[2] Arbitrators appointed under collective bargaining agreements to determine whether discipline issued by an employer complies with the just cause standard have formulated a variety of definitions of just cause.[3] Arbitrators often include in the definition of just cause some obligation on the part of the employer to investigate prior to imposing discipline.[4] Just as arbitrators differ on the definition of just cause generally, arbitrators differ on what the employer must do to meet the procedural requirement.[5] Similarly, arbitrators differ as to the appropriate remedy in cases in which it is found that the employer did not meet the procedural requirements of the investigation.[6]

Part I of this article will review the development of the just cause standard. Part II will consider the various ways that arbitrators define just cause. Part III will review the investigation/due process requirement of just cause and the remedies imposed by arbitrators in cases where the employer's investigation was flawed. Finally, Part IV will offer an approach to be used by arbitrators in evaluating a flawed investigation by an employer prior to issuing discipline.

I. Development of the "Just Cause" Requirement

At-will employment is the common law presumption in employment relationships which allows an employer to discharge an employee "for good cause, for no cause, or even for cause morally wrong without being thereby guilty of legal wrong."[7] In his seminal article Professor Blades stated:

---

*Professor of Business Law, Western New England University. The author would like to thank the following individuals Lan Katany, Christopher St. Martin, Mark Squires, Nicole Piquette and Kyle Deskus for their research assistance and thoughtful comments and suggestions. Special thanks to my wife for her review of the article and continued support for my work.

[1] ELKOURI & ELKOURI, How Arbitration Works, 930-31 (6th ed. 2003); *see also* Wendi J. Delmendo, *Determining Just Cause: An Equitable Solution for the Workplace*, 66 WASH. L. REV. 831, 832 (1991).

[2] Jack Stieber, et al., *Protection against Unjust Discharge: The Need for a Federal Statute*, 16 U. MICH. J.L. REFORM 319, 337 (1983).

[3] Howell L. Lankford, et al., *Did He do It?: Employer Handbook 'Just Cause' Meets the Collective Bargaining Agreement*, 17 LERC MONOGRAPH SER. 17, 21 (2003).

[4] *See Id.* at 23.

[5] *See infra* at notes 38-39 and accompanying text.

[6] *See infra* at notes 80-99 and accompanying text.

[7] Spierling v. First Am. Home Health Servs., 737 A. 2d 1250, 1256 (Pa. Super. Ct. 1999); *see also* Martha S. West, *The Case against Reinstatement in Wrongful Discharge*, 1988 U. ILL. L. REV. 1, 12 (1988).

> Despite this irreversible trend, the law has adhered to the age-old rule that all employers "may dismiss their employees at will . . . for good cause, for no cause, *or even for cause morally wrong*, without being thereby guilty of legal wrong." [citation omitted]. This traditional rule, which forces the non-union employee to rely on the whim of his employer for preservation of his livelihood, is what most tends to make him a docile follower of his employer's every wish.[8]

Over the years courts and legislatures have limited the at-will doctrine through the creation of a public policy exception, implied covenants of good faith and fair dealing, and contract rights created by employee handbooks."[9]

One other limitation on the at-will doctrine emerged as a result of the National Labor Relations Act. With the passage of the National Labor Relations Act in 1935, employees were given the right to "bargain collectively through representatives of their own choosing."[10] Through the bargaining process, employers and unions have generally agreed to require that the employer have just cause to discipline employees covered by the collective bargaining agreement.[11] Even when collective bargaining agreements do not specifically include just cause language, just cause standards may be implied through the language of the contract.[12] This provides a greater amount of protection to employees against arbitrary decision making by employers. While just cause has various interpretations, at its essence is that discipline be in good faith or based on a "fair and honest cause or reason."[13] Just cause requirements have been subject to some criticism. Critics argue that it hinders an employer's ability to terminate inefficient employees where the termination is based solely "on the fact that another person could perform the employee's job more efficiently."[14]

When there is a dispute as to whether there was just cause for discipline or discharge, the collective bargaining agreement will likely provide for an arbitrator to resolve the dispute between the employer and employee.[15] An arbitrator's decision will result in one of three outcomes: 1) the employee's grievance is denied and the discipline is upheld entirely for having just cause; 2) the employee's grievance is granted and the disciplinary action is reversed, which may include reinstatement with or without back pay; and 3) the grievance is granted in part, where the arbitrator finds there is just cause for some disciplinary action but that the discipline chosen by the employer was too harsh and the arbitrator modifies the disciplinary action.[16] Given the serious consequences

---

[8] Lawrence E. Blades, *Employment at Will vs. Individual Freedom: On Limiting the Abusive Exercise of Employer Power,* 67 COLUM. L. REV. 1404, 1405 (1967).
[9] *See generally* Foley v. Interactive Data Crop., 765 P.2d 373 (Cal. 1988).
[10] NAT'L LABOR RELATIONS ACT OF 1935, 29 U.S.C. § 157.
[11] ELKOURI, *supra* note 1, at 930-31; *see also* Delmendo*, supra* note 1, at 832.
[12] SFIC Props. v. Int'l Ass'n of Machinists & Aerospace Workers, Dist. Lodge 94, Local Lodge 311, 103 F.3d 923, 926 (9th Cir. 1996).
[13] *See* Losacco v. F.D. Rich Constr. Co., 992 F.2d 382, 384 (1st Cir. 1993); Peyton v. Sun T.V. & Appliances, 44 Ohio App. 2d 10, 12 (Ohio Ct. App. 1975); Delmendo, *supra* note 3, at 832, 834.
[14] *See* John P. Frantz, *Market Ordering Versus Statutory Control of Termination Decisions: A Case for the Inefficiency of Just Cause Dismissal Requirements*, 20 HARV. J. L. & PUB. POL'Y 555, 566 (1997).
[15] Carlton Snow, *Deciding an Arbitration Case: The Evolution of Arbitral Principles in "Sleeping on the Job" Decisions*, 2 WIDENER J. PUB. L. 491, 492 (1993).
[16] *See* Margaret A. Lucero & Robert E. Allen, *The Arbitration of Cases Involving Aggression against Supervisors*, 53 DISP. RESOL. J. 57, 60 (1998).

that result from an arbitrator's decision, it is important to identify the factors that contribute to an arbitrator's decision, particularly the definition of just cause.

II. Defining "Just Cause"

Sometimes a collective bargaining agreement will provide guidance as to what just cause means, but more often collective bargaining agreements are silent on what is meant by just cause.[17] However, even if the contract defines just cause, oftentimes it provides little guidance, and arbitrators must consider its application and meaning.[18] During the early years that just cause provisions were included in collective bargaining agreements, "arbitrators interpreted just cause by giving substantial deference to management's decision," and acted more like an appellate court.[19] After World War II, Arbitrator Platt argued for the appropriateness of "a de novo hearing and a de novo determination of whether or not the grievant actually did whatever he or she has been disciplined or discharged for."[20] In his 1947 decision, *Riley Stoker Corp.*, Arbitrator Platt articulated an early version of the definition of "sufficient cause." Platt stated:

> It is ordinarily the function of an Arbitrator in interpreting a contract provision which requires "sufficient cause" as a condition precedent to discharge not only to determine whether the employee involved is guilty of wrongdoing and, if so, to confirm the employer's right to discipline where its exercise is essential to the objective of efficiency, but also to safeguard the interests of the discharged employee by making reasonably sure that the causes for discharge were just and equitable and such as would appeal to reasonable and fair-minded persons as warranting discharge. To be sure, no standards exist to aid an Arbitrator in finding a conclusive answer to such a question and, therefore, perhaps the best he can do is to decide what a reasonable man, mindful of the habits and customs of industrial life and of the standards of justice and fair dealing prevalent in the community ought to have done under similar circumstances and in that light to decide whether the conduct of the discharged employee was defensible and the disciplinary penalty just.[21]

General definitions and references to just cause do not provide much guidance to help determine how to apply the standard.[22] In *Lockheed Aircraft Corp.,* Arbitrator Warns stated:

---

[17] Steiber, *supra* note 2, at 337.
[18] Lankford, *supra* note 3, at 21. "Parties to many collective bargaining agreements have incorporated just cause or similar phrases in their contracts for more than 50 years, generally without defining that term. Instead, the term has been defined by arbitrators in numerous decisions and scholarly publications." *Id.* at 17.
[19] *Id.*
[20] *Id.*
[21] Riley Stoker Corp., 7 Lab. Arb. 764 (Platt, Arb). Harry H. Platt was a member of the National Academy of Arbitrators. During "World War II, Platt was [the] Chairman of [the] regional war labor board panels [responsible for] resolv[ing] labor-management disputes." *Harry H. Platt Is Dead at 83; Lawyer and Labor Arbitrator*, N.Y. TIMES, June 18, 1985, *available at* http://www.nytimes.com/1985/06/18/us/harry-h-platt-is-dead-at-83-lawyer-and-labor-arbitrator.html; NATIONAL ACADEMY OF ARBITRATORS, Interview by Joseph Krislov with Harry H. Platt, (Oct. 24, 1980), http://www.naarb.org/interviews/HarryPlatt.PDF.
[22] Lockheed Aircraft Corp., 27 Lab. Arb. (BNA) 512, 7 (1956) (Warns, Arb.); *see also* Snow, *supra* note 15, at 507.

> On the face of it, "just cause" appears so vague as to give no guidance at all to the arbitrator. This is not true, however. Over the years, the "common law of arbitration" has defined this phrase in fairly understandable terms. In deciding whether the Company's disciplinary action will be upheld, the test is whether fair-minded and experienced men, fully cognizant of the facts of industrial life, would find the punishment consistent with the offense.[23]

Similarly, Arbitrator James Doyle defined just cause as a "standard which should be applied in a manner that will distinguish the unduly harsh, unfair, biased, prejudiced, or arbitrary action from the fair and reasonable judgment in which reasonable minds would concur."[24]

On the other side of the spectrum, just cause definitions utilized by arbitrators can be very strict. A well-known and widely referenced standard developed by arbitrator Carroll Daugherty includes seven factors that an arbitrator must consider to determine if there is just cause for the disciplinary action. The following seven questions are considered under the Daugherty standard in order to determine whether just cause exists for the discipline or termination:

> (1) Did the employer provide the employee forewarning or knowledge of the possible or probable disciplinary consequences of the employee's conduct? (2) Was the employer's rule or managerial order reasonably related to a) the orderly, efficient and safe operation of the employer's business and b) the performance that the employer might properly expect of the employee? (3) Did the employer, before administering discipline to the employee, make an effort to discover whether the employee did in fact violate or disobey the rule or order of the employer? (4) Was the employer's investigation conducted fairly and objectively? (5) At the investigation, did the "judge" obtain substantial evidence or proof that the employee was guilty as charged? (6) Whether the employer applied its rules, orders and penalties even-handedly and without discrimination to all employees? (7) Was the degree of discipline administered by the employer in a particular case reasonably related to a) the seriousness of the employee's proven offense and b) the record of the employee in his service with the employer?[25]

Arbitrator Daugherty stated, "a 'no' to any one or more of the…questions normally signifies that just and proper cause did not exist."[26] Other arbitrators have criticized Daugherty's test as being too focused on the investigatory factor and recommend its use as a guideline rather than a strict formula. [27]

---

[23] Lockheed Aircraft Corp., 27 Lab. Arb. (BNA) at 7.

[24] *See* Lucero & Allen, *supra* note 16, at 59.

[25] Grief Brothers Cooperage Corp., 42 Lab. Arb. Rep. (BNA) 555, 558 (1964) (Daugherty, Arb.); Enterprise Wire Co., 46 Lab. Arb. Rep. (BNA) 359, 362-65 (1964) (Daugherty, Arb.).

[26] *Grief Bros. Cooperage Corp.*, 42 Lab. Arb. Rep. (BNA) at 558.

[27] Lankford, *supra* note 3, at 22; *see also* Saint-Gobain Containers, 132 Lab. Arb. 116, 125 (2013) (Wolff, Arb.) (arguing that Arbitrator Daugherty's just cause standard is misplaced because they are based on his experience as an arbitrator under the National Railroad Adjustment Board of the Railway Labor Act, where the procedures are not *de novo*). Arbitrator Wolff quoted Arbitrator Dunsford, who stated, "Whatever their virtues in the railroad industry, the undiscriminating transfer of these tests to the private sector, where hearings before an arbitrator are *de novo* and an almost infinite variety of grievance arrangements are found, is inappropriate. Designed for an arbitration system

In *N.C Dep't of Env't & Natural Res. v. Carroll*, the North Carolina Supreme Court interpreted the meaning of just cause and stated, "[j]ust cause, like justice itself, is not susceptible of precise definition. [citations omitted]. It is a flexible concept, embodying notions of equity and fairness that can only be determined upon an examination of the facts and circumstances of each individual case."[28] As a result of criticisms of a formulaic test, there has been a de-emphasis on Arbitrator Daugherty's seven factors. However, similar "factor" tests have been formulated with regard to the just cause standard. For instance, Arbitrator Levak stated that:

> Whether an employee has been discharged for just cause commonly involves an analysis of whether three basic components of that term have been justified: 1) Was the employee afforded fundamental due process rights…for example, did he or she have forewarning or foreknowledge that his or her conduct would lead to discipline, and was a fair investigation conducted; and was the employee treated fairly…2) Was the charged offense(s) proved? And 3) was the penalty imposed reasonably related to the seriousness of the offense(s), the employee's disciplinary record and any mitigating or extenuating circumstances?[29]

Arbitrator Lankford also used a three part test that asked: 1) whether the grievant actually did what he was disciplined for; 2) whether the grievant should have known that the sort of misbehavior he engaged in could result in discipline; and 3) was the disciplinary process fair?[30] These tests by Levak and Lankford are a balance between Daugherty's strict test and the more general definitions of just cause.

III. The Investigation Factor of Just Cause

Whichever definition of just cause is applied, factors that are considered by arbitrators to determine whether there was just cause contain some procedural obligation on the part of the employer prior to imposing discipline.[31] Most obviously, employers are required to prove that the employee actually engaged in the alleged misconduct.[32] To do so an employer must conduct a complete

---

different from the one in which they are now employed, the tests generate a vague confusion about the meaning of due process further compounded by the pretense that they simply reflect prevailing practice." *Id.*

[28] N.C. Dep't of Env't & Natural Res. v. Carroll, 599 S.E.2d 888, 900 (N.C. 2004).

[29] Benton County, Oregon, 1995 Lab. Arb. Supp. 116112 at p. 9 (Levak, 1995); *see also* Lankford, *supra* note 3, at 23.

[30] Lankford, *supra* note 3, at 23; *see also* Albertson's Inc., 115 Lab. Arb. (BNA) 886, 891 n.3. (2000) (Gangle, Arb.).

[31] *See* Landford, *supra* note 3, at 23; In the public sector, due process safeguards are imposed. Arbitrator Sambuco stated, "Public-Sector employees who are found to have more than unilateral expectation of continued employment are said to have a property interest in their employment, which may not be taken away without procedural due process. This procedural due process requires two key elements: notice and the opportunity to be heard. In *Cleveland Board of Education v. Loundermill* the Supreme Court explained that a public employee with a property interest is, at a minimum, entitled to "oral or written notice of the charges against him, an explanation of the employer's evidence, and an opportunity to present his side of the story" before the proposed action is taken." 2014 AAA LEXIS 127 at 28 (Sambuco, 2014).

