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PROFESSIONAL LIABILITY DEFENSE QUARTERLY

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- **9th Annual Meeting: October 3-5, NOLA. Register Today**
- **PLDF Website Google Analytics Data: Page 18**
- **Our Annual Meeting Sponsors: Pages 18-19**
- **Board of Directors Application Deadline: September 1, 2018**

PROFESSIONAL LIABILITY RISKS: ESTATE ASSET VALUATION, BY: LOUIE CASTORIA, ESQ. AND MATTHEW TORNINCASA, ESQ.

Despite the best efforts of the Egyptian Pharaohs, the saying, "You can't take it with you" seems to apply to everyone. We all face the certainty of our eventual demise, and with it the transfer of our assets to others, including (for some of us, mainly the wealthy) our dear Uncle Sam, who takes his cut via the estate tax.

In 2014 the federal estate tax generated $19.3 billion, only one-sixth of one percent of the federal government's revenues. To put that number in perspective, the authors' states of residence, Florida and California, had 2014 budgets of $74.2 billion and $156.4 billion, respectively.

Along with revenue, the federal estate tax also produces disputes and litigation between decedents' estates or their beneficiaries and the Internal Revenue Service, much of it surrounding what the property held by the decedent's estate is worth. These valuation claims also can give rise to professional liability issues:

- Did the attorney or estate planner structure the decedent's assets in a way that reduced the estate's tax exposure, assuming that was the decedent's goal?
- Did the appraiser meet the standard of care when providing property valuations to the estate's accountant/tax preparer?
- Did the attorney or CPA preparing the Estate Tax Return obtain sufficient evidence of the valuation of the property to support the values reported to the government?

What is the Standard?

The Internal Revenue Code requires that an IRS Form 706 Estate Tax return report the "fair market value" of the estate's property. The phrase has the same meaning as in other contexts: the amount that a hypothetical willing buyer would pay to buy the assets and a hypothetical seller would accept, both parties having full knowledge of the material facts. It is important that the parties be hypothetical. The estate is not required to have a letter of intent from a willing buyer, and the buyer need not take into account any unique, non-market driven value that the decedent or beneficiaries may place on the property, such an emotional attachment.

A common example is the family home, where the children (now beneficiaries) were raised. Despite all the holiday memories, family reunions, high school prom photos, and other intangibles, the home is just a house in the hypothetical seller's and buyer's eyes. It still has four bedrooms, 2½ baths, a detached

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LETTER FROM THE PRESIDENT, BY: ERIN K. HIGGINS, ESQ.

"Laissez les bon temps rouler!" The good times certainly will roll during the PLDF Annual Meeting, which is fast approaching (October 3-5, 2018). Our room block at the Westin Canal Place in New Orleans is nearly full, so do not delay in signing up. We will have a full slate of programming on professional liability topics of interest to our members, including emerging and expanding risks for lawyers and insurance agents, preparing physicians for testimony, claim reduction strategies for architects and accountants, successful defense themes for real estate professionals, and best practices for defending not-for-profit board members. You will learn a lot, and strengthen your professional networks at the same time.

As a reminder, we are accepting applications for those interested in running for the PLDF Board, or for appointment as a committee chair or vice-

Erin K. Higgins of **Conn Kavanaugh Rosenthal Peisch & Ford** LLP of **Boston**, Massachusetts, is President of PLDF. She may be reached at ehiggins@connkavanaugh.com.

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PROFESSIONAL RISKS: ESTATE VALUATION, CONT'D

garage, 3,897 square feet of floor space, and that burn on the deck from when Uncle Guido knocked over the Weber grill.

For some types of property—publicly traded stocks, for example—the market sets the values, printed daily in major newspapers and readily available on the internet. For real estate, fine art, collectables, ownership interests in closely-held companies, and other unique property an appraiser or financial analyst may stand in for the hypothetical parties in establishing the fair market value.

There can be significant consequences to an Estate for under-reporting asset values in a 706 tax return. The Internal Revenue Code imposes penalties for undervaluing assets (Section 6662(g)), in addition to charging the unpaid taxes and interest on them. The IRS may waive the penalties if the estate proves that its property valuations were reasonable, and resulted from a good faith effort to ascertain the fair market value. (Treasury Regulations, §1.6664-4(b)(1).) But in obtaining a waiver of penalties, the estate may go through a lengthy and expensive process that requiring the assistance of expert tax attorneys, additional appraisals, and, potentially, a visit to the U.S. Tax Court.

Values change over time, but for estate tax purposes the value that matters is what the property was worth on the date of the decedent's death. (Internal Revenue Code, "IRC," §2031(a).) This may result in unintended windfalls or shortfalls to the beneficiaries, who do not receive the property immediately. If a decedent owned stock in a highly volatile start-up company, the amount paid to the beneficiary six months after the decedent's passing might be very different than the stock's value on the date of death. (Recall that the estate tax isn't designed to measure what the beneficiary receives, but what the government receives based on the date of death valuation.)

Where a company's stock is not publicly-traded, there is no easy reference to a closing price on the date of death. In that circumstance Section 2031(b) of the IRC requires that the value be determined by referring to listed securities of other corporations that are in the same or generally-same businesses. Of course, it's not that simple. A start-up may have little or no track record of stock purchases or sales, and comparing it to a large, established high-tech company would be Apple to oranges, so to speak.

Other factors commonly used in reaching valuations of closely-held corporations' stock are derived from the Tax Court case of *Mandelbaum v. Commissioner*, T.C. Memo.1995–255, affd. without published opinion 91 F.3d 124 (3d Cir.1996), and are sometimes called the "Mandelbaum Factors:

- Private versus public sales of the stock, if there have been any public sales
- Financial statement analysis—essentially a securities analysis of the corporation based on a detailed review of its financials and trends
- The company's dividend policy, which can impact the value of the stock to the beneficiary if, for example, the company has routinely paid dividends or has failed to do so
- The nature of the company, its history, its position in the industry, and its economic outlook
- The company's management—perhaps a very telling factor if the decedent *was* the key manager
- Amount of control in transferred shares—will the beneficiary receive a controlling interest, or at most a passive interest in the company's future
- Holding period for the stock
- Restrictions on transferability of stock
- The company's redemption policy
- Costs associated with making a public offering

In assessing these factors it's important to get the estimated asset value right the first time. Strongly supported appraisals can shift the burden of proof in Tax Court from the taxpayers to the government. Conversely, taxpayers who submit inconsistent valuations or valuations that lack meaningful support will not establish credible evidence to support their case, leaving the court with the government's valuation. (Sometimes, as in the *Mandelbaum* case, the court rejects both sides' valuations and comes to its own conclusions.)

Control, and Lack of It

One of the Mandelbaum Factors, the amount of control in the transferred shares, ties in with the "minority interest discount" that is loved by planners and, which can apply to fractionalized interests in property. Put simply, a beneficiary who receives 51 per cent or more of the ownership in an asset, absent other restrictions, gets to call the shots. As one of Mel Brooks' characters in *History of the World, Part 1* observed, "It's good to be the King." Correspondingly, a beneficiary who receives a non-controlling interest in property arguably receives less value.

In a publicly-traded company, a share of stock in the majority shareholder's hands has the same fair market value as the one share owned by someone else. This is not necessarily so in cases of divided ownership of a unique asset—a collector's classic automobile, a work of art, or a parcel of real property, for example.

In a simple example, a private company, founded by two owners, holds title to an apartment building. Owner A holds 60 percent of the company, Investor B owns 40 percent. Investor B passes away, and the Estate of B has the building appraised as of the date of death at

"There can be significant consequences to an Estate for under-reporting asset values in a 706 tax return."

PROFESSIONAL RISKS: ESTATE VALUATION, CONT'D

$1,000,000. Assume the appraisal is correct. Is the value of the Estate of B's asset $400,000?

Perhaps not. As a minority interest holder, the Estate of B can't make decisions about the property—whether to sell it, convert it to condos, or paint it purple. Once the beneficiary obtains B's 40 percent interest, he or she is limited in whom he can sell it to, because only passive investors, as B was, will be interested.

The minority interest discount recognizes that the Estate of B's interest may be worth less than 40 percent of the property's appraised value—not a lot less because the investment is secured by real property—but perhaps 5 to 15 percent less. Determining the right amount of the discount requires a different type of appraisal than the $1,000,000 appraisal on the building. It will entail a review of comparable transactions involving the sale of minority interests in other, similarly-situated residential property.

Let's use the same example, except it is Investor A who passes away, and a controlling interest is held by the Estate of A. Under the terms of Investor A's family trust, all the Estate of A's assets are to be distributed in equal shares to A's six children. As none of the children will receive a controlling interest in the property, can the Estate claim a minority interest discount? No, it can't, because on the date of A's death, the 60 percent interest in the property was under A's Trust's sole ownership. (In analogous circumstances, see *Ahmanson Foundation v. U.S.*, 674 F.2d 761, 768-769 (9th Cir. 1981), *Estate of Adler v. Commissioner*, T.C. Memo 2011-28,101 Tax Court Memos (CCH) 1118 T.C. 2011).)

With all the methods by which title to property may be held—community property, joint tenancy, family trusts, irrevocable trusts, Qualified Terminable Interest Property (QTIP) trusts, etc.—there are many variations on these fact patterns and in the outcome of Tax Court and appellate decisions. (Contrast the above cases with *Mellinger v. Commissioner*, 112 T.C. 26 (1999) (ownership equally split between one spouse's QTIP trust and the other spouse's trust), and *Propstra v. U.S.*, 680 F.2d 1248, 1250 (9th Cir. 1982) (community property ownership).)

The unifying theme in many of these cases is whether, on the date of the decedent's passing, ownership of the subject asset, or proportional interest in the asset, was unified in the estate.

Take-Aways

Minority interest estate tax discounts that may be available under the above authorities have professional liability implications for accountants, appraisers, and attorneys. We provide the following observations for each profession, without implying that they represent the applicable standards of care:

Accountants and other tax professionals should consider having an early discussion with a deceased client's executor/executrix regarding the availability of a minority interest discount, as well as the additional expenses necessary to support the discount. The discussion should be followed by a written confirmation of the advice given and the estate representative's decision, if any. Moreover, if the engagement will not include such "peri-mortem tax planning" the engagement letter should specifically exclude such services to prevent a disappointed beneficiary from later claiming that discounts were not pursued.

Property appraisers typically estimate the full value of an asset, but are not asked to consider whether a minority interest in the asset should have a reduced value from its basic "value times percent of ownership" calculation. To provide data that a tax professional can use to claim a minority interest discount, the appraiser will need to conduct a detailed analysis of comparable sales of minority interests in similar assets, if asked to do so.

Lawyers who perform estate planning services should consider whether state laws that affect management power over property held in multiple trusts may allow the IRS to aggregate the ownership of large assets, for estate tax purposes.

The above topics may be relevant to other professions as well, such as financial advisors and real estate or valuable property brokers.

As a practical matter, the estate tax is not a significant issue for the estates of most Americans. The law currently exempts estates of $5.6 million or less. But for the wealthy, who create or can afford to buy the kinds of valuable property for which minority interest discounts are typically claims, even a 5 percent discount on estate taxation can be significant.

In the 2016 presidential campaign the winning candidate vowed to repeal the estate tax. That hasn't occurred yet, and until it happens we'll still need the phrase "minority interest discount" in our vocabulary.

Louie Castoria is a partner in **Kaufman Dolowich & Voluck** LLP in the firm's **San Francisco** office. He is the Co-Chair of the firm's Professional Liability Practice Group, a member of the Board of Directors of PLDF, and is a California certified mediator and arbitrator. Louie may be reached at lcastoria@kdvlaw.com.

Matthew A. Tornincasa is a partner in **Shendell & Pollock** P.L. in the firm's **Boca Raton** office and concentrates his practice on defense of professionals, including attorneys and CPAs. He is a co-chair of the PLDF's Young Professionals Group. Matt may be reached at matt@shendellpollock.com.

***PLDQ*'s Fall 2018 Issue**

We encourage member submission of articles pertinent to professional liability claims administration, defense trial advocacy, or professional liability substantive law. The manuscript deadline for the next issue is:

November 1, 2018.

"Minority interest estate tax discounts that may be available under the above authorities have [PL] implications for accountants, appraiser and attorneys."

DEFENDING THE PHYSICAL THERAPIST, BY: MARK V. GENDE, ESQ. AND WILLIAM NEINAST

"The physical therapist stretched my leg too far and ruptured my tendon," alleges the plaintiff.

"I did not stretch his leg too far at any time, and he never complained to me of any excessive pain associated with any modality or manipulation," responds your physical therapist at your first meeting. Who do you believe?

Because the alleged incident occurred in the patient's home or in a nearly empty treatment room, there are no corroborating witnesses for either side, or worse, the only witness is a member of the patient's family.

How do you defend?

These are circumstances which defense counsel must often face in physical therapist cases. Counsel's assessment of these cases can easily devolve into a quagmire of he-said-she-said allegations, frustrating to both defense counsel and insurance adjusters and tempting counsel and adjuster alike to seek an early resolution for fear that the case may only get worse.

Effectively defending the physical therapist case is increasingly important as the number of physical therapists and value of related claims increases. The American Physical Therapy Association predicts an influx of more than thirty thousand new physical therapists within the next seven years. *Demand for PTs Likely to Increase, Even with More Graduates Available*, AM. PHYSICAL THERAPY ASSOC. (Mar. 6, 2015).

One driver of the increase in physical therapist is the aging of the population. Today, approximately one out of every seven Americans are over the age of 65. *2017 Profile of Older Americans*, ADMIN. FOR CMTY. LIVING, DEP'T. OF HEALTH AND HUMAN SERVS. (April 2018). By 2040, that number will rise to one in five. *Id.* As lifespan increases and more individuals join the senior population, demand for physical therapists will increase proportionally, because older patients tend to be more susceptible to conditions requiring physical therapy, such as chronic debilitating diseases and musculoskeletal traumas resulting from falls.

Another driver of the increase in physical therapist claims is the increase in personal injury claims and litigation, where physical therapy is a normal component of treatment plans. Therefore, one insurer-led study found the total paid indemnity for physical therapists claims increased by almost six hundred percent from 1995-2004, a trend which shows no signs of abating. *Physical Therapy Claims Study*, CNA & HPSO.

The focus of this article is to outline several defense strategies counsel and carrier must evaluate before reaching the conclusion that the he-said-she-said physical therapy case is an indefensible swearing match demanding early settlement. This listing is, of course, not exhaustive.

Affidavit of Merit Requirement

It is now generally established that a physical therapist is a professional rendering care and treatment to a patient, triggering in some states an affidavit of merit requirement and potentially pre-suit mediation procedures. *See, e.g.*, *Perry v. Valerio*, 143 A.3d 1202, 1207 (Conn. App. Ct. 2016) (requiring affidavit of merit); *Corbo v. Garcia*, 949 So. 2d 366, 370 (Fla. Dist. Ct. App. 2007) (applying pre-suit requirements to action against physical therapist). Some states also recognize a shorter statute of limitations period for professional actions than general negligence actions. *See, e.g.*, *Meiselman v. Fogel*, 50 A.D.3d 979, 980 (N.Y. App. Div. 2008).

States, however, typically recognize exceptions to the affidavit of merit requirement, including the exception that the complained-of negligence was not a professional service, such as when a patient falls in a medical practice building while trying to navigate a stairway, which is deemed a premises liability action. When confronted with a claim unaccompanied by an affidavit of merit, counsel should evaluate whether the facts demand the case be treated as a professional action requiring an affidavit of merit, and whether a shorter statute of limitation than that for general negligence may implicated.

Because of the extensive array of modalities that physical therapists employ, determining whether an affidavit of merit is required is not always apparent. While in *Churchill v. Columbus Community Hospital*, 285 Neb. 759, 830 N.W.2d 53 (2013) the applicability of the statute of limitations is the main focus and not an affidavit of merit, the case is instructive for both points. The question was whether a patient slipping while exiting unattended from an aboveground pool following a therapy session was part of the therapist's professional service. The plaintiff argued that the therapist watching her exit the pool via the stairs was not part of the physical therapy services. The therapist argued that he was evaluating the patient's ability to get in and out of the pool unassisted as part of his professional services. The court agreed with the therapist and found the plaintiff had failed to file within the mandated statute of limitations for professional actions. This case illustrates how defense counsel should consider every aspect of the therapist's services in arguing that a claim falls within the therapist's professional services and thus requires an affidavit of merit or benefits from a statute of limitations that may be shorter than general negligence causes of action.

Bolstering Credibility Through Therapy Records

It is difficult to overstate the importance of thorough and accurate documentation. In evaluating a physical therapist case, counsel's first inquiry is into the therapist's case files. The difficulties created by inadequate,

"Another driver of the increase in physical therapist claims is the increase in personal injury claims and litigation, where physical therapy is a normal component of treatment plans."

PHYSICAL THERAPIST DEFENSE, CONT'D

inaccurate, incomplete, or missing treatment records do not need to be recounted. But counsel should take full measure of the value of a case file that is properly documented. Bolstering your therapist's credibility is a chief goal against "he-said-she-said" allegations . A well-documented file is a meaningful way to illustrate to a jury that your therapist is credible, and that her credibility extends to her denial of injuring the plaintiff.

Defense counsel and adjusters should carefully review all treatment records to ensure the presence of at a minimum the following, which are commonly required under state physical therapy practice acts: (1) a physician's order for therapy, (2) a properly documented initial evaluation report, (3) a fully developed plan of care, including at a minimum treatment to be rendered, frequency and duration of treatment, and measurable goals, (4) clinical notes for each treatment session signed and dated by the therapist rendering treatment, and (5) a discharge note. Additional documentation may include incident reports for any falls, injuries, or patient complaints of excessive pain related to modalities or manipulations employed by the therapist.

Establishing that your therapist and her practice group keep full and accurate records, including accurate and timely records of all incidents, in compliance with the state's physical therapy practice act is important evidence in bolstering the credibility of your therapist's testimony concerning her actions. Showing a pattern of properly documenting supporting actions that meet the standard of care is the sort of weight and credibility evidence that may help sway a jury to trust your client over the plaintiff. While complete, accurate, and credible records alone do not create a full defense (while the lack thereof may thwart one), they do provide a valuable foundation on which to build.

Reasonableness under the Circumstances

While at first review certain courses of treatment may seem unusual or even inappropriate to the untrained, it is important to remember that the unique circumstances of each patient often require physical therapists to employ innovative treatment strategies, and such innovative or unique treatment strategies may fully comply with the standard of care and be reasonable under the circumstances.

In a recent unreported case, a plaintiff brought a malpractice action against a physical therapist after falling off a telephone book which the therapist was using for "step up" therapy. The patient reinjured a recently replaced knee. The therapy occurred in an at-home setting. The patient alleged malpractice. The therapist argued that using objects naturally found in the home was reasonable under the circumstances. The therapist also argued the plaintiff presented no proof that the therapist's use of the phone book had caused her to fall. The jury returned a defense verdict.

Although at first review a phone book does not appear to be typical equipment for physical therapy modalities, this example illustrates how physical therapists may make use techniques that may appear unusual but do not represent deviations from the appropriate standard of care. When defending physical therapists, it is important to evaluate the totality of the circumstances to determine what was a reasonable modality or manipulation, because therapists may have to be adaptive to treat effectively the challenges of each patient.

Evaluating reasonableness under the circumstances requires a full understanding of the patient's condition, the setting in which the care was provided, the rationale of the therapist, and the opinion of an expert experienced in similar therapy settings.