[32] *See* Lucero & Allen, *supra* note 16, at 62.

investigation.[33] A study of arbitration decisions showed that out of "269 private sector discipline cases . . . eleven categories emerged as primary reasons given by arbitrators for reversing or softening the disciplinary action of management."[34] One of these eleven categories was the lack of evidence to support "the charge of wrongdoing."[35] As noted by Blancero and Bohlander, "[a] thorough investigation is critical to upholding any charge of employee misconduct."[36]

In addition to the need for an employer to conduct a complete investigation in order to gather the evidence to prove that the employee is guilty of the offense, many arbitrators will require that some level of investigation must have occurred to meet basic procedural due process requirements.[37] Arbitrators differ greatly over what is required for an investigation to meet the just cause requirement. Some arbitrators will find that the failure to perform an adequate investigation before the discipline is issued violates procedural due process resulting in the reversal of the discipline or termination.[38] On the other hand, other arbitrators will not allow an inadequate pre-disciplinary investigation to affect their decision as to whether or not there was just cause to terminate or discipline the employee.[39]

The section that follows will examine cases where the union or arbitrator raised an investigatory defect and will analyze how arbitrators have determined if there was just cause for the employee discipline in those cases. A review of the cases reveals a conflict between arbitrators in defining whether there is a defect in the investigation, and what type of defect requires a finding that the employer lacked just cause to discipline an employee.

A. Alleged Flawed Investigation but Finding of Just Cause

1. Witnesses Known but not Interviewed

---

[33] Donna Blancero & George Bohlander, *Minimizing Arbitrator 'Reversals' in Discipline and Discharge Cases*, 46 LAB. L.J. 616, 620 (1995).
[34] *Id.* at 616-17.
[35] *Id.* at 617.
[36] *Id.* at 620.
[37] Employers should note that there are risks associated with investigations that are beyond the scope of this article, but should be briefly mentioned. One concern for a unionized workplace is *Weingarten* rights, which requires that employers allow employees to request to have union representative present at interviews that the employee "reasonably believes" the investigation will result in disciplinary action. *See N.L.R.B. v. Weingarten*, 420 U.S. 251 (1975). Another category of risks employers face regard privacy rights employees have that employers may breach in order to gain information during an investigation. *See* Fred Naffziger & Larry Phillips, *Conducting Employee Investigations Prior to Imposition of Discipline*, 19 MIDWEST L. REV. 153, 153-67 (2004) (discussing the risk of using polygraph tests and urine tests); Joyce Oliner, *Careful how you investigate*, 96 A.B.A. BANKING J. 60, 62 (2004) (regarding the risks associated with the use electronic devices to gather information during investigations, such as e-mail seizures and video recorders).
[38] *See e.g.*, Chauffeurs, Teamsters and Helpers Local Union No. 878 v. Coca-Cola Bottling Co., 613 F.2d. 716 (8th Cir. 1980). (finding that there would have been just cause if there was procedural due process, but since grievant was not given an opportunity to give his side of the story, there was no just cause for the termination).
[39] *See* 2004 AAA LEXIS 139 at 31 (2004) (Kaplan, Arb.) (noting that "the just cause standard does not necessarily require that the discharge be overturned because an employee is not able to tell his story prior to the discharge. There must also be a showing of prejudice to the Grievant"); *2011 AAA LEXIS 380* at 11 (2011) (Drucker, Arb.) (asserting that although the investigation was not complete in this case, it was "adequate to provide the decision-maker…with a reliable account of what happened," and that the employer's failure to allow Grievant to provide his side of the story is "not fatal to just cause").

In *Hovensa LLC*, the Union argued that there were problems with the investigation because the employer did not interview the grievant's supervisor.[40] The arbitrator found that the failure to interview the supervisor would not have resulted in any relevant information since the grievant was terminated for theft, and there were no allegations that the grievant had been given permission to take the items by her supervisor.[41] Therefore, speaking to the supervisor would not have resolved any dispute over what happened.

In another case where the grievant was a police officer, the Union alleged that the sergeant who investigated the vehicle accident that the grievant had been involved in "failed to take into account the actions of an unlicensed driver of the vehicle who suddenly stopped after entering the intersection."[42] The arbitrator was unsympathetic and stated that the grievant had ample opportunity to bring up this issue in his statement to the sergeant conducting the investigation and during the due process meeting, but failed to do so.[43]

2. Timing of Discipline

In *Marquette Inn*, the investigator interviewed the victim of an alleged assault by the grievant, a security guard, and a janitor and consulted with top management prior to interviewing the grievant.[44] The Union argued that the investigator should have also interviewed the grievant before meeting with management.[45] The arbitrator found that while procedurally the investigator should have interviewed the grievant prior to consultation with management, there was no proof that the decision to discharge was finalized at that consultation before the grievant was given the opportunity for an interview.[46] The arbitrator denied the grievance, stating that vacating the discharge on procedural grounds would force him to disregard compelling substantive evidence that was arrived at despite procedural flaws.[47]

3. Failure to Interview the Grievant

In *Wiltech of Florida Corp.*, the arbitrator noted that the general notion of just cause requires that the employer conduct a fair investigation before taking disciplinary action, citing Daugherty's seven tests.[48] However, the arbitrator stated that the "employer's failure to conduct a pre-discharge interview with the grievant is not *always* fatal to the discharge action."[49] In that case, it was not

---

[40] Hovensa LLC, 129 Lab. Arb. (BNA) 790, 793 (2011) (Abrams, Arb.).
[41] *Id.*
[42] 2012 AAA LEXIS 125 at 10 (2012) (Molina, Arb.).
[43] *Id.* at 18.
[44] Marquette Inn and Hotel and Restaurant Employees, Local 17, 79 Lab. Arb. Rep. (BNA) 1259 (1982) (Flagler, Arb.).
[45] *Id.*
[46] *Id.*
[47] *Id.*
[48] Wiltech of Florida Corp., 130 Lab. Arb. (BNA) 628, 634 (2012) (Smith, Arb.).
[49] *Id.; see also* A.O. Thompson Lumber Co., 96 Lab. Arb. Rep. (BNA) 585 (1991) (Berger, Arb.) (stating that there were no due process violations because Grievant had an opportunity to discuss the Company's decision but walked away instead); Lamar Construction Co., 98 Lab. Arb. Rep. (BNA) 500 (1992) (Kanner, Arb.) (arguing that the failure to properly investigate, by not interviewing Grievant before the discipline was issued, should not result in dismissal of an otherwise meritorious discipline based upon just cause).

fatal to the discharge case because the grievant was terminated for his arrest for illegal drug possession on the property, and the grievant admitted to law enforcement that the illegal drugs and paraphernalia that were found in a car were his.[50]

In *Kelly-Moore Paint Co.*, even though the arbitrator held that the grievance was not arbitrable because of timeliness issues, he addressed the level of investigation conducted by the employer and noted that it was not a fatal flaw that the grievant did not present his side of the story.[51] The arbitrator stated that during the investigation, no one asked the grievant for his story, but the grievant had ample opportunity to speak up and chose not to.[52] In another case, the arbitrator held that even though there was only a brief conversation between the grievant and Superintendent of the prison before discipline was imposed, the sole question was whether the grievant failed to write an incident report as he was told to.[53] The arbitrator found that there was sufficient evidence to show that grievant failed to write the report and dismissed the Union's contentions that the "investigatory flaws undermine[d] the validity of the imposed discipline."[54]

4. No Prejudice From the Procedural Defect

In *American Electric Power*, the grievant was terminated for being involved in a "no fault accident" and for his "continued overall unacceptable job performance."[55] The Union argued that the discipline imposed should have been overturned "because the company officials who investigated the accident were not trained to conduct such an investigation."[56] Although the arbitrator agreed that those who investigated the accident were not trained to investigate vehicle accidents, he concluded that the grievant was not prejudiced by the procedural defect.[57] He noted that the grievant admitted during the grievance procedure that he ran a red light and struck another vehicle.[58]

Although arbitrators are concerned about incomplete investigations, particularly cases in which the grievant is not interviewed, they have not found such flaws fatal in all cases. Specifically, in cases in which the grievant was not interviewed, arbitrators have not found the flaw fatal where the grievant had an opportunity to bring the information to the attention of the employer prior to the decision to terminate, or where the grievant had admitted to the conduct at issue during a police investigation, or where the evidence of misconduct is proven by objective evidence, such as the failure to write a report. These decisions indicate that arbitrators do not take a mechanical approach to analyzing the completeness of an investigation. They consider whether the "missing

---

[50] *Id.*
[51] Kelly-Moore Paint Co., 130 Lab. Arb. Rep. (BNA) 215, 218 (2012) (Staudohar, Arb.).
[52] *Id.*
[53] 2011 AAA LEXIS 729 at 14 (2011) (Brynie, Arb.).
[54] *Id.*
[55] Am. Elec. Power, 129 Lab. Arb. (BNA) 1213, 1216 (2011) (Jennings, Arb.).
[56] *Id.* at 1232.
[57] *Compare Id.*, *with* 2007 AAA LEXIS 940 (2007) (Davis, Arb.) (finding that there was no just cause because the investigation re-enactment did not re-create all the conditions of the accident and the Employer did not interview the Grievant, ask him any questions, or use him to help reenact the accident).
[58] *Id.* at 1232.

information" is relevant and whether other information gathered during the investigation or before the decision to terminate cures any concerns with the investigation.

B. Flawed Investigation Yields Finding of no Just Cause

1. Investigation Produces Insufficient Evidence to Prove Misconduct

Investigations may be so faulty that they do not provide sufficient evidence to prove that the grievant engaged in misconduct. Arbitrator Gagne provided this reason in one of his decisions where the grievant was a teacher and it was alleged that she had kicked a student.[59] The grievant asserted that she merely had tapped the bottom of the student's shoe during class to move it from the aisle.[60] The arbitrator noted that the employer had failed to interview any of the other students in the class, other than the complaining student, which would have resolved the conflict of determining whether the student's or the grievant's account of the incident was correct.[61] Thus, where the investigation is faulty, there is a likelihood that the employer's procedural flaw led to its failure to obtain the necessary information to meet its burden of proof.[62]

2. Timing of Discipline With Investigation

In some cases, discipline that precedes the completion of an investigation will be grounds to sustain a grievance. In *Recycle Ann Arbor*, the arbitrator noted, in sustaining the grievance, that the "CEO suspended the grievant on March 18, 2011, but there [was] no evidence that [the employer] seriously considered in the intervening investigatory period whether discharge was warranted."[63] Similarly, in *Plumas Unified School District*, the arbitrator sustained the grievance and found that there was not a full and fair investigation into the alleged misconduct and that "[w]hile meetings eventually did occur, they were out of sequence with regard to the administered action. In essence, the [employer] created a disciplinary action mode before the investigation . . . ."[64]

Also, in *MidAmerican Energy Co.*, the employer accused the grievant of falsifying time records. Similar to *Recycle Ann Arbor* and *Plumas Unified School District,* the arbitrator sustained the grievance concluding that at the investigatory meeting "a management representative . . . aggressively questioned Grievant in a manner suggesting that the [employer] had already concluded that he had deliberately falsified time records."[65] These cases show that arbitrators find it important that meaningful investigations occur before disciplinary action to determine whether the facts support a conclusion that the grievant engaged in misconduct that would justify disciplinary action.

---

[59] 2011 AAA LEXIS 651 at 8 (2011) (Gagne, Arb.).
[60] *Id.* at 6.
[61] *Id.* at 12-13.
[62] *See e.g.*, 2012 AAA LEXIS 52 at 32 (2012) (Nelson, Arb.) (finding that the employer failed to fully investigate, and if it had, it would have found out that grievant was not violating the employer dress code policy when he wore sunglasses; rather, the grievant was wearing the sunglasses for medical reasons).
[63] Recycle Ann Arbor, 129 Lab. Arb. (BNA) 1793, 1798 (2012) (Brodsky, Arb.).
[64] Plumas Unified Sch. Dist., 130 Lab. Arb. (BNA) 53, 61 (2011) (Riker, Arb.).
[65] MidAmerican Energy Co., 129 Lab. Arb. (BNA) 1592 (2011) (Neigh, Arb.).

3. Failure to Interview the Grievant

Arbitrator Coburn found that an employer "failed to undertake the most basic step of investigating the allegations: it did not interview Grievant about the allegations relating to the incident [that caused his termination]."[66] Despite this conclusion, Arbitrator Coburn did not base his finding of lack of just cause on this procedural defect and relied instead on the insufficiency of the evidence presented at the arbitration hearing
to prove that the grievant engaged in the alleged misconduct. The arbitrator stated, "I do not need to address whether the [Employer's] failure to investigate the incident thoroughly constituted an independent basis for setting aside Grievant's discharge."[67]

However, in *Crane Plumbing Limited Partnership*, after being accused of pulling a knife on a co-worker, the grievant was not interviewed by his supervisor.[68] The supervisor argued that the Union always filed grievances over discharges and he would have a chance to hear the grievant's side of the story during the grievance meeting.[69] The arbitrator found that the grievant must be interviewed as part of the pending investigation and not after the employee is discharged. The arbitrator noted:

> [I]t seems to the arbitrator that by the time a grievant has been discharged, a grievance filed and grievance meetings held the situation has fundamentally changed. Management by this time may well feel that they have a position to defend, i.e. that their action in discharging a grievant was correct, i.e. meets just cause standards. Egos may well come into play and it may be difficult to rescind the discharge.[70]

In *City of Massillon, Ohio* the arbitrator noted that by interviewing the grievant, unwarranted discipline may be avoided if the employee brings forth exculpatory information.[71] Alternatively,

---

[66] 2011 AAA LEXIS 572 at 20-21 (2011) (Coburn, Arb.).

[67] *Id.* at 25; *see also* 2012 AAA LEXIS 11 at 32 (2012) (Bullard, Arb.) The Arbitrator concluded that just cause did not exist in part because the employer failed to interview grievant. *Id.*

[68] In re CR/PL Limited Partnership (Crane Plumbing) [Mansfield, Ohio], 107 Lab. Arb. Rep. (BNA) 1084 (1996) (Fullmer, Arb.); see *also 2011 AAA LEXIS 389* at 22 (Cooper, Arb.) Director of nursing requested Grievant appear for an investigative interview, at which time she gave grievant a signed letter of termination and her final paycheck. Arbitrator found that by deciding to terminate prior to the investigative conference, the investigation could not have been full, fair, and thorough. *Id.*

[69] *Id.* at 1087.

[70] *Id.; see also* Platte Chemical Company, Greenville, Mississippi, 126 Lab. Arb. Rep. (BNA) 1751, 1757 (2009) (Knecht, Arb.) (stating grievants must be given the chance to answer to the charges against them. In this case, the first time the grievants knew that an investigation had been conducted was at the meeting during which they were discharged. Because they were not given an adequate opportunity to give their side of the case, the grievance was sustained); see *also* In re City of Sandy [Ore.] and Sandy Police Association, 129 Lab. Arb. Rep. (BNA) 669, 679 (2011) (Calhoun, Arb.) (Due process during an investigation means that the minds of management are open. Their minds cannot already be made up before the grievant is interviewed).