Attacking Proximate Cause

Plaintiffs have the burden of proving that your therapist's deviation from the standard of care proximately caused the injury in question. Plaintiff's counsel's tendency to gloss over the facts needed to prove proximate causation is not a novel problem. *See Fryar v. Touchstone Physical Therapy, Inc.*, 365 Ark. 295, 229 S.W.3d 7 (2006) (requiring expert testimony to prove proximate cause and granting summary judgment to physical therapist). Therefore, in evaluating a physical therapist liability it is vital to thoroughly evaluate plaintiff's ability to prove proximate cause.

While it seems like basic tort law, the practitioner may overlook the fact that courts have and will dismiss cases against physical therapists for failure to prove proximate cause. For example *see Fryar supra, Marra v. Hughes,* 123 A.D.3d 1307 (2014); *Shank v. Mehling*, 84 A.D.3d (2011); *Carey v. Indiana Physical Therapy, Inc.*, 926 N.E.2d 1126 (Ind. Ct. App. 2010); *Carlos v. CNA Ins. Co.*, 04-1264 (La. App. 5 Cir. 3/1/05), 900 So. 2d 146. A failure to prove proximate case can arise in several circumstances.

The acts or omissions of others may operate to sever the causal chain. Physical therapy patients generally see other medical professionals in addition to their therapist. While plaintiffs may attempt to limit their allegations to your client, errors may arise anywhere along the continuum of care. Scrutiny of medical records from other providers can reveal discrepancies in care, failures of documentation, and underlying unaddressed problems, which may have caused or contributed to the complained of injury.

Even in cases where the physical therapy provided the proverbial straw to break the camel's back, the negligence of another individual, as opposed to a medical

> "Showing a pattern of properly documenting supporting actions that meet the [SOC] is the sort of weight and credibility evidence that may help sway a jury …."

PLDF AND DIVERSITY

The Professional Liability Defense Federation supports diversity in our member recruitment efforts, in our committee and association leadership positions, and in the choices of counsel, expert witnesses and mediators involved in professional liability claims.

PHYSICAL THERAPIST DEFENSE, CONT'D

practitioner, may be implicated in creating an underlying condition that may operate to mitigate exposure. *See Carey*, 926 N.E.2d at 1130 (where the court was unable to determine whether RDSD was caused by the therapist or the original motor vehicle accident).

Even in the absence of third-party negligence, plaintiffs may bring insufficient evidence to prove proximate cause. Plaintiffs may allege injuries which as a matter of medical fact cannot result from the therapeutic course of treatment provided by your therapist, or which may have occurred regardless of the level of care provided. *See Carlos,* 900 So.2d at 149-50; *Flores v. Center for Spinal Evaluation and Rehabilitation*, 865 S.W.2d 261 (1993). In *Carlos*, for example, the plaintiff claimed that after a spinal surgery he lifted too much weight at the direction of his physical therapist, and that this overexertion necessitated another surgery. *Carlos*, 900 So.2d at 146-47. The Louisiana Court of Appeals declined to find a plausible causal connection, pointing to deposition testimony from the plaintiff's treating physician stating that approximately ten percent of patients would require such a surgery regardless of treatment or re-injury. *Id.* at 149-50.

Plaintiff's counsel may artfully plead facts to weave a version of events which sounds right. At first glance, the facts in *Carlos* make sense: lifting heavy objects could ostensibly re-injure a patient's back. The pieces seem to fall into place and the plaintiff's story of causation may seem logical, leading defense counsel to forego more careful scrutiny of the facts. Yet as seen in *Carlos,* thorough investigation combined with expert defense testimony on causation can defeat what may appear to be a solid case from the plaintiff.

Physical therapy patients may also experience an intervening event, such as a fall or strain through normal activities of daily living in which the therapist had no involvement at all.

Attacking Plaintiff's Credibility

Consideration should be given to the credulity of the plaintiff in he-said-she-said actions against therapists. In one unreported matter, defense counsel secured a favorable settlement in a matter where the physical therapist ruptured the patient's biceps tendon during a contraindicated manipulation following a rotator cuff surgery, leaving the patient permanently disabled. The understandable inclination is to resolve cases of clear liability like this at the earliest juncture. However, that may not always be the most prudent course of action. This favorable settlement was reached only after defense counsel obtained a damaging surveillance report of the plaintiff.

There are many well-known ways to attack the credibility of a plaintiff, including past criminal actions, excessive claims history, and adverse credibility witnesses. But the gold standard is to catch the plaintiff lying about or seriously misrepresenting the extent of his allegedly related injury, evidence typically secured by surveillance or through testimony of impeaching witnesses.

However, in order to lay the groundwork for fruitful surveillance operation or for the testimony of witnesses who will rebut plaintiff's injury allegations, it is necessary to litigate the case normally up to at least the deposition of the plaintiff. While under oath in deposition it is crucial to thoroughly question the plaintiff about how the alleged injury has impacted his or her life. A thorough and detailed examination of what the plaintiff cannot do now that he or she was able to do before the incident must be aggressively pursued. How the alleged injury has affected his or her work, family, household chores, hobbies, recreation, and other areas of life should be explored and not left until the plaintiff lists specific, observable examples.

Once you have this testimony under oath, you have the material necessary to perform an effective surveillance or to begin interviewing impeachment witnesses. Until sworn testimony is locked down, surveillance and impeachment is premature. Surveillance prior to a deposition is conducted mainly on the hope that the plaintiff will be found to be doing something believed to be inconsistent with his alleged injury. Surveillance post-deposition allows the targeting of surveillance to specific locations and actions and provides a standard by which the plaintiff can be unequivocally impeached, if his actions are inconsistent with his sworn testimony. Because surveillance video may be required to be turned over to the other side regardless of its impeachment value, it is essential that defense counsel and carrier take these necessary steps to ensure to the extent possible that the surveillance will be useful.

Conclusion

Defending the physical therapist presents many challenges. One of the most formidable is overcoming the he-said-she-said nature of the complaint. By paying careful attention to pre-suite affidavit requirements, bolstering your therapist's credibility through careful patient record's examination, exploring the bounds of what are truly reasonable modalities and manipulations under the circumstances, attacking proximate cause, and attacking the credibility of the patient, defense counsel may be able to turn an apparently indefensible claim into a favorable settlement or even a defense verdict at trial.

Mark V. Gende is a member of **Sweeny Wingate & Barrow,** P.A., in **Columbia, South Carolina**. Mark specializes in the defense of medical malpractice, nursing home and assisted living facility claims. He may be reached at mvg@swblaw.com.

William A. Neinast is a third-year law student at the University of South Carolina School of Law and serves as Associate Editor in Chief of the Law Review.

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- **Miscellaneous PL & Cyber**

"Plaintiffs may allege injuries which as a matter of medical fact cannot result from the … treatment provided by your therapist".

BITS AND BYTES: CYBER CASE LAW REVIEW, BY JANUARY D. ALLEN, ESQ.

Coverage: I'm Not Clear on What You Mean by "Direct"

A number of courts have recently been called upon to determine whether there is a sufficient causal link between unauthorized use of a computer and an insured's loss, such that coverage under a cyber policy would be triggered. As expected, specific policy provisions and specific facts of the loss inform such decisions. However, differing interpretations of policy terms by courts lends uncertainty to coverage questions going forward. Within the last few months two circuit courts of appeal have reached different conclusions on how the term "direct" is to be interpreted.

In *Interactive Communications Int'l, Inc. v. Great American Ins. Co.*, 2018 WL 2149769 (11th Cir. May 2018), Great West questioned whether coverage was to be afforded for its' insured's loss resulting from fraudulent calls to the insured's computer system to cash in chits, that ultimately resulted in the insured transferring funds to a third party, who in turn placed those funds on accounts held by the perpetrators. Specifically, the Eleventh Circuit was tasked with examining whether a "direct" causal link existed between unauthorized use of computer and loss, as needed to establish coverage under the particular cyber policy at issue. The policy indicated, in relevant part, that the insurer would "pay for the loss of, and loss from, damage to money, securities, and other property *resulting directly from the use of any computer*…" (*emphasis added*). The Eleventh Circuit found that, due to a number of intervening actions by the insured and others (approvals, transfers of funds between a number of locations, etc.) prior to the loss, coverage did not exist. Specifically, it held, "[t]he lack of immediacy—and the presence of intermediate steps, acts, and actors" led to the conclusion that the loss did not directly result from the computer fraud. *Id.* at *5. In sum, the Eleventh Circuit found that "direct" meant "immediate." This decision provides comfort to carriers by following strict construction principles, giving meaning to each term, and rendering none superfluous. However, it also raises questions as the efficacy and value of cyber polices drafted with such "direct" provisions, especially in view of the ever-increasing complexity of cyber attacks.

But, just to make insurers and insureds alike more uncertain as to where they stand, not all courts interpreting the term "direct" have reached the same conclusion. In July, the Sixth Circuit became the first circuit court of appeals to hold that loss caused by a company employee tricked by a phishing scam would be covered by a cyber insurance policy. *American Tooling Center v. Travelers Casualty & Surety*, No. 17-20144, 895 F.3d 455 (6th Cir. July 2018). In *American Tooling*, a company employee received an invoice believed to be from an actual vendor, and took steps to make payment on the same. Interestingly, as with *Interactive Communications*, above, there were several intermediate steps between the fraudulent activity and the actual loss (fraudulent invoice sent in an email, employee inputs payment data into software, then a separate employee logs into the software to approve the wire transfer, then the loss occurs). The policy provision at issue read as follows: "[t]he Company will pay the Insured for the Insured's direct loss of, or direct loss from damage to, Money, Securities and Other Property *directly caused by Computer Fraud*." (*Emphasis added*). Travelers argued that the loss from the phishing scam was not a "direct loss," and was not "directly caused by Computer Fraud." The Sixth Circuit bluntly stated: "[e]ach of these arguments fails: ATC's loss is covered by the policy." *Id.* at 459. Relying on Michigan law, the Sixth Circuit found that "direct" was equivalent to proximate cause. *Id.* at 460. The Court held that because a computer was used to send fraudulent emails fraudulently causing the transfer, the loss involved "Computer Fraud," and the fraudulent emails were the proximate cause of the insured's loss. *Id.* at 462. Illustrative of its desire to reach a decision that did not defeat the insured's expectations, the Sixth Circuit offered the following analogy:

> Imagine Alex owes Blair five dollars. Alex reaches into her purse and pulls out a five dollar bill. As she is about to hand Blair the money, Casey runs by and snatches the bill from Alex's fingers. Travelers' theory would have us say that Casey caused no direct loss to Alex because Alex owed that money to Blair and was preparing to hand him the five dollar bill. This interpretation defies common sense.

Id. at 461. The differing interpretation of the term "direct" by the 11th Circuit in *Interactive Communications* was noted by the *American Tooling* Court. However, the Sixth Circuit took pains not to criticize their sister circuit, or even expressly state that they would not adopt the same interpretation. Revisions in cyber policy provisions and/or increases in policy premiums are expected to be on the horizon following this decision.

Standing: None Shall Pass

Mega breaches involving consumer data have given rise to more and more class action suits. An initial question in almost all these suits is whether class members have standing. Recent case law continues to emphasize that those who have not already suffered identity theft will have a difficult time showing injury-in-fact.

"Revisions in cyber policy provisions and/or increases in policy premiums are expected to be on the horizon following this decision."

Contact PLDF:
Christine S. Jensen
Managing Director
Professional Liability Defense Federation
1350 AT&T Tower
901 Marquette Avenue South
Minneapolis, MN 55402
(612) 481-4169
cjensen@pldf.org

CYBER CASE LAW REVIEW, CONT'D

Hutton v. National Board of Examiners in Optometry, Inc., 892 F.3d 613 (4th Cir. 2018), arose from a breach in the database of the National Board of Examiners in Optometry ("NBEO"). Every graduating optometry student is required to provide their personal information to the NBEO in order to sit for board-certifying exams. The information included names, social security numbers, dates of birth, addresses, and credit card information. The district court dismissed the action based on failure to establish that the Plaintiffs had Article III standing. The complaints were not viewed to have sufficiently alleged an injury -in-fact that was fairly traceable to NBEO. The Fourth Circuit reversed. Although the Plaintiffs had not incurred any fraudulent charges and had not been denied credit or been required to pay higher interest, the Fourth Circuit found that they had suffered an injury-in-fact. Of note, in 2017, this same circuit court in data breach litigation against McDonald's had found that a plaintiff fails to "establish Article III standing based on the harm from the increased risk of future identity theft and the cost of measure to protect against it." However, the Fourth Circuit stated that the facts in NBEO were distinguishable. Specifically, the court focused on the fact that the Plaintiffs' data had already been misused to fraudulently apply for credit cards with one plaintiff receiving a card they did not apply for in the mail. Additionally, at least one Plaintiff had reported a slight temporary decrease in her credit score attributable to the opening of the unauthorized new credit account. In sum, actual misuse, even without significant and lasting effect, was sufficient to find an injury-in-fact.

The currently pending District of Colorado case, *Gordon et al. v. Chipotle Mexican Grill, Inc.*, 17-CV-1415-CMA-MLC (D. Colo.), leaves open the possibility that standing may be afforded where the amount of personal information affected is sufficient to enable the future possibility of identity theft. The case involves a 2017 data breach of Chipotle's credit/debit card systems. The class members are consumers whose payment card information has been affected; however, none have alleged identity theft or actual misuse of their information to date. Ripe for decision is the Defendant's motion to dismiss, based in large part on alleged lack of standing. On August 1, 2018, the magistrate judge issued his recommendations to the Article III judge on each of the issues raised. Examining precedent in various jurisdictions, the magistrate judge has advised that "a risk of future identity theft is sufficient for standing only if the data breach exposed the types of personally identifiable information that can enable identity theft." *Id.* at *7. Whether this criterion is met depends on the extent of the breach. In the case at hand it was the magistrate's impression that the payment card information of Chipotle customers did not rise to this level. *Accord, Antman v. Uber Technologies, Inc.*, 15-cv-01175-LB (N.D. Cal. 2018), (granting motion to dismiss for lack of standing as breach involving driver's license numbers of former drivers did not involve personal identifying information ("PII") that would give rise to a real and imminent risk of identity theft). Nonetheless, if the magistrate's recommendations are adopted in full by the Article III judge, the dicta could give leverage to standing arguments based on theft of PII, even in the absence of prior misuse of that data. The Ninth Circuit also recently reached a similar conclusion. *See, In re Zappos.com*, 2018 WL 1883212 (9th Cir. 2018) (where breach involved full credit card numbers, names, passwords, email addresses, and telephone numbers, plaintiffs had standing).

The Economic Loss Rule: Let's Go Forum Shopping

Does the economic loss rule bar negligence claims of a consumer affected by a retailer's data breach? Well, the classic legal answer applies: it depends. Whether the economic loss rule applies, or an independent duty exists, or some other exception will be found, varies greatly from state-to-state.

In *Gordon, supra*, the magistrate judge also examined application of the economic loss rule to bar negligence claims under the laws of each of the states where class representatives resided. The laws of Arizona, California, Colorado, Illinois, and Missouri were examined by the Court. Under Arizona law, the magistrate concluded that the doctrine did not bar tort claims, as there was no contract between the parties regarding data security. The same conclusion was reached under California law, albeit for different reasons. California has a 'special exception' to the economic loss rule based on the following factors: (1) the extent to which the transaction was intended to affect the plaintiff, (2) the foreseeability of the harm to the plaintiff, (3) the degree of certainty that the plaintiff suffered injury, (4) the closeness of the connection between the defendant's conduct and the injury suffered, (5) the moral blame attached to the defendant's conduct, and (6) the policy of preventing future harm. The magistrate noted that California courts have been finding this special exception applicable in data breach cases. *See e.g., In re Yahoo! Inc. Customer Data Security Breach Litigation*, Case No. 16-MD-02752-LHK, 2018 WL 1243332 (N.D. Cal. 2018) (fact issue regarding special relationship precluded dismissal of plaintiffs' claims based on the economic loss rule). But the magistrate concluded that the plaintiffs' tort claims would be barred under Illinois, Missouri, and Colorado law. Under Illinois law, the magistrate's recommendation was to dismiss the plaintiffs' tort claims as there was no common law duty to safeguard the consumers' card information based on the case of *Cooney v. Chicago Public Schools*, 943 N.E. 2d 23, 28 (Ill. App. 2010). In *Cooney*, the Illinois

"Whether the economic loss rule applies, or an independent duty exists, … varies from state-to-state."

PLDF Amicus Program

Please let us know of appeals in your jurisdictions implicating important professional liability issues that might have broad-based significance.

CYBER CASE LAW REVIEW, CONT'D

appellate court held that it would not create a new legal duty beyond statutes already in place, noting that the Illinois data breach statute only requires the breached party give notice of the breach to consumers. *See also, Community Bank of Trenton v. Schnuck Markets, Inc.*, 887 F.3d 803 (7th Cir. 2018) (upholding dismissal under Illinois and Missouri law based in part on economic loss rule). There was also no support for a finding of special relationship or independent duty under Missouri or Colorado law. Ultimately, with Chipotle headquartered in Colorado, the magistrate stated that choice of law provisions required the application of the laws of that state. As a consequence, the magistrate recommended the dismissal of all plaintiffs' claims based on Colorado's economic loss rule.

Georgia, by contrast, appears to be in line with California and Arizona with respect to finding a duty to protect customers' information. In *In re Arby's Restaurant Group, Inc. Litigation*, 2018 WL 2128441, *5 (N.D. Ga. March 2018), the Northern District of Georgia held that "allegations that a company knew of a foreseeable risk to its data security systems are sufficient to establish the existence of a plausible legal duty and survive a motion to dismiss." The *Arby's* Court then quoted from its prior orders in the *Home Depot* litigation with favor:

> The Court declines the Defendant's invitation to hold that it had no legal duty to safeguard information even though it had warnings that its data security was inadequate and failed to heed them. To hold that no such duty existed would allow retailers to use outdated security measures and turn a blind eye to the ever-increasing risk of cyber attacks, leaving consumers with no recourse to recover damages even though the retailer was in a superior position to safeguard the public from such a risk.

In re Home Depot, Inc. Customer Data Security Breach Litigation, 1:14-md-2583-TWT, 2016 WL 2897520 (N.D. Ga. 2016), at *4. The Court also rejected arguments that the economic loss rule should apply, citing the existence of an independent duty. *In re Arby's*, 2018 WL 2128441 at * 13. It stated, "barring these types of data breach claims under the economic loss rule would be inconsistent with the protective policy objectives of tort law." *Id.*

The Arby's Court also declined to dismiss negligence per se claims founded upon Section 5 of the Federal Trade Commission Act. Plaintiffs alleged that Arby's had violated Section 5 of the FTCA by failing to use reasonable measures to protect cardholder data, and this in constituted an unfair or deceptive trade practice. The Court rejected Arby's counter arguments that Section 5 of the FTCA only generally proscribes unfair or deceptive practices and does not enumerate any required or prohibited acts, and that the plaintiffs had failed to allege how specifically Arby's had violated the FTCA. In doing so, the Arby's Court concluded that Section 5 of the FTCA was sufficiently definite to form the foundation of a negligence per se claim. Would the outcome on negligence per se claims premised on Section 5 of the FTCA now be different in light of the June 2018 decision of the 11th Circuit in *LabMD v. Federal Trade Commission*, 894 F.3d 1221 (11th Cir. June 2018)? To be explored in a future article…

January D. Allen is a partner at the firm of **Overturf McGath & Hull,** P.C. in **Denver, Colorado**. She focuses on the defense of licensed professionals, commercial litigation, and intellectual property matters. She can be reached at jda@omhlaw.com.