[71] City of Massillon, Ohio, 123 Lab. Arb. Rep. (BNA) 1374, 1378 (2007) (Fullmer, Arb.) (finding whether intentional or otherwise, grievant was deprived of his due process rights by Company's failure to provide him opportunity to offer an explanation for the actions of which he was accused); see *also 2011 AAA LEXIS 392* at 6 (De Treux, Arb.) (finding that because employer only interviewed Doctor, he only had a report that stated the grievant expressed a desire to kill her manager. By failing to interview grievant, employee did not have the additional knowledge that grievant had sought treatment and had seen a psychiatrist).

if no such information comes forth, the employer is able to proceed with the discipline on what is presumably an even sounder basis.[72]

Similarly, in *Shaefer's Ambulance Service*, the employer informed the grievant that he was suspended pending an investigation.[73] Afterward, the grievant was not given a chance to tell his side of the story prior to arbitration.[74] The arbitrator found that because the Employer did not provide the grievant with a chance to offer denials, explanations, or justifications that are relevant before the employer makes its final decision, the investigation could not be considered thorough and therefore the grievance had to be sustained.[75]

4. Inadequate Notice

In a case decided by Arbitrator Philip Dunn, the employer "communicated with the grievant" prior to issuing discipline but did not use the word investigation.[76]
The employer argued that it "did inform the grievant that Vice President B had expressed concern about 'apparent inconsistencies in the mileage figures. . . ."[77] Arbitrator Dunn concluded that the employer "failed to provide to the grievant sufficient pre-disciplinary notice that she was under investigation for allegedly falsifying the VMC entries . . . and an opportunity to make an informed response to the alleged misconduct."[78] Dunn found that the grievant was prejudiced by not being able to respond "while events were still fresh in her mind . . . ."[79]

In contrast to the cases in which an incomplete investigation did not lead to a finding that the discipline issued to an employee lacked just cause, some arbitrators have concluded just cause was lacking. The above cited cases indicate that arbitrators have concluded that the employer lacked just cause where credibility was at issue and the employer failed to interview witnesses that could have resolved or shed light on the truth, where an employer disciplined an employee before an investigation, or where the manner in which the grievant was interviewed indicated that the employer had predetermined discipline.

C. Remedying Procedural Defects

The above-mentioned decision by Arbitrator Dunn highlights the problem that arbitrators face when they discover an inadequate investigation. Arbitrators must consider what effect it should have on their decision on the merits of the case. A variety of remedies have been awarded by arbitrators when there is otherwise sufficient evidence at the arbitration hearing to prove that the grievant committed the misconduct alleged but there had been an inadequate investigation by the employer. The following cases will detail the various approaches arbitrators have taken when they encounter this problem.

---

[72] *City of Massillon, Ohio,* 123 Lab. Arb. Rep. (BNA) at 1378.
[73] *See* Shaefer's Ambulance Service, 104 Lab. Arb. Rep. (BNA) 481 (1995) (Calhoun, Arb.).
[74] *Id.*
[75] *Id.*
[76] 2011 AAA LEXIS 622 at 19 (2011) (Dunn, Arb.).
[77] *Id.* at 19.
[78] *Id.*
[79] *Id.* at 23.

1. No Just Cause: Reinstatement and/or Reduced Discipline Without Back Pay

In the case regarding insufficient notice of charges decided by Arbitrator Dunn, Dunn found that based on the information at the arbitration hearing, the grievant engaged in the alleged misconduct. Although he found that the investigatory defects required a finding that there was no just cause for the discipline, Dunn refused to award the grievant back pay or benefits.[80] The arbitrator stated, "given the severity of the grievant's proven misconduct on July 4, and also giving due weight to her prior disciplinary record, it is not appropriate to include as part of the remedy in this case any order that the Employer pay to the grievant any back pay or benefits."[81]

Arbitrator Hoffman also found that the employer established that the grievant engaged in the alleged misconduct.[82] However, because the employer did not give the grievant an opportunity to be heard before the employer issued its discipline, the grievance was sustained.[83] Arbitrator Hoffman did not award back pay and ordered that grievant be given a final warning for sleeping while on duty in lieu of discharge.[84] In *Jefferson Partners*, the grievant was discharged for using vulgar language towards a dispatcher, and although the arbitrator found that the grievant did in fact use vulgar language, he reduced the punishment because the Director relied solely on the dispatcher's side of the story indicating that the grievant was not accorded a full, fair, and thorough investigation.[85]

2. Awarding Back Pay Due to Investigatory Defect

In a 2010 case, the grievant, a cocktail server, was caught on camera tossing a quarter at a customer in a casino because he tipped her poorly.[86] Although the arbitrator was persuaded by the record, including admissions by the grievant, that the grievant committed a "serious breach of decorum," used "poor judgment", and engaged in "poor customer service," he determined that the decision of the employer to terminate the grievant was excessive.[87] In addition to reducing the termination to a suspension, the arbitrator awarded the grievant back pay for the entire period she was out of work because the employer did not interview the grievant during the investigation of the incident.[88]

---

[80] *Id.* at 28.
[81] *Id.*
[82] 2011 AAA LEXIS 524 at 31 (2011) (Hoffman, Arb.).
[83] *Id.*
[84] *Id.; see also* Durham School Services Co., 130 Lab. Arb. 1153, 1162-63 (2012) (Toedt, Arb.) (finding the termination was not for just cause because of the failure to interview the grievant, but reducing the termination to a final written warning because there was enough evidence to find that the grievant engaged in the misconduct); see CSL Behring LLC, 129 Lab. Arb. 87, 91-92 (2011) (Jenks, Arb.) (finding that the employer "rushed to judgment in terminating [the employee]. By not providing the grievant with an opportunity to be heard and to present evidence in his favor, the Company disregarded due process and, in so doing, violated proper cause." Although Arbitrator Jenks concluded that "had the Company followed due process in hearing the grievant's story, the grievant would have been disciplined for proper cause and there would have been no legitimate recourse to that action," he concluded that as a result of the grievant not being given an opportunity to tell his side of the story it was appropriate to reinstate the employee.
[85] In re Jefferson Partners, L.P. and Amalgamated Transit Union, Local 1498, 109 Lab. Arb. Rep. (BNA) 335 (1997) (Bailey, Arb.)
[86] *See* 2010 AAA LEXIS 1026 at 8 (Brent, Arb.).
[87] *Id.* at 9.
[88] *Id.*

3. *Grievance Sustained in Full*

In *City of Hesperia*, the arbitrator found that the investigator was not neutral which contributed to his finding of lack of just cause. The investigator was a private detective hired by the employer's human resources department. The arbitrator noted that the "investigator was highly motivated to 'earn' her fee by coming up with as many charges as she could . . . [t]he motivation and bias of the investigator was clearly demonstrated when she manufactured her own evidence against the grievant."[89] Therefore, the grievance was sustained in full and the grievant was awarded back pay.

In *City of Sandy*, the grievant was a police officer and the arbitrator found that the investigator and decision maker's minds were made up before the grievant was able to present his side of the story. The arbitrator stated that, "[d]ue process during the investigation means management's mind is open, that its position on the important question of guilt or innocence is not polarized."[90]

In another case, Arbitrator Dana Eischen also decided not to make a decision on the merits of a case because there were investigatory defects relating to a biased investigator. Arbitrator Eischen asserted in that case that there was bias because of "the multiple roles played by [the] Director in this case as complainant, charging officer, investigator, fact-finder including resolution of credibility/recollection conflicts between herself and the accused employees, determiner of culpability, decider of penalty and imposer of discipline"[91] Arbitrator Eischen concluded that this resulted in a gross violation of the just cause requirement that there be a "full and fair" investigation.[92] As a result of the investigatory defects, the arbitrator did not reach the merits of the case.

In *Local 878 v. Coca-Cola Bottling Co*., the grievant broke a case of soda and blamed it on a packing shortage, but was later seen to be sweeping up the remains of a case.[93] The supervisor discharged the grievant that day when he returned from deliveries without giving the grievant the opportunity to tell his side of the story. The court enforced the arbitrator's conclusion that "a lack of procedural fairness caused [the employee's] dismissal to fall short of the just cause standard."[94]

In *2010 AAA LEXIS 1179*, an employer made two attempts to contact a grievant by phone, but did not leave a message either time.[95] The arbitrator determined that this was an insufficient attempt to interview the grievant and that a fair investigation could not be complete until the accused employee was given the opportunity to be heard.[96] The Arbitrator stated:

---

[89] City of Hesperia, 129 Lab. Arb. (BNA) 805, 807 (2011) (Scholtz, Arb.).
[90] City of Sandy, 129 Lab. Arb. (BNA) 669, 679 (2011) (Calhoun, Arb.).
[91] *2011 AAA LEXIS 568* at 34-35 (2011) (Eischen, Arb.).
[92] *Id.*; *see also 2012 AAA LEXIS 148* at 16 (2012) (Kerner, Arb.) (holding that there was no just cause because of the procedural due process defects); see Pacific County, 132 Lab. Arb. 261, 267 (2013) (Coss, Arb.) (finding that there was an investigatory defect when the employer asked a key witness leading questions regarding critical events, biased towards assuming the grievant acted inappropriately, thereby resulting in no just cause).
[93] *See* Local 878 v. Coca-Cola bottling Co., 613 F. 2d. 716 (8th Cir. 1980).
[94] *Id.* at 717; see *also 2011 AAA LEXIS 524* at 29 (Hoffman, Arb.). Although the arbitrator found that the Employer successfully established that Grievant was sleeping while on duty, because the Company also failed to interview Grievant when conducting its investigation the grievance was sustained. *Id.*
[95] 2010 AAA LEXIS 1179 at 5 (Goldman Arb.).
[96] *Id.*

> It is axiomatic that the termination of an employee under a just cause standard requires a full and fair investigation. No fair investigation can be complete until the accused employee is given an opportunity to be heard. Few principles are as fundamental. The complete failure of the Employer to investigate the Grievant's side of the story in this case means that the Employer violated a fundamental due process requirement of the just cause standard. This is not a technicality; it is a fatal procedural error. In the absence of any opportunity for the Grievant to present her side of the case, the termination must be found in violation of the collective bargaining agreement and must be set aside.[97]

The arbitrator sustained the grievance due to the failure of the employer to investigate the grievant's side of the story.[98]

In *In re Trinity East*, the employer suspended the grievant for alleged insubordination before interviewing the grievant to obtain her version of the facts.[99] The arbitrator found that there had been no interview and therefore sustained the grievance for lack of just cause.[100]

IV. The "Flawed Investigation with Prejudice" Rule

Arbitrators consider a number of procedural and substantive factors in determining whether an employer's discipline of an employee is for just cause. One major factor is whether a sufficient investigation occurred to form the basis of the employer's decision to discipline the employee.[101] However, arbitrators differ when determining when an employer's inadequate investigation is a sufficient reason to overturn its decision to discipline the employee.[102]

Cases in which the arbitrator has found just cause to discipline the employee despite flaws in the employer's investigation include decisions where: (a) a known witness was not interviewed; (b) the investigation was not conducted in a timely manner; (c) the grievant was not interviewed; and (d) the flaw was not found to prejudice the grievant.[103] In these cases, the arbitrator weighs the minor effect of the investigative flaw against evidence that the employee engaged in misconduct.[104]

In other cases, arbitrators have concluded that an employer did not have just cause where: (a) the investigation did not sufficiently prove misconduct; (b) the disciplinary action was taken before the completion of the investigation; (c) the grievant was not interviewed; and (d) the grievant was not given adequate notice of the charges.[105] In these cases, arbitrators either found the employer

---

[97] *Id.*
[98] *Id.* at 7-8.
[99] Trinity East, 131 Lab. Arb. 1242, 1245 (2013) (Fullmer, Arb.).
[100] *Id.*
[101] *See supra* notes 31-39 and accompanying text.
[102] *See supra* notes 40-58 and accompanying text.
[103] *Id.*
[104] *Id.*
[105] *See supra* notes 59-79 and accompanying text.

to be biased before the investigation or that the investigation was so flawed that it failed to produce sufficient evidence that the employee engaged in misconduct.[106]

Arbitrators who have found an employer's investigation inadequate have taken differing approaches in fashioning a remedy. Arbitrators who have found a flaw in the investigatory process have provided for the following remedies: (a) reinstatement and/or reduced discipline without back pay; (b) awarding back pay due to the investigatory defect; and (c) sustaining the grievance in full.[107]

Under the longstanding practice that arbitration hearings are de novo procedures, the importance of carefully reviewing the investigatory process underlying the decision to discipline has been significantly diminished. Without a de novo arbitration process, a flawed investigation could lead to a flawed decision to discipline an employee and an appellate type of deferential review of the arbitration decision could lead to the affirming of the employer's underlying decision. However, under a de novo process, flaws in the investigatory process are likely to lead to a finding that the employer lacked just cause because it was unable to show sufficient facts to prove that the employee was guilty of the offense upon which the discipline was issued.

Although interviewing the disciplined employee should be part of any employer's investigation to avoid missing important facts and to allow a kind of discovery process that could be useful at arbitration, the fact that the employee is not interviewed should not per se be a fatal flaw in proving just cause. Under a de novo review, the employee will be given an opportunity to tell his or her story in full at the arbitration hearing. Facts that the employer missed by not interviewing the employee or by not interviewing other witnesses may be fatal to the employer's case, but the arbitrator is in a position to correct the outcome by reinstating the employee with back pay.

The question that remains is whether an investigation can be flawed in such a way to prejudice an employee despite the opportunity for a de novo arbitration hearing. An employee could be prejudiced if he would have brought time sensitive information to the attention of the employer that could have helped to clear the employee that is no longer available. Such evidence could be in the form of the testimony of a supervisor or other agent of the employer whom the employee believes observed the conduct at issue, or it could be a document that the employee believes would clarify or resolve the matter. Although the Union could likely subpoena the supervisor and the document for the hearing, or make an information request during the grievance procedure, such evidence could be lost by the time the grievance reached the grievance process or the arbitration hearing months or even years later. A supervisor could have left the employ of the employer and be outside the authority of the employer at the time of hearing, or a document that existed at the time of the incident could have been destroyed or simply lost at the point the hearing is held. Under such circumstances, the lack of investigation could well be prejudicial to the employee and would justify evaluating the level of prejudice to the employee.

In another scenario, the employer could wait until very late in the investigatory process before interviewing the disciplined employee or gathering information supportive of the employee's position. At the point that the employee is interviewed or the supportive evidence is gathered, the

---

[106] *Id.*
[107] *See supra* notes 80-99 and accompanying text.

employer may well be convinced that the employee is guilty of the conduct at issue. In such a case, the employer's decision regarding discipline may not be likely to change and the interview of the employee becomes perfunctory and pro forma.

Similarly, an employee could be prejudiced if the evidence demonstrates that the employer conducted a perfunctory investigation by ignoring evidence supportive of the employee's position. In short, a case where an employee's inability to access information available or that could have been available to the employer during the investigation significantly interferes with the employee's ability to demonstrate that just cause did not exist.

A. Remedying the Prejudicial Investigation

In a case in which an arbitrator concludes that the employer's flawed or biased investigation prejudiced the employee, a reinstatement order and back pay could be justified even if evidence exists supporting the employer's decision. In such a case, if the evidence that would likely have been available through a full and fair investigation would have made a critical difference in the decision to discipline or in the level of discipline issued, the employer should not benefit from the flawed investigation. Arbitrators should depart from the well-established rule of granting substantial deference to employers because granting deference to employers, where procedural due process safeguards were absent, has led to improper treatment or discipline of employees where such safeguards would have exonerated or at least explained the employee's conduct.[108] Providing an arbitrator such discretion in cases in which potentially helpful evidence to the employee was not available due to the employer's flawed investigation would be consistent with Arbitrator Scales statement in a 2006 decision.[109] Scales stated, "[t]he only circumstances under which a penalty imposed by management can be rightfully set aside by an arbitrator are those where discrimination, unfairness, or capricious and arbitrary action are proved-in other words, where there has been abuse of discretion."[110] Remedying a prejudicial flaw with a reinstatement and back pay remedy is akin to an arbitrator drawing an adverse inference from the fact that a critical witness did not testify or that critical evidence was not introduced into evidence.[111] In *2012 AAA LEXIS 258*, Arbitrator Colflesh stated,

> I will not decline to draw an adverse inference against a party who willfully withholds evidence critical to the other side, nor will I issue an Award against a party that has been denied evidence by the willful act or omission of its opponent. To do so would deny justice permanently . . . .[112]

In *2006 AAA LEXIS 610*, Arbitrator Zack drew an adverse inference in a case in which the employer relied upon a video tape in determining to discipline an employee but erased the video prior to providing the Union with an opportunity to review the video. Arbitrator Zack stated:

> The Union protests the Company's failure to provide it with copies of the videotapes taken while Grievant was lumping. Although it would have set to rest some of the issues in dispute in this case if the Company had retained the videos

[108] 2005 AAA LEXIS 1216 at 40 (Stein, Arb.); 2006 AAA LEXIS 206 at 46-47 (Scales, Arb.).
[109] 2006 AAA LEXIS 206 at 47.
[110] *Id.*
[111] *See* 2012 AAA LEXIS 258 at 15 (Colflesh, Arb.).
[112] *Id.*

> routinely taken of the area, the erasure of the videotape appears to have occurred in routine fashion. Unfortunately, the Company relied on its viewing of the videotape prior to its erasure to support its position that there was no interaction between Grievant and Employee A. Having failed to provide the Union with that evidence precludes me from accepting the Company's version when they have denied the Union equal access thereto, and justifies my drawing an adverse inference from that premature erasure.[113]

B. Imposing Due Process through Collective Bargaining

Although generally imposing a due process requirement before finding just cause may not be warranted, a union and employer could negotiate a provision requiring an employer to fully and fairly investigate prior to issuing discipline through the collective bargaining process. At the outset, a provision in the contract can require a full and fair investigation, and could even specify the steps required of such an investigation. Such steps could require that: 1) the employee is offered the opportunity to be interviewed early in the process and at the end of the process to respond to information gathered during the investigation; 2) the employer follows up on evidence brought to its attention by the employee; and 3) a show cause hearing be required prior to disciplining an employee.[114] Moreover, a negotiated provision could set forth penalties to be imposed on the employer for its failure to comply with the investigatory process, including the overturning of the discipline, reduction of the penalty, and/or the awarding of back pay in cases in which back pay would normally not be directed by an arbitrator.[115]

Conclusion

A standard for protecting a disciplined employee against an incomplete investigation is critical in light of the fact that the livelihood of the employee is at risk. Under a de novo arbitration process, an employee can generally obtain remedial relief if an employer's investigation was flawed. Therefore, it should be presumed that an incomplete investigation can be raised by the grievant at the arbitration hearing. Thus, a witness not interviewed, a document not reviewed, or information that the grievant did not have an opportunity to provide during the investigation can be presented at the hearing. However, if the employer's incomplete investigation prejudices an employee by denying the employee the ability to present evidence at the arbitration hearing, or is so biased as to bring into question the employer's motivation for taking disciplinary action in the first place, a finding of just cause should be questioned.

Applying the presumption that the investigation is complete, and finding a lack of just cause in only those cases that the grievant has been prejudiced balances the right of the employer to discipline an employee for misconduct against the employee's need to be protected from an

---

[113] 2006 AAA LEXIS 610 at 30 (Zack Arb.).

[114] *See* 2013 AAA LEXIS 380 (Chiesa, Arb.) This case provides an example of contract language allowing an employee to request a hearing.

[115] Providing an arbitrator such authority in cases of flawed investigations would be similar to the contractually provided authority of an arbitrator to dismiss a meritorious grievance where the union has not complied with contractually imposed time limits for processing a grievance. *See 2011 AAA LEXIS 266* at 16-18 (Schwartz, Arb.) The arbitrator stated, "It is well established that where parties negotiated for time limits in their contract, those time limits must be respected by the arbitrator." *Id.*

employer's arbitrary and capricious action. In cases in which such prejudice exists, a reinstatement order and the awarding of back pay maybe justified even if evidence exists that the employee engaged in some level of misconduct. A union wanting to expand the parameter of the above standard can negotiate through the collective bargaining process an investigatory process to further protect employees. Such a negotiated process could impose penalties upon an employer that fails to follow the contractually required process.[116]

[116] *Id.*

BENEFIT CORPORATIONS ARE RAPIDLY EXPANDING TO PROVIDE LEGAL PROTECTION FOR FIRMS SEEKING TO BE SOCIALLY RESPONSIBLE AS WELL AS PROFITABLE

By

Kevin Farmer*

Introduction

Socially responsible businesses have achieved prominence among investors, consumers and MBAs to an unprecedented degree. There is compelling evidence in support: nearly sixty-eight million consumers in the United States have stated a preference for purchasing goods and services from firms that aim to be responsible to improve society or the environment;[1] sixty-nine percent of employees, especially coveted MBAs, consider the social and environmental track record of prospective employers in deciding where to work;[2] and socially responsible investing has grown to capture approximately ten percent of assets under management (with a value of nearly $2.3 trillion).[3] Firms that manifest corporate social responsibility are big business and all signs point to that trend becoming even bigger. It is all the more remarkable given a dominant legal paradigm that emphasizes shareholders over all other stakeholders in corporations organized for profit. If a corporate form could be created that modifies the paradigm to provide legal protection to entrepreneurs who are anxious for social change as well as profits, the possibilities for investors, customers and employees are paradigm shifting. Over the past four years, many states have adopted statutes that create a new governance form to provide a legal foundation to help—benefit corporations. In sum, benefit corporations alter shareholder primacy by placing the interests of other stakeholders on an equal plane. They articulate social and environmental goals protect directors and officers assigned to oversee their pursuit and measure their performance against third-party standards in annual reports to shareholders that are available for public review.

The jurisprudential and ethical debate that framed the dominant paradigm, shareholder primacy, is summarized in Part I. Three waves of legislative efforts to ameliorate shareholder primacy are discussed with emphasis on their limitations or flaws in Part II. The most recent and promising development in corporate law, the benefit corporation, is explained in Part III. California's statute is highlighted but is materially similar to legislation enacted in twenty-five other states and under consideration in thirteen others. The trajectory of benefit corporations is discussed in Part IV. The paper closes with the admonition that only experience will determine whether benefit corporations become footnotes in law reviews or lightning in a bottle for entrepreneurs, investors and society.

---

* J.D., Ph.D., Associate Professor, Mang. & Human Res. Dep't, California State Polytechnic University, Pomona.

[1] William H. Clark, Jr. & Elizabeth K. Babson, *How Benefit Corporations are Redefining the Purpose of Business Corporations,* 38 WM. MITCHELL L. REV. 817, 819-20 (2012).

[2] *Id.* at 821.

[3] *Id.* at 822.

I. The Jurisprudential and Ethical Debate in a Nutshell

The jurisprudential issue of whether corporations are possessed of a single-minded devotion to generating profits for their shareholders was framed in dueling articles that appeared in the 1932 edition of the Harvard Law Review. Professor Dodd opined that while it was not unreasonable to limit corporate managers to the pursuit of profit for their shareholders, the better view was that a single-minded focus on profits was undesirable because society, which creates the corporate form, can and should demand more.

> [P]ublic opinion, which ultimately makes law, has made and is today making substantial strides in the direction of a view of the business corporation as an economic institution which has a social service as well as a profit-making function, that this view has already had some effect upon legal theory, and that it is likely to have a greatly increased effect upon the latter in the near future.[4]

He was inspired to advocate this position to contradict the Michigan Supreme Court's momentous decision in *Dodge v. Ford Motor Co.*[5] In that case the court invalidated Henry Ford's attempt to discontinue paying special dividends in lieu of expanding the company's business. Giving testimony that would be the envy of any corporate executive, Ford explained that the firm was making too much money and had an obligation to serve the firm's employees, customers and the public.[6] The court ordered Ford to resume paying the special dividend though it refrained from challenging his expansion plans. In words that have become hallowed to many legal theorists[7] and a few appellate courts,[8] the Michigan Supreme court proclaimed that a "business corporation is organized and carried on primarily for the profit of the stockholders."[9]

Taking up the gauntlet thrown by his colleague, Professor Berle eloquently buttressed the rationale for *Dodge* in arguing that there is no room for altruism in a profit-making corporation's mission due to the fact that there was no viable system of corporate control in competition with shareholder primacy.[10] Although boards of directors can today be socially conscious while making a profit "[h]istorically, and as a matter of law, corporate

---

[4] E. Merrick Dodd, Jr., *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1148 (1932).
[5] Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919).
[6] STEPHEN BAINBRIDGE, CORPORATION LAW & ECONOMICS 411 (2002).
[7] *See, e.g.,* Robert Sprague & Aaron J. Lyttle, *Shareholder Primacy and the Business Judgment Rule: Arguments for Expanded Corporate Democracy,* 16 STAN. J. L. BUS. & FIN. 1, 4 (2010); Judd F. Sneirson, *Green is Good: Sustainability, Profitability, and a New Paradigm for Corporate Governance,* 94 IOWA L. REV. 987, 989 (2010); FRANKLIN A. GEVURTZ, CORPORATION LAW 308-13 (2000).
[8] *See, e.g.,* eBay Domestic Holdings v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010); Katz v. Oak Industries, 508 A.2d 873, 879 (Del. 1986); Long v. Norwood Hills Corp., 380 S.W.2d 451, 476 (Mo. Ct. App. 1964).
[9] *Dodge*, 170 N.W. at 684.
[10] A. A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note.* 45 HARV. L. REV. 1365, 1367-68 (1932).

managements have been required to run their affairs in the interests of their security holders."[11]

Although the view that corporations exist to reap profits to the exclusion of all other stakeholders became the dominant paradigm in United States corporate law, it was not without criticism. Several commentators have opined that the rule espoused by the *Dodge* court was dicta or has been overstated.[12] As a practical matter, *Dodge* has little impact as directors who direct corporate funds to socially responsible causes in the ordinary, day-to-day functions of the firm are cloaked by the business judgment rule.[13] "As the law evolved, corporate altruism began to be seen as proper so long as it was likely to provide direct benefits to the corporation and its shareholders. Applying the business judgment rule, moreover, many courts essentially presumed that an altruistic decision was in the corporation's best interests."[14]

The absence of an enforceable legal doctrine to hold directors and officers liable for corporate social responsibility did not foreclose further controversy. More recently the debate has raged as a matter of business ethics in another set of dueling articles. On the one hand, Milton Friedman,[15] among others, argued that corporate executives serve their shareholders, principals, best when they deliver profits. They violate their duty as agents when they devote corporate funds to any other cause no matter how socially desirable.[16] The shareholders are free to spend their share of the profits on matters as they see fit but do not entrust the corporation's managers with such largesse.

> In a free enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in custom.[17]

---

[11] *Id.* at 1365.

[12] *See, e.g.,* Jonathan R. Macey, *A Close Read of an Excellent Commentary on Dodge v. Ford,* 3 VA. L. & BUS. REV. 177, 180 (2008).

[13] *See* BAINBRIDGE, *supra* note 6, at 412.

[14] *Id.* at 412; *see, e.g.,* Shlensky v. Wrigley, 237 N.E.2d 776 (Ill. App. 1968) (reasoning that the owners of the Chicago Cubs could consider the needs of the neighborhood surrounding Wrigley Field in deciding that night baseball was not in the best interests of the firm); *see also* Steven J. Haymore, *Public(ly Oriented) Companies: B Corporations and the Delaware Stakeholder Provision Dilemma,* 64 VAND. L. REV. 1311, 1326 (2011); Sprague & Lyttle, *supra* note 7, at 4; D. Gordon Smith, *The Shareholder Primacy Norm,* 23 J. CORP. L. 277, 278 (1998).

[15] Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits,* N.Y. TIMES MAGAZINE, and Sept. 1970, at SM17.

[16] *See* Janine S. Hiller, *The Benefit Corporation and Corporate Social Responsibility*, 118 J. BUS. ETHICS 287, 288-89 (2013) (reviewing the Dodge decision and succeeding case law on shareholder primacy and wealth maximization).

[17] Friedman, *supra* note 15, at SM18.

The logic, as well as compelling financial return, of Friedman's position has been widely embraced by ethicists.[18]

Others, led by Robert Hay and Edmund Gray as well as Thomas Mulligan, contend that managers must be socially responsible for two reasons. First, they are responsible to corporate stakeholders such as employees, customers and the community as well as shareholders and, therefore, must balance the interests of all when they engage in socially responsible actions. Second, not only are corporations responsible for many of society's ills (e.g., unemployment, pollution) but are well able to remedy them with their superior financial resources and, as such, should link market value with moral value.[19] Unlike the Berle-Dodd debate, the current dialogue is pending in the court of public opinion with ebbs and flows that result in one side coming into vogue before giving way to the other. Although ethical determinism among consumers and employees is promising, among ethical theoreticians it remains elusive.

II. Corporate Variations are Enacted in an Attempt to Reconcile Corporate Social Responsibility With Profitability

If directors and officers have not faced liability to shareholders for diverting corporate funds to social causes there seems little for them to worry about. However, the absence of precedent does not foreclose the possibility that hostile shareholders could successfully vent their wrath in litigation. Accordingly, safe harbors have been sought for those who wish to engage in socially responsible actions without the specter of a shareholder derivative suit dampening their enthusiasm. As Professor Berle presaged,[20] corporate lawyers have been at the forefront in creating options for the socially inclined founded in corporate statutes rather than jurisprudence or ethics. The corporate variations have come in three waves with each wave curing a limitation or flaw in its predecessor: constituency statutes, low-profit limited liability companies and flexible purpose corporations.

A. Constituency Statutes

The business judgment rule protects directors and officers from liability for most errors committed in the day-to-day operations of a corporation as long as they act with reasonable care, in good faith and exclusively for the exclusive benefit of the corporation.[21] Even actions that overtly help employees, customers or the community are cloaked with protection based on the presumption that those actions inure to the long term benefit of the

---

[18] *See* Antony Page & Robert A. Katz, *Is Social Enterprise the New Corporate Social Responsibility,* 34 SEATTLE U. L. REV. 1351, 1351-84 (2011); Alissa Mickels, *Beyond Corporate Social Responsibility: Reconciling the Ideals of a For-Benefit Corporation with Director Fiduciary Duties in the U.S. and Europe*, 32 HASTINGS INT'L. & COMP. L. REV. 271, 271-300 (2009).

[19] Robert Hay & Edmund Gray, *Introduction to Social Responsibility, in* ETHICS AND VALUES: BASIC READINGS IN THEORY AND PRACTICE (David Keller ed., 2002); Thomas M. Mulligan, *The Moral Mission of Business,* in ETHICAL THEORY AND BUSINESS (Thomas Beauchamp and Norman Bowie, eds., 1993); *See also* Joseph S. Spoelr, *The Social Responsibility of Business,* 42 AM. J. JURIS. 277 (1997).

[20] Berle, *supra* note 10, at 1371 (development in the corporate field is more likely to come through lawyers than any other group).

[21] eBay Domestic Holdings v. Newmark, 16 A.3d 1, 33-34 (Del. Ch. 2010).

corporation.[22] But presumptions are not law. To change the legal landscape, Pennsylvania was in the vanguard of a movement to change corporation governance by adopting constituency statutes.[23] With an eye towards hostile takeover situations, constituency statutes address the corporate social responsibility debate by expressly authorizing directors to consider the impact their decisions will have on employees, suppliers, customers, creditors as well as the local and global communities.[24] These statutes do not obligate directors to consider non shareholder interests and create no right of action by non-shareholders against the corporation.[25] In effect, they codify the presumption that corporate social responsibility benefits the corporation in conducting ordinary affairs of the firm. Constituency statutes have been criticized for their lack of transparency, ambiguity in reconciling differing stakeholder interests and the absence of a standard of review to be applied to directors who benefit non-shareholders over shareholders.[26] Essentially, though noble in purpose they failed to solve the problem of reconciling social responsibility with shareholder primacy.