"To hold that no such duty existed would allow retailers to use outdated security measures and turn a blind eye to the ever increasing risks of cyber attacks."

UNCONSCIOUS BIAS IN THE WORKPLACE, BY ROBERT G. CHADWICK, JR., ESQ.

This year, the term "unconscious bias" has exploded onto the public stage in media coverage of multiple incidents alleged to be examples of racial profiling. On April 12, 2018, for instance, two African-American men were arrested at a Philadelphia Starbucks, allegedly for trespassing. The media coverage of these arrests, which was aided by a cell phone video, sparked immediate accusations of racial bias.

In response, Starbucks closed more than 8,000 company-owned stores on May 29, 2018 to provide its employees with racial bias training. In announcing the closures, the coffee-chain said the training would specifically address "unconscious bias."

In the wake of the media attention surrounding unconscious bias, potential discrimination claimants and their lawyers likely have taken notice. Prudence thus dictates that employers and their legal counsel likewise be educated as to unconscious bias in the workplace.

Is Unconscious Bias Real?

The term "unconscious bias" may be new to some and may seem counterintuitive. After all, how can a person be biased without knowing it? In truth, the concept of unconscious bias, also known as implicit or cognitive bias, is real, and psychologists have studied it for years. As noted by Harvard University researchers:

> "… psychological research routinely exposes counter-intentional, unconscious biases. The prevalence of these biases suggests that even the most well-meaning person unwittingly

UNCONSCIOUS BIAS, CONT'D

> allows unconscious thoughts and feelings to influence seemingly objective decisions."

Mahzarin Banaji, Max H. Bazerman, and Dolly Chugh (2003), "How (Un)ethical Are You?", *Harvard Business Review 81*, No. 12, 56.

Courts and legal scholars also have recognized the concept. In *U.S. v. Stephens*, 421 F.3d 503, 515 (7th Cir. 2005), the Seventh Circuit opined: "Unfortunately … unconscious bias is not limited to one particular area of society … the evidence of continued racial stereotyping in employment, housing, insurance and many other areas makes that apparent."

Specifically, as to employment, legal scholar Linda Hamilton Krieger suggests "a large number of biased employment decisions result not from discriminatory motivation … but from a variety of unintentional categorization-related judgment errors characterizing normal human cognitive functioning." Linda Hamilton Krieger, *The Content of Our Categories: A Cognitive Bias Approach to Discrimination and Equal Employment Opportunity*, 47 Stan. L. Rev. 1161 (1995)."

What Is Unconscious Bias?

Harvard researchers identify two types of unconscious bias – implicit prejudice and in-group favoritism. They explain implicit prejudice as follows:

> "Most fair-minded people strive to judge others according to their merits, but our research shows how often people instead judge according to unconscious stereotypes and attitudes, or 'implicit prejudice.' What makes implicit prejudice so common and persistent is that it is rooted in the fundamental mechanics of thought. Early on, we learn to associate things that commonly go together and expect them to inevitably co-exist: thunder and rain, for instance, or gray hair and old age. …
>
> But, of course, our associations only reflect approximations of the truth; they are rarely applicable to every encounter. Rain doesn't always accompany thunder, and the young can also go gray. Nonetheless, because we automatically make such associations to help us organize our world, we grow to trust them, and they can blind us to those instances in which the associations are not accurate-when they don't align with our expectations."

See Mahzarin Banaji, Max H. Bazerman, and Dolly Chugh, *supra* at 58. They also explain how overt bias differs from unconscious or implicit bias.

> "Because implicit prejudice arises from the ordinary and unconscious tendency to make associations, it is distinct from conscious forms of prejudice, such as overt racism or sexism. This distinction explains why people who are free from conscious prejudice may still harbor biases and act accordingly. Exposed to images that juxtapose black men and violence, portray women as sex objects, imply that the physically disabled are mentally weak and the poor are lazy, even the most consciously unbiased person is bound to make biased associations: These associations play out in the workplace just as they do anywhere else."
>
> *Id*.

Harvard researchers explain in-group favoritism as follows:

> "Not surprisingly, we tend to do more favors for those we know, and those we know tend to be like ourselves: people who share our nationality, social class, and perhaps religion, race, employer, or alma mater. This all sounds rather innocent … But when those in the majority or those in power allocate scarce resources (such as jobs, promotions, and mortgages) to people just like them, they effectively discriminate against those who are different from them … Thus for a wide array of managerial tasks … qualified minority candidates are subtly and unconsciously discriminated against, sometimes simply because they are in the minority: There are not enough of them to counter the propensity for in-group favoritism in the majority."

Id. at 60.

Even if a person does not display overt bigotry or hatred toward a minority group, therefore, the person may still unconsciously discriminate against a member of the group by relying upon (1) inaccurate or unfair cultural generalizations or stereotypes, or (2) in-group favoritism toward a majority group.

Is Unconscious Bias in the Workplace Unlawful?

Courts have long recognized that making employment decisions based on unconscious bias of which they may or may not be entirely aware can be unlawful.

In *Thomas v. Eastman Kodak Co*., 183 F.3d 38, 42 (1st Cir. 1999), a race discrimination suit under Title VII of the Civil Rights Act of 1964, the First Circuit observed: "Title VII's prohibition against 'disparate treatment because of race extends both to employer acts based on conscious racial animus and to employer decisions that are based on stereotyped thinking or other forms of less conscious bias." The court concluded that plaintiffs can indeed challenge "subjective evaluations which could easily mask covert or unconscious race discrimination." *Id*. at 58.

In *Price v. Waterhouse v. Hopkins,* 490 U.S. 228, 250-52 (1989), the U.S. Supreme Court recognized that stereotyping can constitute evidence of discrimination. In the specific context of sex stereotyping, the Court found an employer who acts on the basis of a belief that a woman cannot be aggressive, or that she must not be, has acted on the basis of gender. *Id*. at 250.

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"[B]iased employment decisions [may] result not from discriminatory motivation … but from a variety of unintentional categorization-related judgment errors … ."

UNCONSCIOUS BIAS, CONT'D

In *Kimble v. Wisconsin Dept. of Workforce Development,* 690 F.Supp.2d 765 (E.D.Wis. 2010), an African American male alleged he had been discriminated against because of race and gender in being denied a raise. In ruling in his favor, the court cited many of the common stereotypes regarding black males:

> "… scholars have long recognized that black males are subject to distinct stereotypes. For example, some white Americans believe that black males are less intelligent than other groups, including black females. [citations omitted] As a result, black males are sometimes monitored more closely than members of other groups. [citations omitted] Other stereotypical attitudes focus on cultural styles – black men are sometimes thought to be more direct, expressive and assertive than white men, [citation omitted] and on black uncontrollability as, for example, having a bad temper [citation omitted]."

Id. at 770-71. The court then went on to cite examples of conduct by the plaintiff's supervisor, which included avoiding contact with the plaintiff, taking little interest in the plaintiff, and being quick to blame the plaintiff and slow to recognize his achievements.

Unconscious bias becomes unlawful discrimination, therefore, when it (a) is tied to a protected characteristic, such as race, color, national origin, age, sex, disability or religion, and (b) influences an employment decision. Predictably, an employment decision is more susceptible to being tainted by unconscious bias when subjective criteria are involved. Under such circumstances, a stereotype may unwittingly bias how the decision-maker processes and interprets information and how other people are judged.

How is Unconscious Bias Proven?

Employment discrimination jurisprudence has shown that proof of the existence of unconscious bias in society has never been difficult.

Such jurisprudence has routinely admitted expert testimony regarding social framework analysis, which specifically addresses issues of stereotyping and discrimination. In *Hopkins*, the Supreme Court considered expert psychological testimony on gender stereotyping. In *Tuli v. Brigham & Women's Hospital, Inc.*, 592 F.Supp.2d 208, 215 n. 7 (D.Mass. 2013), the court acknowledged that, since some kinds of stereotyping and bias operate unconsciously, expert testimony could be helpful as to an area that the jury may not have common knowledge.

Some jurisprudence, such as *Kimble* above, has simply taken judicial notice of common stereotypes. In *Zamprano-Lamhaouhi v. New York City Bd. Of Ed.*, 866 F.Supp.2d 147, 172 n. 10 (E.D.N.Y. 2011), for instance, the court denied summary judgment as to a gender and pregnancy discrimination claim. In doing so, the court took judicial notice of the real-world prevalence of the stereotype that pregnant women and mothers - though not fathers – are viewed as relatively less qualified for employment, less competent, less reliable, and less committed to work, and are held to relatively higher work standards.

Absent direct proof, however, proving unconscious bias influenced an employment decision is more difficult, but not impossible. The plaintiff in *Kimble* above met this burden with examples of supervisory behavior over a 12-year period. The plaintiff in *Hopkins* met this burden by showing the tendency of unique employees (that is, single employees belonging to a protective class, such as a single female or a single minority in pool of employees) to be evaluated more harshly in a subjective evaluation process.

What Are the Risks Presented by Unconscious Bias?

An unwanted employment discrimination suit is obviously a risk presented by unconscious bias in employment decision-making. As many employers already know, the cost of defending such a suit can be daunting.

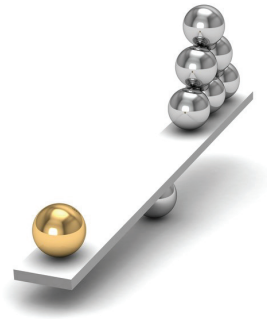
For some employers, overconfidence presents an even greater risk. Without an understanding of the psychology of unconscious bias, an employer may hold to the unwavering belief that an unbiased employment decision was made. By the time the employer does understand the psychology, high defense costs may be the price of its overconfidence. Even worse, the employer may be facing the harsh reality of legal liability to one or more claimants.