B. Low-profit Limited Liability Companies

Low-profit limited liability companies (commonly referred to as "L3Cs") have been created by amendments to general limited liability statutes in nine states.[27] Firms incorporated under these amendments manifest for-profit enterprises that aim to serve social goals and do so largely by attracting contributions from tax-exempt foundations by providing greater transparency in satisfying federal tax regulations than limited liability companies afford.[28] Although low-profit firms reserve the right to earn a profit, their focus is in achieving social goals funded by contributions from tax-exempt organizations that would ordinarily be constrained from funding profit-making firms. Thus, they manifest a desire to achieve corporate social responsibility but are far more limited in scope than a firm that pursues profits to an equal, or greater, degree than it does good deeds. Although L3Cs are an improvement over constituency statutes, they also fail to effectively balance social responsibility with shareholder primacy.

C. Flexible Purpose Corporations

California, which does not recognize constituency or low-profit limited liability companies, is the only state to have adopted the flexible purpose corporation when its

---

[22] *See* BAINBRIDGE, *supra* note 6, at 414; Haymore, *supra* note 14, at 1326.
[23] *See* Snierson, *supra* note 7, at 998; David Millon, *Two Models of Corporate Social Responsibility,* 46 WAKE FOREST L. REV. 523, 526-28 (2011).
[24] *See* BAINBRIDGE, *supra* note 6, at 415.
[25] *Id; see also* Marleen A. O'Connor, *Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers,* 69 N.C. L. REV. 1189, 1233-34 (1991) (noting non-shareholders lack standing to enforce constituency statutes).
[26] *See* John Tyler, *Negating the Legal Problem of Having "Two Masters": A Framework for L3C Fiduciary Duties and Accountability,* 35 VT. L. REV. 117, 135 (2010).
[27] AMS. FOR CMTY. DEV., http://americansforcommunitydevelopment.org/legislation.html (last visited November 22, 2014) (Illinois, Louisiana, Maine, Michigan, North Carolina, Rhode Island, Utah, Vermont, Wyoming).
[28] Lynda Smiddy, *The Vermont L3C & Other Developments in Social Entrepreneurship,* 35 VT. L. REV. 3, 4 (2010).

corporate code was amended in October 2011.[29] This corporate form represents a substantial advancement in validating the effort of profit-making corporations to accomplish socially desirable objectives. New entities, or existing firms whose shareholders vote (by two-third of the voting shares) to adopt the flexible purpose form, must prominently include the term "flexible purpose" in the articles of incorporation and the articles must also clearly state the corporation's purpose.[30] Flexible purpose corporations must have a special purpose that is defined in the statute as carrying out a charitable or public purpose which a nonprofit corporation public benefit corporation is allowed to carry out or promote positive, or minimize negative, short-term or long-term effects of the corporation's activities on the firm's employees, suppliers, customers, creditors, the community, society or the environment.[31] Directors can, but are not required to, take into consideration one or more special purposes in addition to making profits and cannot be held liable for failing to maximize shareholder returns by pursuing the corporation's special purpose.[32] Although the shareholders can institute a derivative action against the directors, as is the case with any corporation, the statute does not create an independent cause of action in favor of third parties against directors for failing to achieve the corporation's special purpose.[33] Flexible purpose corporations are more transparent than traditional corporations in that they must publish regular reports to their shareholders and post on their web sites their objectives as well as their progress toward accomplishing their special purpose.[34]

Significantly, the statute lacks any express metric for evaluating the special purpose for which the flexible corporation was created and, therefore, implicitly grants directors unfettered discretion in balancing the firm's special purpose with maximizing profits.[35] Corporate lawyers distinguish the flexible benefit corporation from low-profit limited liability companies, or benefit corporations discussed in the next section, based on its superior ability to enable profit-making firms seeking traditional capital market investments to perform socially conscious activities,[36] the narrower focus of the qualified special purpose stated in the articles of incorporation[37] and fewer hard public benefits compared to benefit corporations.[38]

---

[29] CORPORATE FLEXIBILITY ACT OF 2011, 2014 Cal. Legis. Serv. Ch. 694 (S.B. 1301) (current version at CAL. CORP. CODE §§ 2500-3503 (West 2014)).
[30] *Id.* § 2602 (a).
[31] *Id.* § 2602 (b)(2).
[32] *Id.* § 2700 (c); *see also* Christen Clarke, *Article: California's Flexible Purpose Corporation: A Step Forward, A Step Back, or No Step at All?,* 5 PEPP. J. BUS. ENTR. & L. 301, 323-24 (2012) (noting legislators expected that directors of flexible benefit purpose corporations would pursue profits along with social welfare).
[33] CORP. § 2602 (B).
[34] *Id.* § 3501.
[35] Felicia R. Resor, Comment, *Benefit Corporation Legislation,* 12 WYO. L. REV. 91, 103 (2012).
[36] Susan H. Mac Cormac, *New Corporate Forms: Flexible Purpose Corporations, Benefit Corporations and L3Cs,* http://www.law.berkeley.edu/files/bclbe/Berkeley_Handout_1182011_-_1.pdf (last visited November 20, 2014).
[37] Sergei Tokmakov, *What's a Flexible Purpose Corporation?* (Jan. 7, 2012), http://ezinearticles.com/?Whats-a-Flexible-Purpose-Corporation?&id=6802620.
[38] William T. Manierre, *California's New Entities: Benefit Corporations and Flexible Purpose Corporations* (Feb. 22, 2012), http://www.martindale.com/corporate-law/article_Sheppard-Mullin-Richter-Hampton-LLP_1452404.htm.

III. Benefit Corporations Manifest a Superior Legal Foundation for Entrepreneurs Who Seek Corporate Responsibility Along with Profits

In 2012, California[39] joined twenty-five other states that have created benefit corporations as a socially beneficial, legally sanctioned option to traditional corporations and their emphasis on generating profits for shareholders.[40] Joining a nationwide movement, several California firms (with Patagonia, Inc. being the most prominent) immediately filed for benefit corporation status. The California's statute[41] is emblematic of the wave of benefit corporation legislation that is the focus of this paper. All states that have enacted benefit legislation have done so because they have been driven by the same non-profit organization, B Lab, whose mission is to address the world's most pressing problems by using business as a force for good.[42] Benefit corporations are like traditional corporations in that they are for-profit and are subject to the general corporation law except to the extent they conflict with the benefit corporation statute.[43] Unlike traditional corporations, benefit corporations overtly aim to achieve comprehensive and transparent social and environmental standards, provide legal accountability standards of compliance and promote public policies that support sustainable businesses.[44] Benefit corporations differ from flexible purpose corporations by virtue of the fact that they are designed for use by private companies focused on sustainability and seek socially responsible capital (e.g. venture firms) rather than capital in traditional capital markets.[45]

---

[39] *See* Marc Lifsher, *A Dozen Companies Sign Up To Be Do-Good "Benefit Corporations",* L.A. TIMES, January 4, 2012, at B1; *Business: Firms with Benefits; B Corps,* ECONOMIST, January 7, 2012, at 57-58; Angus Loten, *With New Law, Profits Take a Back Seat,* WALL. ST. J., January 19, 2012, at B1.

[40] *State by State Legislative Status,* BENEFIT CORP. INFORMATION CENTER, http://www.benefitcorp.net/state-by-state-legislative-status (last visited November 22, 2014) (Arizona, Arkansas, Colorado, Connecticut, Delaware, Florida, Hawaii, Illinois, Louisiana, Maryland, Massachusetts, Minnesota, Nebraska, Nevada, New Hampshire, New Jersey, New York, Oregon, Pennsylvania, Rhode Island, South Carolina, Utah, Vermont, Virginia and West Virginia). Bills to create benefit corporations are now pending in Alaska, Alabama, Georgia, Idaho, Indiana, Iowa, Kansas, Kentucky, Michigan, Montana, Ohio, Puerto Rico and Wisconsin. *Id.*

[41] CAL. CORP. CODE §§ 14600-14631 (West 2014).

[42] *Certified B Corporation*, B LAB – THE NONPROFIT BEHIND B CORPS, http://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps (last visited November 22, 2014). B Lab's initial foray into the realm of socially conscious investing consisted of certifying extant corporations for their compliance by performing audits based on its standards for positive overall social and environment and licensing corporations that comply as "B Corps". *Legislation,* CERTIFIED B. CORPORATION, http://www.bcorporation.net/publicpolicy (last visited August 18, 2014); *see also* Mac Cormac, *supra* note 36, at 1. Benefit corporations differ in that they create a novel corporate form that reconciles public benefits and profitability. B Lab has provided model legislation that states have adopted with little variation. It explains the rapid expansion of the benefit corporation format on the fact that the format is voluntary and that it costs states nothing to add it to the corporate codes. *Id.*; *see* Aurelien Loric, Note, *Designing a Legal Vehicle for Social Enterprises: An Issue Spotting Exercise*, 5 COLUM. J. TAX L. 100, 124-25 (2013-2014) (benefit corporations are legal forms while B Corp. is a label granted by B Lab); *see also* Mystica M. Alexander, *Benefit Corporations-The Latest Development in the Evolution of Social Enterprise: Are They Worthy of a Taxpayer Subsidy?,* 38 SETON HALL LEGIS. J. 219, 251 (2014) (arguing legislative requirements for benefit corporations vary slightly but the need to provide a general public benefit represents a common ground between them).

[43] CORP. § 14600(c).

[44] *Legislation,* CERTIFIED B CORPORATION, http://www.bcorporation.net/what-are-b-corps/legislation (last visited November 22, 2014).

[45] *See* Mac Cormac, *supra* note 36, at 1. *See generally* W. Derrick Britt, R. Todd Johnson & Susan H. Mac Cormac, *Proposed Amendments to the California Corporations Code for a New Corporate Form: The Flexible Purpose Corporation and Senate Bill 201- Frequently Asked Questions,* LAW FOR CHANGE (Feb. 23, 2011), http://www.lawforchange.org/NewsBot.asp?MODE=VIEW&ID=4149.

Benefit corporations possess three principal characteristics: the corporate purpose must include a provision that creates a material, positive impact on society and the environment, director and officer fiduciary duties are expanded to require consideration of nonfinancial interests, and reports on the corporation's overall social and environmental performance measured against a comprehensive, credible, independent and transparent third-party standard are mandatory.[46] Each of these features requires elaboration.

The California Corporations Code requires that the articles of incorporation include a general public benefit with the option of also including a specific public benefit (e.g., jobs creation program for the mentally challenged, an arts appreciation program for inner-city youths). A general public benefit is one that has a material positive impact on society and the environment, taken as a whole, due to the business operations of the firm.[47] Seven permissive, non-exhaustive special benefits listed in the statute are providing low-income or underserved individuals or communities with beneficial products or services, promoting economic opportunity for individuals and communities beyond the creation of jobs in the ordinary course of business, preserving the environment, improving human health, promoting the arts, sciences or advancement of knowledge, increasing the flow of capital to entities with a public benefit purpose and the catchall provision of accomplishing any other particular benefit for society and the environment.[48] The general and specific public benefit, if any, are to be viewed holistically. Thus if a firm were to donate almost all of its profits to charity to achieve its general public benefit but exploits non-sustainable resources or pollutes the environment in doing so it would not be acting in a manner consistent with the statute.[49]

To encourage directors to act in a manner that effectuates the achievement of a general public purpose, the statute provides that they must act in the best interests of the benefit corporation and, toward that end, shall consider the impact of any action upon employees, suppliers, customers, the community and society, local and global concerns, the short and long term interests of the benefit corporation along with shareholders.[50] Significantly, although it is to be expected that directors will benefit persons and entities outside of the benefit corporation, directors and officers bear no fiduciary duty to the general public or any specific group outside of the benefit corporation.[51] The power to redress a benefit corporation's failure to pursue its general or specific public duty or violation of a standard of care can only be accomplished in a benefit enforcement proceeding that can be filed by shareholders, directors, those with a five percent or greater equity stake in the firm or those specified in the articles of incorporation or bylaws.[52] Courts can issue injunctions but cannot impose monetary damages.[53]

---

[46] *See* Clark & Babson, *supra* note 1, at 838-39; *see also* JAMES F. FOTENOS ET AL., CALIFORNIA PRACTICE GUIDE: CORPORATIONS ¶¶ 9:500- 9:625 (2013 Update).
[47] CORP. § 14601(c).
[48] *Id.* § 14601 (e)(1)-(7).
[49] Clark & Babson, *supra* note 1, at 842.
[50] CORP. § 14620 (b).
[51] *Id.* §§ 14620(i), 14622(d).
[52] *Id.* § 14623(a)-(b).
[53] *Id.* § 14623(c).

Benefit corporations instill confidence by adherence to a credible third party standard[54] and measure performance with the utmost transparency. A benefit director must be appointed and that person must use his or her good faith, reasonable judgment and discretion to consider the firm's impact on the enumerated stakeholders and to appoint specific officers to effectuate their programs.[55] By designating specific people to create and implement socially responsible programs, the statute creates accountability and transparency. Those individuals designated become motivated to achieve their financial and social responsible goals for own success as well as that of the firm. Also, the board of directors must deliver an annual report to shareholders within one hundred and twenty days after the end of the fiscal year[56] that describes the process and rationale for selecting a third-party standard used to prepare the report, the ways in which the general public benefit was pursued and the extent it was achieved as well as ways in which a specific public benefit, if any, was pursued and the extent to which it was achieved.[57] The report must also include an assessment of the corporation's overall social and environmental performance measured against a third party standard.[58] If the board of directors concludes that the benefit corporation has failed to pursue the firm's general and specific, if any, public benefit it must so state in the report and describe in detail its failure.[59] Transparency is maximized by the fact that the firm must post a copy of its report on its web site or, if the firm has no web site, by providing copies free of charge to anyone who requests one.[60] In an effort to hold down costs, benefit corporations are not required to have their benefit report audited by an outside party.[61]

Given the recent emergence of benefit corporation statutes it is hardly surprising that no appellate courts have had occasion to address this new corporate form. Nascent legal and ethical commentary has been conflicting and largely student-driven. One professor writing in the Columbia Business Review predicts that the tension between profit-making and public causes is almost certain to invite hostility from courts steeped in the dominant paradigm of shareholder primacy.[62] A student commentator extols benefit corporations

---

[54] The third party standard used to define, report and assess overall corporate social and environmental performance must offer a comprehensive metric developed by an entity that has no material financial relationship with the benefit corporation, limits the membership of its officers in industry associations or specific businesses in the relevant industry and uses a balanced, multi-stakeholder approach, including public comments, to develop the standard. *Id.* § 14601(g). Global Reporting Initiative, GreenSeal, Underwriters Laboratories, ISO2600 and Green America are well-known third party standard organizations. Clark & Babson, *supra* note 1, at 845-46. B Lab also offers a third-party certification process free of charge. *Make it Official,* CERTIFIED B CORPORATION, http://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/make-it-official (last visited November 22, 2014).

[55] CORP. §§ 14620 (a), 14622.

[56] *Id.* § 14630.

[57] *Id.* § 14630 (a)(1).

[58] *Id.* § 14630 (a)(2).

[59] *Id.* §§ 14630 (a)(4), 14621.

[60] *Id.* § 14630 (c)(d).

[61] Clark & Babson, *supra* note 1, at 846; *see also Protect Your Mission*, CERTIFIED B CORPORATION, http://www.bcorporation.net/become-a-b-corp/why-become-a-b-corp/protect-your-mission (last visited November 22, 2014).