How Do Employers Combat Unconscious Bias?

The use of objective criteria in employment decisions is a partial answer to unconscious bias, but subjectivity cannot always be avoided. Similarly, blind decision-making may mitigate the influence of unconscious bias, but may not always be feasible, especially for smaller employers. Audits of employment decisions may uncover patent bias but miss more subtle bias.

The ultimate answer is management training. In this regard, the goal of the training should be three-fold.

First, managerial employees need to be educated as to the psychology of unconscious bias. Even though the concept has been existence for decades, few lay people were aware of its existence before this year. Knowledge of the existence of unconscious bias, moreover, does not necessarily equate to an understanding of the concept.



"[A] stereotype may unwittingly bias how the decision-maker processes and interprets information and how other people are judged."

UNCONSCIOUS BIAS, CONT'D

Second, managerial employees need to learn to distrust their own self-perceptions. Otherwise, training may fall on deaf ears. As Harvard researchers have stressed:

> "Most of us believe that we are ethical and unbiased. We imagine we're good decision makers, able to objectively size up a job candidate … and reach a fair and rational conclusion that's in our, and our organization's, best interests. But more than two decades of research confirms that, in reality, most of us fall woefully short of our inflated self-perception."

See Mahzarin Banaji, Max H. Bazerman, and Dolly Chugh, *supra* at 56.

Instead, managerial employees should be shown unconscious bias. Such a demonstration can be accomplished through employee testing. Since 1998, the one-line Implicit-Association Test ("IAT") has been publicly available for individuals to assess their unconscious biases. The results of testing can be unsettling, but the first step toward combatting bias is to turn a hidden bias into a visible one. Once preconceived beliefs have been dispelled, the employees will be more receptive to training.

Finally, managerial employees should be provided the necessary information for combatting unconscious bias in decision-making. This information includes the fallacies behind certain stereotypes and the review of specific situations likely to arise in decision-making. Once managerial employees know how to fight back these biases, they will be better informed in mitigating the legal risks present in any employment decision.

Robert G. Chadwick Jr. is a managing member of **Seltzer, Chadwick, Soefje & Ladik, PLLC**, in its **Dallas** office. He is Board Certified in Labor & Employment Law by the Texas Board of Legal Specialization. He may be reached at rchadwick@realclearcounsel.com.

INCOMPLETE SELLERS' REAL ESTATE DISCLOSURE COMPLICATIONS, BY: GLEN R. OLSON, ESQ. AND JONATHAN RIZZARDI, ESQ.

An issue that frequently arises in real estate agents and brokers professional liability litigation concerns the disclosure of a materially unfavorable condition at the property listed for sale. Often the unfavorable condition is not disclosed at all and then the question is whether it was called for by a particular jurisdiction's real estate disclosure laws, and/or the forms used by real estate agents and brokers in that jurisdiction.

A recent decision out of the federal district courts in Hawaii, *Lindstrom v. Moffett Properties* (April 26, 2018) 2018 WL 1975677, addresses an interesting variant on this non-disclosure issue: what happens where the condition, but not its full extent, is disclosed? Further, what happens when portions of the disclosure that should be filled out, are not completed?

Factual Background

Lindstrom arose out of the sale of a 2013 sale of a subdivision parcel. The seller, Reid, had acquired the parcel along with an adjoining property in Lahaina. The Lindstroms purchased one of those two lots from Reid. Fischer, a licensed real estate salesperson and employee of Moffett Properties, represented Reid in the 2013 sale. The principal of that entity, William Moffett, was involved as well.

Prior to the closure of the disputed transaction, the Lindstroms owned another home in the same subdivision; they contacted Moffett after they saw a For Sale sign and Moffett showed them the Reid property. The buyers told Moffett that they wanted to build a home alongside the ravine on the western-most end of the property. Moffett pointed out the obvious presence of uncompacted loose fill in that area, which would not allow a home to be constructed in that area.

Moffett then prepared a purchase contract with a $1 million offer for the property including a dual agency consent addendum similar to the one utilized in many states, including California, allowing Moffett to operate as both the real estate broker for both the buyer and seller in the transaction. The seller countered at $1.224 million and the Lindstroms accepted that counter with a contract that included an "as is" condition addendum.

Shortly thereafter, Reid provided a seller's real property disclosure statement which required him to disclose all "material facts" concerning the property. Fischer assisted Reid with completing the form. In discovery in the litigation Reid claimed that, when Fischer knew something about the property that Reid did not, that information was included in the disclosure form.

On the form, in response to the inquiry: "Is there filled land on the property?" (Question 41), Reid checked "yes." He did not include any further information or an explanation in Section H of the disclosure form, as it directed, although he provided a typed addendum that included his explanations to other questions to which he had provided affirmative

> A frequent issue in real estate A&B E&O claims "concerns the disclosure of a materially unfavorable condition at the property listed for sale."

INCOMPLETE REAL ESTATE DISCLOSURES, CONT'D

responses. Reid's explanation for not filling out this portion was that, while it was obvious that there was fill on the property, he had no information as to its extent. In discovery, Reid acknowledged that his failure to provide a narrative along with the "Yes" response after the fill question was an oversight. Had he filled out that question, he claimed he would have simply said that fill was present and that he had no additional information to provide as to either its nature or extent.

Fischer, however, as the seller's agent, did have additional knowledge regarding the fill. He had observed a substantial amount of it in the ravine at the western end of the property and this became apparent from his deposition testimony. Fischer understood that he shared with Moffett that there was fill on the property. He understood that Moffett had then conveyed that information to the buyers, the Lindstroms.

Moffett then had a subsequent discussion with the Lindstroms as to whether they intended to do a soils investigation at the property. He offered his assistance in providing referrals to geotechnical professionals "to evaluate the soils conditions," and Moffett claimed that the Lindstroms declined. The Lindstroms disputed this version of events and claimed that Moffett did not warn them of the need to have the fill condition investigated.

Shortly after the sale, the Lindstroms along with their architect began to plan the construction of a home on the property. They received a previously prepared topographic file and site study plans that addressed the developer's fill on the lot. Moffett understood that the Lindstroms' architect had received the information and was discussing it with the Lindstroms.

The deal then closed and, the Lindstroms later claimed they learned that there was a massive amount of fill containing uncompacted material, some of which was trash. They argued, however, that prior to 2014, they were unaware of the massive amounts of fill on the property and they argued they would not have bought the property knowing that the soils preparation work would have to put their house construction plans out of budget.

In the Lindstroms' federal court suit, following discovery on the knowledge and disclosure issues, Reid and the Moffett defendants moved for summary judgment. Their motion addressed their alleged failure to fully disclose the nature and extent of the fill and whether that issue amounted to an actionable misrepresentation, a common element essential to the claims remained in the Lindstrom suit.

Denial of Summary Judgment

The federal court denied summary judgment, and its ruling makes plain the perils of incomplete real estate disclosures. The court noted that Reid's failure to include any further explanation presented an issue of fact as to whether the seller's disclosure was complete, and was "prepared in good faith and with due care." In particular, there was a dispute over the seller's knowledge regarding the fill that were not made known to the Lindstroms prior to the sale.

The court did note that the seller's disclosure did not require Reid or his agent to undertake any "inspections of generally inaccessible areas." Nonetheless, the seller was obligated to fully and accurately disclose in writing to a buyer all material facts concerning the property.

While in deposition, Reid testified that his omission of an explanation regarding the fill was unintentional, the court concluded that it could determine as a matter of law that the non-disclosure was, in fact, unintentional or an oversight. Importantly, the record also demonstrated that while Reid's agent, Fischer, had further information regarding the quantity of fill and aided Reid in the completion of the seller's disclosure, Fischer's additional observations regarding the quantity of fill were also absent from Section H or the addendum.

The court then concluded that the defendants were not entitled to summary judgment on the breach of contract claims, breach of fiduciary duty claims or the then pending misrepresentation claims. The Lindstroms had also alleged, as is common in many states, a violation of the Unfair and Deceptive Trade Practices statutes (HRS, Chapter 480) as to Moffett Properties. To the extent that the Lindstroms' UDAP claim rested upon the same alleged omitted disclosure information with respect to the fill conditions, the court's prior analysis applied and precluded the entry of summary judgment.

Comment

The *Lindstrom* decision is a cautionary tale with respect to real estate agent/broker liability. First, incomplete disclosure forms, including forms that require an explanation in support of checked "Yes" answers to questions, are problematic particularly when the issue is raised later on summary judgment and the assertion is that an omission by itself creates a triable issue of fact.

Second, although the seller is the one making the representations as to the condition of the property, care has to be exercised in situations where, as in *Lindstrom*, both seller and the seller's agent have knowledge of certain aspects the condition. Because the disclosure was jointly prepared by the seller with the assistance of its agent, the court looked to the knowledge of both parties with respect to what had been disclosed and what had to be explained. This can be a case specific issue, however, as in many instances separate disclosures are made by the seller

"The *Lindstrom* decision is a cautionary tale with respect to real estate agent/ broker liability."

INCOMPLETE REAL ESTATE DISCLOSURES, CONT'D

and the seller's agent.

Glen R. Olson is a partner of **Long & Levit LLP**, in **San Francisco**, specializing in professional liability litigation. He defends lawyers, real estate agents, insurance agents and brokers and escrow agents. Glen may be reached at golson@longlevit.com.

Jonathan R. Rizzardi is senior counsel with **Long & Levit,** LLP in **San Francisco**. His practice focuses on the counseling and defense of real estate professionals, judges and lawyers, and design professionals. Jonathan may be reached at jrizzardi@longlevit.com.