[62] Christopher Lacovara, Note, *Strange Creatures: A Hybrid Approach to Fiduciary Duty in Benefit Corporations,* COLUM. BUS. L. REV. 815, 820, 880 (2011).

because they establish clear and transparent accountability standards for corporate social responsibility and create economic opportunity in a manner consistent with state public policy.[63] Another student commentator acknowledges that while benefit corporations advance the cause of corporate social responsibility they are incomplete in that they fail to provide sufficient guidance to directors and officers on the mission of the firm or to prospective investors in deciding whether to contribute capital or disadvantage the firm's competitiveness.[64] Yet another student salutes the benefit corporation but calls for deeper, more wide-ranging reforms in corporate law.[65] From the vantage point of business ethics, one theoretician views the benefit corporation as a sinister attempt to further insulate corporations from societal scrutiny and urges close scrutiny as they evolve.

> The establishment of a third-party evaluator that is neither elected, nor appointed by individuals who are elected (e.g., which is not government), nor controlled by the market, and that is in a mutually beneficial financial relationship with the benefit corporation, suggests that benefit corporations control the process of [corporate social responsibility] for themselves, and not for the citizenry as a whole. It follows that, from a citizen's point of view, at the very least benefit corporations should be carefully monitored.[66]

IV. The Trajectory of Benefit Corporations

With all due respect to the legal and ethics commentators who have been in the vanguard of analysis, no provision of the statutes enacting benefit corporations is vague, ambiguous or incomplete. On the contrary, they provide clear guidance and protections for firms whose owners deliberately choose to align social entrepreneurship with profitability. Directors of those firms now have the prerogative, expressly protected by law, to consider public benefits along with turning a profit. No longer need they look over their shoulder awaiting a derivative lawsuit that can transform jurisprudential and ethical debates into debilitating legal judgments. Unlike their brethren in traditional corporations, their liability is limited to shareholders who allege that directors failed to pursue—not accomplish—general or specific public benefits just as it is when they fail to produce profits through malfeasance that transcends the broad protection for ordinary operations embodied in the business judgment rule. And, in contrast to limited liability companies and flexible purpose corporations, the goals—goals that must have a material positive, or minimize a negative, impact on society or the environment—are made clearer in benefit corporations by virtue of the third party certification standards that directors have discretion to select. Accountability and transparency are achieved as appointed directors and officers are held to

---

[63] *See* Resor, *supra* note 35, at 108-13.

[64] Steven Munch, Note and Comment, *Improving the Benefit Corporation: How Traditional Governance Mechanisms Can Enhance the Innovative New Business Form,* 7 NW. J. L. & SOC. POL'Y. 170, 188 (2012); *see also* Ashley Schoenjahn, Comment, *New Faces of Corporate Responsibility: Will New Entity Forms Allow Businesses to Do Good?,* 37 J. CORP. L. 453 (2012).

[65] Michael R. Deskins, Comment, *Benefit Corporation Legislation, Version 1.0 – A Breakthrough in Stakeholder Rights?,* 15 LEWIS & CLARK L. REV. 1047 (2011).

[66] Rae Andre, *Assessing the Accountability of the Benefit Corporation: Will This New Gray Sector Organization Enhance Corporate Social Responsibility?,* 110 J. BUS. ETHICS 1, 16 (2012).

explain their efforts to be socially responsible in annual reports to shareholders, who have the power to evaluate their performance, and in the court of public opinion when their reports appear on corporate web sites.

Over a century ago, Oliver Wendell Holmes proclaimed that the "life of the law has not been logic, it has been experience."[67] Such caution will certainly shape the future of benefit corporations as real world experience provides the bellwether on the capacity of benefit corporations to achieve social goals while pursuing profits. Since California has joined the ranks of a burgeoning number of states that recognize benefit corporations (to augment the protection it extended to investors in traditional capital markets with flexible purpose corporations) it will undoubtedly provide a prominent laboratory in which entrepreneurs and investors experiment with socially-conscious corporate forms.[68] For example, if Patagonia seizes a significant market share of the outdoor apparel business it and many other ambitious California benefit corporations[69] will herald the benefit corporation form as one that truly marries profitability with public benefits. By doing so they will spur entrepreneurs and investors who hope to emulate their success.[70] More particularly, if well-known high technology firms such as Zynga or Facebook, for example, choose to place social responsibility on par with profitability by amending their articles of incorporation to become benefit corporations, aspiring entrepreneurs and investors are more likely to follow suit. Simply put, real world entrepreneurs and investors seeking their niche in the market will influence the evolution of benefit corporations to a far greater degree than commentators ever could in hashing out corporate governance theory.

Conclusion

The future of benefit corporations is a saga of potentially epic proportions. They have the potential to accomplish tremendous good for society as well as their investors if this novel form of governance is actually utilized and realizes tangible positive social and environmental results as well as profits. Conversely, they could become historical footnotes in the jurisprudential and ethical debates over corporate social responsibilities that are to come if benefit corporations are not widely adopted or fail. What is certain is that they warrant diligent observation so that future articles will be grounded in experience rather than being cast about in the crosswinds of conflicting commentary.

---

[67] OLIVER WENDELL HOLMES, THE COMMON LAW, 1 (1881).
[68] Joseph Karl Grant, *When Making Money and Making a Sustainable and Societal Difference Collide: Will Benefit Corporations Succeed or Fail?,* 46 IND. L. REV. 581, 591 (2013) (opining benefit corporations are likely to succeed because they are attracting broad support from entrepreneurs, investors, legal experts, citizens and policy makers).
[69] *See* Lifsher, *supra* note 39, at B1.
[70] There is no official registry of benefit corporations but B Corp. lists 1,165 entities that have organized as benefit corporations in 31 countries and across 121 industries. *See B Corps Fellows,* CERTIFIED B CORPORATION, http://www.bcorporation.net (last visited December 10, 2014).

MAJOR ELECTRONIC DISCOVERY ISSUES FOR 2015

By

Vicki M. Luoma[*]

And

Milton Luoma[**]

And

Emmy J. Buboltz[***]

I. Introduction

Ever since the *Zubulake*[1] decision, electronic discovery has dominated the field of civil discovery. Now that we have had a decade of court decisions relating to the subject and a change in rules beginning in December 2014, it is worthwhile to consider the issues that have become pre-eminent in prior years that will likely fully emerge during 2015. These issues include Technology Assisted Review (TAR), Litigation Holds, Early Data Assessment, Cost Shifting, and changes to the Federal Rules of Civil Procedure. This paper addresses each of these topics and discusses the likely future rulings and future directions of these issues based on recent case decisions.

II. Technology Assisted Review (TAR) and Predictive Coding

Technology Assisted Review (TAR) employs a type of artificial intelligence (AI) known as machine learning. Specifically, the most common type of machine learning in this context is a neural network. A neural network is "trained" to classify individual documents as either relevant or not relevant to the issues in question.[2] Training is accomplished by selecting a random sample of all documents to be treated as the training set and having an attorney or other appropriate professional evaluate and label or "code" each document in the training set as either relevant or

---

[*] J.D., M.A., Associate Professor, Minnesota State University-Mankato.
[**] J.D., M.B.A., M.S., Associate Professor, Metropolitan State University.
[***] J.D., Assistant County Attorney, Blue Earth County, Minnesota, Adjunct Professor, Minnesota State University-Mankato.

[1] Zubulake v. UBS Warburg is a series of motion heard between 2003 and 2005 in the United States District Court for the Southern District of New York. Plaintiff Laura Zubulake filed suit against her former employer UBS, alleging gender discrimination, failure to promote, and retaliation. The real interest in the case came when it was alleged that the defendant had failed to produce numerous documents stored electronically. The Judge in this case, Shira Scheindlin, was one of the first to issue opinions about electronic discovery. Her opinions have been influential in all cases decided since her rulings. The opinions are known as Zubulake I, Zubulake III, Zubulake IV, and Zubulake V. Zubulake v UBS Warburg 229 F.R.D. 422 (S.D.N.Y. 2004); Zubulake v. UBS Warburg, 229 F.R.D. 422 (S.D.N.Y. 2004); Zubulake v. UBS Warburg, 217 F.R.D. 309 Zubulake II is not relevant to this paper because the court determined whether the plaintiff was ethically required to report alleged securities violations were revealed in a deposition. The Court ruled that the plaintiff was not under such an obligation.

[2] Tom M. Mitchell, Machine Learning 128 MIT Press and McGraw-Hill Companies (1997).

not relevant.[3] Typically, a training set might consist of 10% of the universe of documents. The training set is processed by the neural network, which self-adjusts its internal weights until it can identify the pre-coded training set documents correctly within some acceptable level of accuracy.[4] The network can then be used to identify the remaining documents as either relevant or not relevant.[5] As this process continues the program learns from this coding and suggests other documents to review. As a result of this process the program produces a prioritized review of the most relevant documents.

Retrieving electronically stored information (ESI) can be complicated and costly. Originally, most attorneys used keyword searches since that methodology was familiar to most attorneys conducting legal research in Westlaw and Lexis-Nexis using search terms such as "electronic discovery" or "contracts of adhesion." The problem with keyword searches is that they are inherently inaccurate, overwhelming, costly and inefficient. A study conducted by David Blair and M.E. Maron in 1985 found that attorneys were only approximately 20% effective in finding all of the ways that a document author might refer to names, ideas or issues in a case, even when the subject is their area of expertise. [6]

The study conducted by Blair and Marion involved a San Francisco Bay Area Rapid Transit (BART) accident. The BART train failed to stop at the end of the line. Attorneys who specialized in these types of accidents were chosen to be participants in a study. The attorneys were given approximately 350,000 pages in the electronic database. When asked, the attorneys thought they had recovered about 75% of all the relevant documents, but instead, they had only retrieved about 20% of the relevant documents. The study found that different parts of the country use different terminology, and depending on which side of the case one represents, attorneys will use vastly different terminology as wide ranging as "unfortunate incident" versus "disaster."[7] The problem this study uncovered was the inability of attorneys and paralegals to determine all of the terminology used by the parties and the myriad of ways information can be described.[8] The Blair and Moran study found that at least 120 words that could be used in lieu of the word "think."[9]

---

[3] *Id*. at 128.
[4] *Id*. at 135.
[5] Maura R. Grossman and Gordon V. Cormack, *The Grossman-Cormack Glossary of Technology-Assisted Review*, 2013 Fed. Cts. L. Rev. 7 (January 2013). This article is the premier article defining terms used in TAR. This article has a foreword by the Honorable John M. Facciola, U.S. Magistrate Judge, who is one of the premier Judges, lectures and leaders in the field of e-discovery.
[6] David C. Blair and M.E. Maron, "An Evaluation of Retrieval Effectiveness for a Full-Text document-retrieval system," Communications of the ACM 28 1985. Although even though this survey is over 25 years old, it is the most thorough, complete, and authoritative of any such survey that has been done. The Sedona Working Conferences with their subsequent publications currently cite this study as the premier study in the field and other leading publications have cited it.
[7] *Id*. at 43.
[8] *Id*. at 44.
[9] *The Sedona Conference Best Practices Commentary on the use of Search and information Retrieval Methods, Special Project Team Working Group Information*, 199 (2007), *available at* https://thesedonaconference.org/download-pub/3669 [hereinafter "Sedona Conferences"]. Sedona Conferences are open to anyone in the field but the working groups our made up of leaders in the field. In this area Working Group 1 Electronic Discovery the experts include Judges, lawyers, and Industry professional with about 35 core participants for the initial meeting and drafting efforts. The Working Group creates a set of recommendations, principles and other educational guidance. These principles are cited in cases and by the courts. Electronic Document Retention and Production is Working Group 1.

Although keyword searches continued to be the preferred method of attorneys, other methods have been developed and recommended, including the use of Boolean conjunctions such as “and,” “or,” and “not” that have still not found the documents the parties were seeking.[10] There has been dialogue concerning other methodologies, such as Technology Assisted Review (TAR), but it is only recently that a real interest and acceptance of TAR methodology has occurred, especially predictive coding. The recommendation of the Sedona Conference in using TAR is to make certain it is understandable to the attorney, the court, the opposing party, and your own client.[11] In the past few years cases have emerged that support various TAR methodologies, especially predictive coding, which are discussed below. The movement toward using TAR does require education and transparency in the process. A few cases have emerged in which the court, the parties and the attorneys have made progress in this area. Several of these cases are discussed below.

The *Da Silva Moore, et al. v. Publicis Groupe* case is the first case in which a court has specifically approved of the use of TAR to search for electronically stored information (ESI).[12] This case concerned an allegation of gender discrimination. Originally both parties had agreed to use TAR, but once they started the discovery process, they disagreed over the actual methodology.[13] The defendants argued that to cull through the more than three million documents the best method was to use predictive coding techniques. Predictive coding is a TAR methodology that uses a combination of human direction and computer concept searching. The combination of the two effectively “trains” the software to recognize the relevant documents.

The use of concept searching is different from keyword searches in that it does not require the users to identify all the possible keywords, but can identify and find documents based on the concepts, including emotions as expressed in phrases associated with emotions, contained in the documents. It normally begins with randomly selected but statistically significant set of seed documents.[14] A team of attorneys who are experts in the field and technicians who are experts in the software must then review and code the seed set of documents by marking them as either relevant or not relevant.[15]

In this case the defendants proposed using a number of test rounds to refine the searches and to ensure accuracy. The defendants planned to share the seed documents used in the process with the plaintiffs[16] as well as the documents reviewed that were tagged either relevant or not relevant by the software. The defendants argued that this process would allow the plaintiffs an opportunity to offer feedback and make corrections as they refined and finalized the process, thereby making the

---

[10] *Id.* at 99.
[11] *Id*. at 101.
[12] *See* Da Silva Moore,. 1279 (ALC)(AJP), 2012 WL 607412 (S.D.N.Y. Feb. 24, 2012).
[13] Technology Assisted Review is also known as Computer Assisted Review or Machine Learning. Predictive learning is just one method of TAR.
[14] *See Alison Nadel, Daniel McGuire, Erica Wenninger, E-Discovery: the Value of Predictive Coding in Internal Investigations*, INSIDE COUNSEL (2013), *available at* http://www.insidecounsel.com/2013/08/13/e-discovery-the-value-of-predictive-coding-in-inte.
[15] *Id*. at 2.
[16] *Id.* A sample set of documents are chosen by subject matter experts and are known as seed documents. Once these seed documents are agreed upon they are the primary reference data that teaches the TAR how to recognize patterns of relevance in the larger document set.

process both fair and transparent. However, the plaintiffs claimed that the defendants' proposed protocol was not as reliable or transparent. Judge Peck found that "computer-assisted review is an acceptable way to search for relevant ESI in appropriate cases."[17] Judge Peck stated that TAR was neither a "magic, Staples-Easy-Button solution" nor "perfect," however it was better than the alternatives. Judge Peck also reminded the parties "the Federal Rules of Civil Procedure do not require perfection."[18]

Eventually Judge Peck approved defendants' use of TAR in this case for five reasons: (1) the parties had agreed to use computer-assisted review, (2) the large volume of ESI involved in the case, (3) the "superiority of computer-assisted review to the available alternatives," such as manual review and keyword searches, (4) the need for cost effectiveness and proportionality under the FRCP, and (5) the transparency of the proposed computer-assisted review process.[19] He further stated that,

What the Bar should take away from this Opinion is that computer-assisted review is an available tool and should be seriously considered for use in large-data-volume cases where it may save the producing party (or both parties) significant amounts of legal fees in document review.[20]

To emphasize his point, Judge Peck pointed out the problem with keyword searches is the difficulty in finding the right terms. In this case, when keyword searches were conducted, they resulted in the following hits, "Training "in 165,208 hits, "Bonus" in 40756 hits, Compensation in "55,602" hits; and, Da Silva Moore's name resulted in "201,179 "hits.[21] Using TAR would greatly reduce the number of hits and make the processes more cost efficient.

The court also emphasized the importance of transparency in the process that allows the opposing side to be more comfortable with TAR. Judge Peck also stated, "This court highly recommends that counsel in future cases be willing to at least discuss, if not agree to, such transparency in the computer-assisted review process."[22] The plaintiffs appealed this decision and United States District Judge Andrew L. Carter, Jr. upheld Magistrate Judge Andrew Peck's order. Judge Carter stated, "That does not mean computer-assisted review must be used in all cases, or that the exact ESI protocol approved here will be appropriate in all future cases that utilize computer-assisted review."[23]

After this decision the prevailing impression was that future courts would require the use of technology assisted review, but in the *Kleen* case the court did not require the defendant to use TAR even though plaintiff argued that the methodology was superior to other methods.[24]I n a class action antitrust suit brought against suppliers of containerboard,[25] the plaintiff brought motions to

[17] Da Silva Moore, 2012 WL 607412 (S.D.N.Y. Feb. 24, 2012), at *85.
[18] *Id.*
[19] *Id.*
[20] *Id.*
[21] *Id.*
[22] *Id.*
[23] *Id.*
[24] Kleen Prods. LLC v. Packaging Corp., No. 10 C 5711 (N.D. Ill. Feb. 21, 2012).
[25] Containerboard is the raw material used to make corrugated paper products.

compel defendants to produce data from all reasonable accessible sources. The defendants offered to retain a leading consulting company to develop and test keyword searches. Plaintiffs argued that keyword searches were not a reliable methodology and argued that TAR would be more accurate. Plaintiffs argued that keyword searches only find about 25% of relevant documents, while a Content-Based Advanced Analytics (CBAA) system that indexes documents that are found to contextually refer to relevant concepts would find 70% of relevant documents at no additional cost. In considering this argument, the court referenced the *Sedona Principle*[26] that a producing party is best situated to evaluate how to accurately produce their information. The parties and the court worked for nearly five months trying to resolve this issue and eventually the court denied the plaintiffs' motion for requiring the use of TAR, without prejudice. The court found that litigants must work cooperatively early in the case, and further, that attorneys must think less adversarial, and more about advocacy in laying the groundwork for an efficient and effective discovery process."[27]

However, in a recent Virginia case, *Global Aerospace Inc. v. Landow Aviation, L.P.* the court ordered the use of predictive coding in spite of the opposition by the plaintiff, finding, "The use of predictive coding is a reasonable means of locating and retrieving documents that may be responsive to requests for production and, therefore, satisfies the Rules of the Supreme Court of Virginia and should be approved in this case to avoid the undue burden and expense associated with the alternative means of culling the ESI documents.[28] This case concerned a negligence claim that came about as a result of three hangars collapsing at the Dulles Jet Center ("DJC") during a snowstorm. There were extensive discovery requests so defendant Landow proposed to review its data via predictive coding, but plaintiff objected to this methodology. The defendant sought judicial approval to use its predictive coding protocol but plaintiff wanted keyword searching or linear review. Defendant argued that both keyword-search and linear-search methods were both cost and time prohibitive, and further, keyword searching was unreliable.

Defendant's ESI began at eight TB and was able to reduce it 250 GB (two million documents) through de-duplication and filtering. Defendant argued that predictive coding is faster, less expensive, and more accurate than either linear review or keyword searching, or a combination of the two. The defendant argued that the procedure would be transparent. They proposed conducting the statistically sound validation protocol. Virginia court Judge James Chamblin found that the defendants' proposed method not only satisfied the state court requirement of "reasonable inquiry," but also was far more than had ever been done in traditional discovery.[29] The use of predictive coding is a reasonable means of locating and retrieving documents and therefore, satisfied the Rules of the Supreme Court of Virginia. Accordingly, the court allowed defendants to using predictive coding for culling. The importance of this case is it is the first case in which predictive coding was used over the opposing party's objection.

In another case decided by Judge Sheindlin concerning the use of TAR, *Nat'l Day Laborer Org. Network v. U.S. Immigration & Customs Enforcement Agency*, the court rejected manual search

[26] Sedona Confereces, *supra* note 9.
[27] Global Aerospace Inc. v. Landow Aviation, L.P., No. 61040 (Loudon County, Va. Cir. Ct. Apr. 23, 2012).
[28] *Id*. at 1.
[29] *Id*.

and suggested the parties look at TAR.[30] Plaintiffs submitted a request under the Freedom of Information Act (FOIA) to determine how much data is shared among the U.S. Immigration Agency (ICE) of the Department of Homeland Security, and the FBI wanting fingerprint and arrest information of detainees. In addition, plaintiffs wanted the methods used by state and local law enforcement agencies regarding their ability to opt out of the information sharing.[31] Defendants argued they manually searched everything and have provided sufficient data.

The court disagreed noting that the government is "not required to search only the files of the custodians who are 'most likely' to have responsive records; it must also search other locations that are reasonably likely to contain records."[32] Judge Scheindlin found that the government attorneys should contact potential custodians to determine whether they were involved in the activity at issue and have relevant information. The court also found that the parties must follow up on potential custodians who fail to respond. Judge Scheindlin ordered further action by the defendants to show that search efforts were documented and verifiable.[33] The court further suggested that the parties look at machine learning tools to find responsive documents.

In yet another recent case, the parties expressed interest in machine learning but were not confident that machine learning was stable and reliable, so the parties agreed that in the interim case management order concerning the production of Electronically Stored Information ("ESI").[34] The plaintiffs alleged that the drug Actos, used for type 2 diabetes controls, increases the risk of bladder cancer in patients and sought damages.[35] The parties agreed to use advanced analytics. As part of the process, the defendant retained the right to review the results before and after predictive coding as well as the right to sample the production. The parties also agreed to have three experts review the information and then both parties would have the right to review the entire sample population and sampling methodology to attempt to reach an agreement that the experts and the system coded the documents accurately. After that process the parties will make an effort to agree on a minimum "relevance score," and followed by those that do not meet that relevance score, which would be manually reviewed for responsiveness before being produced.[36] This case shows where the parties were willing to move towards a TAR solution but lacked the trust and understanding to commit to the process.

In a Delaware case, *EORHB, Inc. v. HOA Holdings, LLC*, the judge not only required TAR but also required the parties to agree on one vendor. This case resulted from a dispute between a buyer and seller of a Hooters Restaurant as to who is responsible for an ongoing breach of contract lawsuit. In a discovery dispute the court directed the parties to use predictive coding technology, and also required that both parties share the use of a single electronic discovery vendor.[37] The court found that "These types of indemnification claims can generate a huge about of documents. Rather

[30] Nat'l Day Laborer Org. Network v. U.S. Immigration & Customs Enforcement Agency, No. 10 Civ. 2488 (SAS), 2012 WL 2878130 (S.D.N.Y. July 13, 2012).
[31] *Id.* at *105.
[32] *Id.* at *106.
[33] *Id.* at *110.
[34] In re Actos (Pioglitazone) Prods. Liab. Litig., MDL No. 6:11-MD-2299 (W.D. La. July 27, 2012).
[35] *Id.* at *8.
[36] *Id.* at *10.
[37] EORHB, Inc. v. HOA Holdings, LLC, No. 7409-VCL (Del. Ch. Oct. 15, 2012).

than investing substantial time instead of burning lots of hours with people reviewing, this is the type of non-expedited case where we can all benefit from some new technology use."[38]

In Indiana's *In re Biomet M2a Magnum Hip Implant Products Liability Litigation*, the parties argued over the correct procedure in use of predictive coding.[39] The defendant had 19.5 million items of ESI and then reduced the number by using keyword-searching methodology to 3.9 million items. The defendant further reduced the number by de-duplication, thus reducing the number of documents to 2.5 million items.[40] Next, the defendant took the 2.5 million documents through a predictive coding tool, using eight attorneys to train the tool and then analyze the result generated by the tool.[41] The defendants conducted statistical sampling that suggested that between .55 and 1.33 percent of the unselected documents would actually be responsive.[42] Plaintiffs argued that the defendant's methodology was incorrect. All the documents should have been put through the predictive coding engine. Then the software would have divided the material into relevant and non-relevant. The defendants argued that when the plaintiffs first reduced the ESI by using keywords the review process was tainted.[43] The court declined to rule on whether it was better to run keyword searches before predictive coding or not, but found the defendant's process acceptable under the Federal Rules of Civil Procedure and the Seventh Circuit.[44]

In reality the plaintiffs were correct in their objections. The predictive coding process is designed to find the relevant documents by searching through all of the ESI. As mentioned earlier, keyword search is ineffective and may have eliminated as much as 80% of relevant data before they used the predictive coding search. These actions and orders come about as a result of not understanding the predictive coding process. Predictive coding typically uses a neural network machine learning approach where a sample of the entire dataset is chosen as a training set. The training set establishes the characteristics or parameters that will determine which documents are relevant and which documents are not relevant, the latter being referred to as the discount pile. After processing the training set, the remaining documents in the dataset will be classified as relevant or not. The discard pile is the area that causes concern in the concept of transparency. Some cases advocate that the appropriate protocol will require the producing party to provide the discard pile as part of the predictive coding training process. The opposition seems to be in fear of producing their non-responsive documents to the other side thereby displaying their lack of understanding the process. While no method is 100% accurate, the predictive coding approach has been more accurate than simple keyword searches.[45]

The *Gordon v. Kaleida* case concerned an allegation of unpaid wages and overtime pay under the Fair Labor Standards Act and state law.[46] The parties could not agree on a keyword search method, so the court suggested that the parties consider predictive coding. The defendants submitted a

---

[38] *Id*. at *12.
[39] In re Biomet M2a Magnum Hip Implant Products Liability Litigation, No. 12-MD-2391 (N.D. Ind. Apr. 18, 2013).
[40] *Id.* at *5. (Deduplication is a data compression technique used to eliminate duplicate copies of repeating data.)
[41] *Id.* at *6.
[42] *Id.*
[43] *Id*.
[44] *Id*.
[45] Sedona Conferences, *supra* note 9.
[46] Gordon v. Kaleida Health, No. 08-CV-378S(F), 2013 WL 2250579 (W.D.N.Y. May 21, 2013).

proposed predictive coding protocol and the plaintiffs objected. The plaintiff argued that they were not offered the chance to provide input to defendant's recommendation and the plaintiffs wanted to force the defendants into a meet-and-confer with their experts to resolve the matter. The court dismissed the motion because the defendants stated they were willing to meet.

In a California case there were 11 different causes of action, including patent infringement, fraud, interference with contract, and theft of trade secrets.[47] Plaintiffs sought more than $1B in damages. Eventually the court dismissed all the plaintiff's claims and the defendant moved for fees and costs. The court decided that the requested $10.2 million for attorney fees and the $392 million for document review provider Black Letter Discovery were reasonable, and then moved to assess the reasonableness of $2.8 million in technology-assisted review ("TAR") costs. In this case the defendant had more than 12 million documents to review. The court then ordered the plaintiff to pay the cost of the TAR software. The court found that using TAR reduced the cost of litigation overall.[48] The importance again of this case is the court recognized the value of TAR and the potential cost savings.

In the future, there will be more courts suggesting or ordering TAR in discovery, and more litigators that will be using a TAR or advocating for it. An appropriate TAR program should help reduce costs and increase accuracy of the discovery process. However, there is a huge range of technology-assisted-review (TAR) tools available to be used in eDiscovery. Parties and courts must be certain that the version of TAR used is the best for their case.[49]

As Judge Peck concluded, "what the Bar should take away from this opinion is that computer-assisted review is an available tool and should be seriously considered for use in large-data volume cases where it may save the producing party significant amounts of legal fees in document review. As with keywords or any other technological solution to eDiscovery, counsel must design an appropriate process, including use of available technology, with appropriate quality control testing, to review and produce ESI."[50] It will take education, cooperation and transparency to make TAR a successful alternative in e-discovery. Every indication is that use of TAR is a trend that will continue well into the future.

Once the decision was made in *Da Silva Moore*[51] to allow TAR, there have been more than 20 court opinions endorsing or allowing the use of TAR with or without key word searches. Some cases have used a combination of key word searches and TAR. In 2013 in the *Biomet*[52]case the Court upheld the combined use of keywords and predictive coding and in 2014 in *Bridgestone v. IBM* [53] the courts also found that this combination of methods is defensible. In the Bridgestone case, IBM opposed the use of predictive coding and also the use of predictive coding in combination with keywords. Their main argument against using the two search methods together was that they were "incompatible." [54] The court decided that use of these two methodologies –

[47] Gabriel Tech. Corp. v. Qualcomm Inc., 2013 WL 410103 (S.D. Cal. Feb. 1, 2013).
[48] *Id.* at *2.
[49] *Id.* at *3.
[50] *Da Silva Moore*, No. 11 Civ. 1279 at 3.
[51] *Id*.
[52] In re Biomet M2a Magnum Hip Implant Prods. Liab. Litig., No. 3:12-MD-2391 (N.D. Ind. Apr. 18, 2013).
[53] *Id.* at *2.
[54] *Id.* at *3.

TAR and keyword searches would be evaluated on the proportionality principles. The court found that the use of these two methodologies was both reasonable and cost-efficient.

In summary, this series of case decisions demonstrates a significant trend toward greater use of technology in eDiscovery that will continue into 2015 and beyond. As leveraging technology proves to be an effective means of dealing with the challenges of electronic discovery and as judges and lawyers become more knowledgeable in the use of such techniques, predictive coding and other technological approaches to discovery will likely become more popular.

III. Litigation Holds

Another important issue in 2014 that will likely continue to be important in 2015 is the litigation hold. A litigation hold is the requirement of potential litigants to notify a potential adverse party and its own employees to stop routinely deleting electronic documents once a party knows or believes litigation may be reasonably anticipated or imminent. Further, it is important for a party contemplating litigation to notify the opposing party to institute a litigation hold because litigation might be imminent.

The *Zubulake* orders, discussed earlier, and decided between the years 2003 to 2005, set the standard for proper electronic discovery procedures, including litigation holds. In the 2006 amendments to the FRCP took next steps to amend the rules to deal with growing problem of ESI. These amended rules did not require litigation holds but did mention them in a note as a method to ensure good practices.[55] The Sedona principles set litigation holds as good practices.[56] Sedona principles recommend that the process of legal holds should be documented and regularly monitored.[57] The Sedona Principles also set triggering factors to institute a litigation hold as to when litigation is "reasonably anticipated."[58]

Regardless of the advisability of litigation holds, the 2006 amendments to FRCP did not require them and until recently, most cases have followed the principle that litigation holds are considered to be best practices. Judge Scheindlin reinforced her opinions concerning the requirement of litigation holds in the *Pension Comm. of the Univ. of Montreal Pension Plan v. Bane of Am. Sec*., which Judge Scheindlin decided in 2009. In that case she found that "the failure to issue a written litigation hold constitutes gross negligence because that failure is likely to result in the destruction of relevant information."[59] Judge Scheindlin asserted that these litigants had "years of judicial decisions," to guide them in satisfying their duty to preserve electronically stored evidence.[60] Therefore, the court further found that any failure to take all appropriate measures to preserve and collect records is "surely negligent."[61]

---

[55] FED. R. CIV. P. Rule 3.
[56] Sedona Conferences, *supra* note 9.
[57] *Id*.
[58] *Id*.
[59] Pension Comm. of the Univ. of Montreal Pension Plan v. Bane of Am. Sec., LLC, 2009.
[60] *Id*. at 44.
[61] *Id*. at 45.