TRIPARTITE RELATIONSHIP MINEFIELD: LACK OF COOPERATION DISCLOSURE, BY: ALICE SHERREN, ESQ. AND DONALD PATRICK ECKLER, ESQ.

A typical attorney-client relationship involves two people or entities: the lawyer, and the client. If the client stops communicating or cooperating with the lawyer, the lawyer is permitted to withdraw from the representation. But when a lawyer is retained by an insurance company to defend an insured, the attorney-client relationship becomes more complicated. Since not all jurisdictions delineate the obligations owed in the same way, lawyers who are retained by insurance companies to defend insureds should be cognizant of the duties their jurisdiction places on them to maintain the client's confidential information.

Tripartite Relationships: Who Is The Client?

The tripartite relationship among an insurance company, its insured, and counsel retained to defend the insured intends that the three work together to achieve a mutually beneficial resolution to the dispute. The interests of the insurance company and the insured are assumed to be aligned, but the relationship among the insurance company, the insured, and the appointed counsel is treated differently in various jurisdictions.

More than 35 states recognize "dual representation" by the appointed counsel of both the insurance company and the insured client. This allows the insured, insurer and counsel to more easily share information, analyze issues, and develop strategy. Although the insurance company retains and pays the lawyer, retained counsel owes the same professional obligations to the insured as if the attorney were hired personally by the insured.

Some states are more restrictive when it comes to the concept of dual representation. In *Pine Island Farmers Coop v. Erstad & Reimer, P.A.*, 696 N.W.2d 444, 452 (Minn. 2002), the Minnesota Supreme Court determined that, in the absence of conflict of interest between the insurer and the insured, the insurer can become a co-client of defense counsel based on contract or tort theory, but only if the insured gives express consent after an explanation of the advantages and risks of dual representation.

But some jurisdictions reject dual representation entirely, and have determined that defense counsel owes a duty of unqualified loyalty to the insured. In these jurisdictions, the implications of the tripartite relationship can exacerbate conflicts between the insurer and the insured.

While many insurance policies, especially professional liability policies, allow the insurance company to control the defense, restrictions placed on defense counsel by an insurer are disfavored in many jurisdictions. Insurer-imposed restrictions on discovery or other litigation costs may be found to violate the insurer's duty to defend as well as the retained attorney's ethical responsibility to exercise independent professional judgment. As a matter of public policy, the lawyer's obligations to the insured client supersede any restrictions dictated by an insurance company. See *In The Matter of the Rules of Professional Conduct and Insurer Imposed Billing Rules and Procedures*, 299 Mont. 321, 335 (Mont. 2000); *Dynamic Concepts, Inc. v. Truck Insurance Exchange*, 61 Cal.App.4th 999, 1009 (1998) (noting that insurer-imposed restrictions may violate the insurer's duty to defend and the lawyer's ethical obligation to exercise independent professional judgment); *In re Youngblood*, 895 S.W.2d 322, 328 (Tenn. 1995) (noting certain insurer-imposed restrictions are prohibited by the rules and inconsistent with public policy).

Regardless of jurisdiction, defense counsel has a duty not to disclose adverse coverage information to the insurer, and the insured has a duty to cooperate even where the insurer has taken an adverse coverage position. Coverage issues may include late reporting, uncovered allegations, dispositive motions that eliminate covered claims and leave only non-covered claims, or damages that are excluded under the policy. In such situations, defense counsel has an obligation to protect confidential information obtained from the insured in the course of the representation – even from the insurance company – all while keeping the insurance company that retained the attorney informed.

Defense counsel's obligations to the insured and the

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> "Insurer-imposed restrictions on discovery or other litigation costs may be found to violate the insurer's duty to defend … ."

TRIPARTITE RELATIONSHIP COOPERATION, CONT'D

insurer become even trickier if the insured fails to communicate or cooperate in the defense. Can the attorney inform the insurer that the insured is not cooperating in the defense? At least one state bar has opined that a failure to cooperate qualifies as "confidential information" obtained from the client, and the lawyer has an ethical obligation to protect such information and not inform the insurer.

The Texas State Bar Hypothetical

According to recent Texas State Bar Opinion No. 669, a lawyer retained by an insurance company to defend an insured may withdraw from the representation if the insured client fails to cooperate, but *may not* disclose to the insurance company or to the court the specific reason for the withdrawal. In coming to this conclusion, the Texas State Bar proposed a hypothetical in which an insured initially cooperated with counsel retained by his insurance company, but over time stopped communicating with counsel or cooperating in the defense. The lawyer retained an investigator to track down the insured client, presumably without informing the insurer he was doing so, but the client still failed to cooperate. The opinion advised that the lawyer could file a motion to withdraw, but should only provide a general explanation to the insurance company and to the court that "professional considerations require withdrawal."

The advisory opinion determined that an insured client's failure to communicate with the retained lawyer is "unprivileged client communication" which is included in the umbrella of "confidential client information" the lawyer is obligated to protect. Texas ethics rules provide that a lawyer shall not knowingly reveal a client's confidential information to third persons the client has not instructed to receive the information, and shall not use a client's confidential information to the disadvantage of the client unless the client consents after consultation. There is an exception to this rule if the information is disclosed to carry out the representation.

The advisory opinion assumes without discussion that the insured client has not agreed to have the insurer receive confidential information, and further assumes that the insured client would be disadvantaged if the lawyer disclosed the insured client's failure to communicate to the insurer. The opinion observes that since the insured client is not communicating with the lawyer, the lawyer cannot obtain consent from the client to disclose this lack of communication to the insurer. The opinion states without analysis that the cooperation of the insured is not necessary to carry out the representation, and concludes such disclosure should be barred.

Criticisms of the Texas Advisory Opinion

To some, this advisory opinion ignores the realities of the tripartite relationship and makes inaccurate assumptions in addition to those mentioned above. The hypothetical appears to assume that the lawyer is not communicating with the insurance company that retained him, the insurer was not communicating with the insured, and the insurer would be unaware that the insured's failure to cooperate was causing problems in the defense of the claim. This seems unlikely, regardless of whether the lawyer expressly told the insurer that the client was not cooperating.

The opinion also fails to recognize that cooperation of the insured client is in the best interest of each prong of the tripartite relationship. The insured client plainly has an interest in maintaining his insurance coverage, which necessarily requires cooperation and communication with retained defense counsel and the insurer. The lawyer, out of both professional duty to his client and self-interest in continuing to bill on the file, has an interest in obtaining the assistance of the insured client in defending the case and avoiding withdrawal. And the insurer has an interest in fulfilling its obligation to provide an adequate defense to its insureds, which necessarily requires communication with and cooperation from the insured.

The opinion ignores that it is in both the insurer and the insured's best interest that the insured cooperate with defense counsel in the defense of the claim, both to maintain coverage and to best resolve the dispute. The lawyer must have communication with the insured client to defend the case, and the insurance company should be diligent in seeking the cooperation of the insured. The discussion in the opinion correctly notes that failure to cooperate could take an insured out of coverage, but neglects to recognize that insurance companies have "duty to cooperate" clauses to ensure the company can defend the insured, and not primarily as a mechanism to avoid coverage. The insurer has an obligation to provide an adequate defense to its insureds, and would not likely succeed on a "failure to cooperate" coverage defense if the insurer did not take reasonable measures to secure such cooperation. If the lawyer could candidly disclose to the insurer that the insured client was not communicating with counsel, the insurance company could then utilize its resources to secure cooperation and each prong of the tripartite relationship would benefit.

Conclusion

Opinion No. 669 from the Texas State Bar only applies to that jurisdiction, but the assumptions, discussion (or lack thereof), and conclusions of the opinion might guide other jurisdictions to differing determinations. Critics of the opinion observe that it fails to consider the realities of insurance defense practice and the true motivations and interests of insurance

> A withdrawing insurance defense attorney "may not disclose to the insurance company or to the court the specific reason for the withdrawal."

TRIPARTITE RELATIONSHIP DISCLOSURE, CONT'D

retained counsel. Contrary to the presumption that underlies the opinion, securing cooperation of the insured benefits the insured, the insurer, and the lawyer in successfully defending the case. A prohibition on a lawyer's disclosure of an insured client's failure to cooperate will likely only increase the chances of the insured client losing coverage, the exact opposite of the interests of the client. Lawyers should consult the rules in their jurisdiction when faced with an insured client who is failing to communicate or cooperate.

Alice M. Sherren is a Claim Attorney with **Minnesota Lawyers Mutual Insurance Company.** Alice directs the defense of LPL claims and speaks on risk management and ethics matters. She may be reached at asherren@mlmins.com.

Donald Patrick Eckler is a partner at **Pretzel & Stouffer,** Chartered, in **Chicago**. Pat defends doctors, lawyers, architects, engineers, appraisers, accountants, mortgage and insurance brokers, surveyors and others. He may be reached at deckler@pretzel-stouffer.com.

PRESIDENT'S LETTER, CONT'D

chair, through September 1, 2018. Please think about this opportunity for yourself, or for someone else in your firm. Speaking for myself, being a member of the PLDF Board has been one of my favorite professional activities.

I hope you enjoy this edition of the Quarterly. As I prepare to hand over the reins to our next PLDF President, Jason Jobe, I want to thank Pat Eckler and Tom Jensen, who devoted many hours to publishing four outstanding issues of the Quarterly over the past year. The articles are timely, informative, and very relevant to the work that we all do. Huge thanks also are due to the terrific PLDF Board, and of course, to our friend and Executive Director, Christine Jensen.

Hope to see many of you in New Orleans! Erin

IMPACT OF PLAINTIFF'S DEATH DURING JUDICIAL VERSUS JURY DELIBERATIONS, BY THOMAS A. LANG, ESQ.