Finally, the court found that the parties that failed to follow the steps outlined by *Zubulake* and are mostly likely guilty of gross negligence.[62] Surprisingly, in 2012 a case also coming out of New York rejected the standards put in place by *Zubulake* and Montreal Pension cases and found that the failure to issue a written litigation hold that resulted in the destruction of relevant and unique documents did not constitute gross negligence and did not warrant sanctions.[63]

In this case, *Chin v. Port Auth. Of New York and New Jersey*, eleven Asian-American police officers claimed that they were victims of racial discrimination and brought suit against the Port Authority of New York and New Jersey.[64] The Port Authority had received a litigation notice but still destroyed 32 promotion folders prior to litigation. The defendants agreed they had received the notice to preserve these documents and that the documents contained unique and relevant information, but they did not preserve the documents. The plaintiffs demanded that the court sanction the defendant for spoliation of evidence. The district court denied a motion for an adverse inference instruction against the defendants. The court determined that the plaintiffs could provide other evidence to prove their claims of discrimination.[65]

On appeal the plaintiffs argued the trial court decision was reversible error. The plaintiffs argued that the defendant's actions constituted gross negligence per se citing Judge Scheindlin in the *Pension* case.[66] The Second Circuit Court of Appeals upheld the district court ruling and found that failure to issue a litigation hold is not gross negligence per se, nor should it necessarily lead to sanctions.[67] The Second Circuit Court of Appeals agreed with the trial court and found that the failure to preserve evidence was just "one factor in the determination of whether discovery sanctions should issue."[68] The court found that rather than automatically finding that the parties had acted grossly negligent, each case must be decided separately to determine whether sanctions are required.[69] With a very radical difference from the *Zubulake* and *Pension* case, the appellate court found that even if a party acted with gross negligence in destroying relevant documents, a trial court has the discretion to impose (or not impose) sanctions based on the totality of the circumstances.[70]

In 2013, following the *Chin* decision Judge Scheindlin decided in the *Sekisui v. Hart* case as follows:

A decade ago, I issued a series of opinions regarding the scope of a litigant's duty to preserve electronic documents and the consequences of a failure to preserve such documents falling within the scope of that duty…. Such obligation should, at this point, be quite clear—especially to the party planning to sue.[71]

---

[62] *Id*. at 47.
[63] Port Authority Police Asian Jade Soc'y of New York & New Jersey Inc. v. Port Authority of New York & New Jersey, 601 F. Supp. 2d 566 (S.D.N.Y. 2009).
[64] *Id*. at 37.
[65] *Id*. at 39.
[66] *Pension*, at 49.
[67] *Chin*, 601 F. Supp. 2d at 569.
[68] *Id*.
[69] *Id*.
[70] *Id*.
[71] Sekisui Am. Corp. v. Hart, No. 12 Civ. 3479(SAS)(FM), 2013 WL 2951924 (S.D.N.Y. June 10, 2013).

In the *Sekisui* case, after several employees left the company, the company sued the former employees. During the discovery process it was discovered that emails were missing. The defendants argued that the plaintiffs should be sanctioned for destroying evidence and argued that Sekisui acted with "'willful, wanton, and reckless disregard for its discovery obligations.'"[72] The plaintiff argued that there was minimal prejudice to defendants and that the deletion was done by mistake.[73] Further, the plaintiff argued that the e-mails were irrelevant to the claims in the lawsuit.[74]

The court found Sekisui's failure to impose litigation hold "may well rise to the level of gross negligence."[75] Judge Scheindlin ruled contrary to finding in the Chin case that an adverse inference jury instruction could be entered against a party that destroys evidence knowingly or even negligently even in the absence of prejudice to the adverse party.[76] Given the disparity of results in the *Chin* and *Sekisui* cases, the future of mandatory litigation holds may well be in question.

IV. Early Data Assessment

Another Sedona best practice that litigators in 2015 must consider is Early Data Assessment. Early Data Assessment (EDA) is the process where the parties narrow the scope of important data early in the litigation. The data are separated between critical and non-critical groupings, the number of key players is narrowed, search methodology is tested, and critical arguments are identified. A thorough EDA strategy normally includes some form of TAR, but it requires more than technology alone. It is also a process that includes key players, data maps, and review of the data processes. EDA allows counsel to furnish "substantial human input on the front end [of automated search technology]" as suggested by the Sedona Conference.[77] The purpose is to help narrow the scope of the search and help determine the types of data to preserve. EDA also helps to get a start on understanding the ESI that is available and to help each party to determine potential process and costs.

According to Judge Peck, "another way to phrase cooperation is 'strategic proactive disclosure of information,' that is, if you are knowledgeable about and tell the other side who your key custodians are and how you propose to search for the requested documents."[78] EDA is important at the very beginning of a case so that the parties have an idea as to how to handle the data, which people need to be involved, and the costs involved. The true importance of this process is that a party can narrow its search for relevant documents, thereby saving time and discovery costs. While no specific law requires this process at this time, in these authors' opinion it will likely become a best practice in 2015 and beyond for all parties. Both parties have a mandate to fully cooperate in discovery, and judges will likely require such cooperation. Early Data

---

[72] *Id*.
[73] *Id*.
[74] *Id*.
[75] *Id*.
[76] *Id*.
[77] *Id*.
[78] Da Silva Moore, et al. v. Publicis Groupe, No. 11 Civ. 1279 (ALC)(AJP), 2012 WL 607412 (S.D.N.Y. Feb. 24, 2012)(Judge Peck), *aff'd*, (Judge Carter), 2012).

Assessment is an excellent example of how parties can cooperate to facilitate discovery and minimize costs of the process.

V. Cost Shifting

Cost shifting is another principle of which litigants must be aware in the coming year. The usual practice is that responding party bears the cost of retrieving data for discovery. There are exceptions if the requested data is overly burdensome or expensive. A party can bring a Rule 26 motion based on the time, amount of documents to search, the cull rate and the type of search methodology. The *Zubulake* case set up seven factors to be reviewed to determine if there should be cost shifting and although they were not adopted by Rules Committee they are persuasive. The seven factors are the following:

1. The extent to which the request is specifically tailored to discover relevant information;
2. The availability of such information from other sources;
3. The total cost of production, compared to the amount in controversy;
4. The total cost of production, compared to the resources available to each party;
5. The relative ability of each party to control costs and its incentive to do so;
6. The importance of the issues at stake in the litigation; and
7. The relative benefits to the parties of obtaining the information.

Rule 26(b)(2) mirrored Judge Scheindlin's two-tiered system to determine whether the data is accessible. "A party need not provide discovery of electronically stored information from sources that the party identifies as not reasonably accessible because of undue burden or cost."[79]

Litigants need to be aware of is the possibility of cost shifting being ordered and the opportunity to request cost shifting. Judge Baylson of the U.S. District Court for the Eastern District of Pennsylvania recently ordered plaintiffs' counsel in *Boeynaems v. LA Fitness Int'l LLC*, a putative class action to pay for extensive discovery that plaintiff said it needed in anticipation of a hearing on whether a class could be certified. The judge found the following where (1) class certification is pending, and (2) the plaintiffs have asked for very extensive discovery, compliance with which will be very expensive absent compelling equitable circumstances to the contrary, the plaintiffs should pay for the discovery they seek.[80]

If the information sought is not reasonably available to the responding party in the ordinary course of business, then, absent special circumstances, the costs of retrieving and reviewing such electronic information may be shared or shifted to the requesting party.[81] In this case the parties had been unable to agree on a discovery plan, so the court authorized the start of discovery on both class action and the merits and directed that discovery should focus on the claims of the named plaintiffs, who are proposed class representatives, and the merits issues that may be relevant as part of the class action determination.

---

[79] FED. R. CIV. P. 26(b)(2)(c).
[80] *Id.*
[81] *Id.*

In shifting the cost of discovery, Judge Baylson stated that "If the plaintiffs have confidence in their contention that the court should certify the class then the plaintiffs should have no objection to making an investment…"[82] Judge Baylson also ruled that "Where the burden of discovery expense is almost entirely on the defendant, principally because the plaintiffs seek class certification, then the plaintiffs should pay the additional expense."[83] The court also ruled that economic motivation and fairness are relevant factors in determining cost shifting.[84]

In light of the foregoing decisions and case trends, the Judicial Conference Advisory Committee is now considering several discovery rule changes, particularly those affecting electronic discovery.

VI. Rule Changes for 2015

The discovery rules were amended in 2006 to clarify rules regarding the new electronic data age, data storage and data retrieval. The purpose was to add some continuity and direction in this new electronic era. However since the passage of these new rules there were concerns from the Business and legal community concerning compliance and sanctions. As a result of complaints and concerns about the issues surrounding the preservation of ESI, and specifically, the uncertainty of the requirements of preservation before litigation, and to protect litigants from abusive cost-leveraging and "gotcha" practices, the Rules Committee decided to review the rules. After the long review process the Advisory Committee passed changes to Rules 1, 4, 6, 16, 26, 34, and 36 and they will take effect in December, 2015.[85]

Some of the amendments to the discovery rules narrow the scope of discovery by eliminating discovery of information that could lead to information relevant to the "subject matter involved in the action" and move proportionality requirements into Rule 26(b)(1). In addition, the rules modify the requirements for responses to Rule 34 requests for production and allow requests under Rule 34 prior to the Rule 26(f) conference. However of all the changes, the most significant change is to Rule 37 and 26.[86]

The current version of Rule 37(e), adopted in 2006, created a safe harbor from sanctions for the loss of information due to "the routine, good-faith operation of an electronic information system. The new rule omits the safe harbor language and sets up barriers before a party may be sanctioned for failing to preserve data. The new rule states the following:

If electronically stored information that should have been preserved in the anticipation or conduct of litigation is lost because a party failed to take reasonable steps to preserve it, and it cannot be restored or replaced through additional discovery, the court may:

[82] *Id.*
[83] *Id.*
[84] *Id.*
[85] Preliminary Draft of Proposed Amendments to the Federal Rules of Appellate, Bankruptcy, Civil, and Criminal Procedure Proposed New Civil Rules of Procedure, August 15, 2014, *available at* http://www.uscourts.gov/uscourts/rules/preliminary-draft-proposed-amendments.pdf.
[86] FED. R. CIV. P. 26 and FED. R. CIV. P. 37.

(1) upon finding prejudice to another party from loss of the information, order measures no greater than necessary to cure the prejudice; or
(2) only upon finding that the party acted with the intent to deprive another party of the information's use in the litigation:
(A) presume that the lost information was unfavorable to the party;
(B) instruct the jury that it may or must presume the information was unfavorable to the party; or
(C) dismiss the action or enter a default judgment.[87]

A litigant seeking sanctions against an opposing litigant for failure to provide ESI would have to show the court the party had a duty to preserve before the information was lost, the party failed to take reasonable steps to preserve the ESI and the ESI "cannot be restored or replaced through additional discovery."[88] This change may significantly alter the civil procedure process.

Further under the present Rule 26, each party bears its own costs of responding to the other side's discovery requests. In the new Rule 26 there is an addition of allocating expenses in a protective order. This change means the court may shift discovery expenses to the requesting party. The courts occasionally shift costs under the present rule but now Rule 26 spells out the possibility and may make litigants wary of requesting discovery. [89]

VII. Conclusion

In conclusion, for the foreseeable future the major areas where electronic discovery best practices will be impacted include developments in Technology Assisted Review (TAR) with predictive coding, litigation hold implementation and management, early data/case assessment, cost shifting, proportionality, and the recent amendments to the discovery rules that go into effect in December 2014.

Ever since the early cases on electronic discovery, the legal profession has been developing best practices. The Federal Rules of Civil Procedure were amended in 2006 to accommodate the changing dynamics of discovery in the electronic age, and the most recent amendments will become effective in December 2014. Best practices have evolved from cases, rules, the Sedona Conferences and Proclamations, and the technological development of document search and retrieval methodologies. These latest changes to the rules may make significant changes in the e-discovery process and litigants and attorneys must be prepared for those changes.

Courts have sanctioned parties for failure to store data in a retrievable manner, failure to initiate and maintain litigation holds, failure to retrieve relevant data, and engaging in data dumping of irrelevant data to obscure any relevant data provided in discovery. In short, the courts have become less tolerant of failure to provide electronic discovery. Attorneys have had to adjust to the concept that while in control of the legal process, at times they need to guide and instruct their clients in the discovery process, while at other times they need to consider outsourcing at least part of the discovery process, including data collection.

---

[87] FED. R. CIV. P. 37.
[88] Sedona Conferences *supra* note 9, at 43.
[89] FED. R. CIV. P. 26.

Attorneys should only review digital evidence for relevance after an expert has searched the raw data and the relevant digital evidence identified using technology assisted review that employs predictive coding methods. Further, attorneys must be knowledgeable regarding the processes and requirements of litigation holds, search methodologies and early case or early data assessment.

Attorneys further need to lead their clients in the move to best practices. Attorneys really do need to understand search methodologies and be a participant in the decision making process. Although attorneys should be familiar with TAR methodologies, best practices suggest that technology assisted review should be conducted by TAR professionals rather than conducting the process by themselves. Thus, best practices in 2014 include a basic understanding TAR, litigation holds, early data assessment, cost shifting, and understanding the new rule changes and their meaning. Additionally, attorneys should fully understand the courts' enhanced requirements of proportionality in both preservation and production of electronic stored information. The increase in requests and granting of cost-shifting allocations should make a difference in the granting of sanctions and parties' fear of sanctions.

SUBMISSION GUIDELINES

As a peer-reviewed law journal whose primary influence and outreach is related to those who teach business law, the *Rocky Mountain Law Journal* requires that all submissions comply with The Bluebook: A Uniform System of Citation (19th Edition). The *Journal* welcomes submissions from other disciplines as well, but compliance with the Bluebook is mandatory.

I. MANUSCRIPT SUBMISSION PROCESS

Submissions should be single-spaced and directed only via email to:

Adam Epstein, Editor-in-Chief
Email: adamepstein@outlook.com

II. COPY

We recommend reviewing previous editions of the Rocky Mountain Law Journal for compliance with style and format, in addition to the checklist below. **The author is primarily responsible for compliance with the latest version of The Bluebook.** In addition, here is a checklist of items before submission:

A. Papers should not normally be longer than 20 single-spaced 8.5 x 11 sized pages, including footnotes, which are also single-spaced.
B. Use 12 point Times New Roman Font.
C. Use 10 point Times New Roman Font for footnotes.
D. Skip lines between section titles.
E. Skip lines between paragraphs.
F. In general, major sections, especially an Introduction and Conclusion, are underlined and are left justified.
G. In general, subsections are italicized and are also left justified.
H. Use full justification for the rest of the article, but not for footnotes.
I. Do not indent paragraphs.
J. Do not number pages. They will be inserted in the editing process.
K. Margins: 1 inch on all sides.
L. Title should be **bolded** and **SMALL CAPITAL LETTERS**.
M. There should be a space after each footnote and before the reference itself, including when using *Id*.

III. ACTION

Consideration for publication of manuscripts is normally made at the annual meeting of the Rocky Mountain Academy of Legal Studies in Business each fall. Manuscripts are encouraged to be submitted via our website beginning in early August to allow sufficient time for distribution to the reviewers. Submission deadlines may be set accordingly. Submissions not selected for publication are not provided feedback. Accepted manuscripts are published electronically via our website at www.rockymountainjournal.org

-END-