Laws which allow for the survival of a claim for personal injuries, beyond the death of the injured party (abrogating the common law, which did not recognize the survival of a cause of action) are nearly universal. Generally, survival actions allow for recovery of damages which were incurred by the injured party, prior to his or her death. In the event that the injured party has a diminished or reduced life expectancy, juries are instructed to consider that reduced life span in awarding future damages, often based on expert testimony introduced at trial. However, any claim for future damages—especially a claim for future tort damages, involves some amount of subjectivity and guesswork. Not only are the nature and extent of future damages rife with speculation, but the duration of said damages is often based on statistical estimates of lifespan, which leave open the potential that the lifespan of the party in interest will fall outside the statistical averages.

Some states also have specific statutes which govern circumstances wherein the plaintiff dies after verdict, but before judgment is entered. *See, e.g.*, Utah Code of Civil Procedure 58A(h): "If a party dies after a verdict or decision upon any issue of fact and before judgment, judgment may nevertheless be entered." *See also,* Va. Code Ann. §8.01-21: "When a party dies...if such fact occurs after verdict, judgment may be entered as if it had not occurred." These rules essentially allow for the court to uphold a jury verdict when the patient dies after the verdict is rendered, but before final judgment is entered (e.g., when a post-trial motion is pending). Additionally, some states have statutes for structured damage awards relating to future damages that have built in contingencies for when a plaintiff dies after a verdict or settlement. *See, e.g.*, Cal. Civ. Proc. Code § 667,7; Wis. Stat. Ann. § 655.015. These statutes mandate that future disbursements for future damages should be terminated or modified in the event of the plaintiff's death. However, not all states have such statutes, and the rare but certainly possible potential remains: what if the plaintiff dies during deliberations, or during trial? What if the plaintiff dies after a verdict, but before entry of a final order (due to a post-trial motion)? The recent Illinois case of *Jefferson v. Mercy Hosp. & Med. Ctr.*, 2018 IL App. (1st) 162219, involved one of these novel circumstances, wherein the plaintiff passed away during jury deliberations, and the holding illustrated the distinctions that have been historically drawn by the courts in determining how the plaintiff's death should affect entry of judgment on the case.

In *Jefferson*, the plaintiff in a medical malpractice case involving significant claimed future damages (in the form of medical expenses, and future pain and suffering) passed away during jury deliberations. *Id.*,

"Some states also have specific statutes which govern circumstances wherein the plaintiff dies after verdict, but before judgment entered"

EFFECT OF PLAINTIFF'S DEATH DURING TRIAL, CONT'D

¶ 28. The jury was not told of the plaintiff's death, and returned a verdict in favor of the plaintiff, including an award of over $15 million for future damages. *Id.* The appellate court ultimately vacated the award of future damages, holding that, upon the patient's death, the claim became a survival action. *Id.*, ¶ 52. In Illinois (as in most other states) the Survival Act "abrogates the common law and allows a cause of action for malpractice to survive the party's death." *Id.,* ¶ 49. Under the Illinois Survival Act, the representatives of the decedent would have a cause of action for medical expenses and pain and suffering of the decedent, up to the date of death. *Id*. A survival action does not allow for recovery of post-death damages. *Id*., ¶ 50. Accordingly, the plaintiff's death – prior to the jury's verdict – served to convert the case to a survival action, thus negating the claim for post-death damages. *Id.*, ¶ 52.

In striking the jury's future damages award, the court in *Jefferson* further noted that the purpose of tort damages is to make the plaintiff whole rather than bestow a windfall, and that the court would run afoul of that principle if the estate was allowed to collect an award for future injuries that the patient will no longer suffer. *Id.* The court also noted that the award for future damages would have been appropriate and affirmed, had the patient passed away at any point in time after judgment was entered on the jury's verdict. *Id.*, ¶53.

The plaintiff in *Jefferson* asked the trial court and the appellate court to enter an order *nunc pro tunc*, entering judgment on the verdict as of the date of the patient's death. The plaintiff cited to various cases which allowed for just such an order, following the death of a plaintiff. In denying this request, the court stressed that there was no order or judgment to be entered *nunc pro tunc*, as of the date of the plaintiff's death, because the jury was still deliberating, and there was no verdict or judgment on which an order could be entered. *Id.*, ¶ 30. As the court noted, a "*nunc pro tunc* order is entry now for something that was done on a previous date and is made to make the record speak now for what was actually done then." *Id.*, ¶ 30. In the cases cited by plaintiff in *Jefferson*, involving a *nunc pro tunc* order entered after a party's death, the case was always ripe for entry of a judgment order. Specifically, entry of a judgment order was delayed due to the court's own inaction, or the verdict had been rendered and was ripe for entry, but a final judgment had not yet been entered due to a post-trial motion or appeal.

The concept of entering an order *nunc pro tunc*, back to the date of plaintiff's death, is rooted in a Supreme Court case nearly 140 years old: *Mitchell v. Overman*, 103 U.S. 62 (1880). In Mitchell, the Court held the following:

> Where the delay in rendering a judgment or a decrees arises from the act of the court...where the delay has been caused either for its convenience, or by the multiplicity or press of business, either the intricacy of the questions involved, or of any other cause not attributable to the laches of the parties, the judgment of the decree may be entered retrospectively, as of a time when it should or might have been entered up. A *nunc pro tunc* order should be granted or refused, as justice may require in view of the circumstances of the particular case.

Mitchell v. Overman, 103 U.S. 62, 64-65 1880).

The decision in *Mitchell* does not provide much substantive detail about the underlying case; the only facts cited are that judgment was entered in favor of plaintiff, with interest, and that the plaintiff had died as of the date of entry of the judgement decree. *Id.*, at 63. There was no indication if the case involved personal injury, or what specific damages were awarded. Regardless, the above cited rule has been followed consistently since *Mitchell*, in cases involving a bench trial or determination. Where a party dies after his case is submitted, but before the opinion issues, and the case would otherwise be rendered moot, the courts have consistently entered judgment *nunc pro tunc* to the date of the party's death. *See Padgett v. Nicholson*, 473 F. 3d 1364 (Fed. Cir. 2007). Similarly, in *West v. United States*, 2009 WL 2169852 (S.D. Miss. 2009) the plaintiff in malpractice case filed against the VA passed away after the case had been fully tried and submitted to the court for ruling. The court had taken the matter under advisement, to consider the evidence and written submissions from the party, but had not yet entered judgment at the time of the plaintiff's death. *Id.*, ¶ 16-17. The delay in judgement by the court was the due to the act of the court; accordingly, the entry of a nunc pro tunc order (which included future damages), as of a date prior to the plaintiff's death was appropriate. *Id.*

Courts have also rejected attempts to vacate damages after the verdict has been entered, but before the entry of final judgment, pending post-trial motions. *Davis v. Jellico Community Hospital, Inc.*, 912 F.2d 129 (6th Cir. 1990), involved a medical malpractice case in the Eastern District of Tennessee, wherein plaintiff claimed a failure to diagnose and treat a subdural hematoma, leading to permanent brain injury. In that case, the jury entered a verdict in favor of the plaintiff for $2.5 million, and judgment was entered on the verdict. Within ten days of the verdict, the defendants filed a post-trial motion for judgment notwithstanding the verdict. Thirty three days after the ver-

"Courts have also rejected attempts to vacate damages after the verdict has been entered, but before entry of final judgment … ."

EFFECT OF PLAINTIFF'S DEATH DURING TRIAL, CONT'D

dict, the plaintiff died, and the defendants amended their post-trial motion to include a request for a new trial on damages, given the plaintiff's death. In support of this request, the defendants cited to certain portions of Federal Rules 59 and 60 (which govern post-trial/post judgment relief), and claimed that the damages award needed to be vacated because final judgment had not been entered in the case (due to the pendency of the post-trial motion.) The court rejected these arguments, and held that the verdict should stand. *Id.*, at 137. The court held that the plaintiff's death shortly after the verdict was not "newly discovered evidence" under Rules 59 or 60, nor was it a "substantial injustice" requiring the reopening of the case or award of a new trial. *Id.*, at 135. As the court somewhat harshly noted, "it is the defendant's responsibility to make clear to the fact finder that the plaintiff could die as soon as he or she leaves the courthouse." *Id.*, at 136. Further, "the fact that a plaintiff dies even a second after judgment is entered does not render evidence regarding an *expected* life span "false" nor the judgment invalid. The testimony regards an expectancy, not a certainty." *Id*.

The defendants in *Davis* also argued that a plaintiff's claim for personal injuries converts to a wrongful death claim in the event that the plaintiff dies during the pendency of the case. *Id.*, at 137. The argument was that the wrongful death claim would not allow for future damages, which would negate the future damages award. *Id*. The court in *Davis* also rejected this argument, noting that there is no provision of Tennessee law which allows for such a conversion. *Id.*

The distinction drawn by the courts, as noted in *Jefferson*, seems curious and somewhat inconsistent on its face – that a delay in ruling by the court on an issue of fact should allow for a *nunc pro tunc* order, taking effect as of the date when the party was still alive, but a "delay" by a jury in rendering a verdict does not. That being said, this distinction has been consistently upheld by various rulings, in the manner cited by the *Jefferson* court, going back to the holding in *Mitchell*. Courts have been consistent on when a case is ripe for judgment – either following jury verdict, or when the court has received all the evidence and is ready to rule. However, the factual and legal distinction between those two situations is obviously profound. The timing of the plaintiff's death in *Jefferson* is exceedingly rare, but it gives rise to illustrate a curious distinction in the law, and allows ample room for argument as to when judgment should become ripe for entry of a *nunc pro tunc* order.

Thomas A. Lang is a partner at **Cunningham, Meyer & Vedrine** in **Chicago**, who focuses his practice in civil litigation with an emphasis on medical malpractice, professional liability, and general commercial litigation. He may be reached at tlang@cmvlaw.com.

> "'[I]t is the defendant's responsibility to make clear to the fact finder that the plaintiff could die as soon as he or she leaves the courthouse.'"

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