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## **Second Circuit Update**

by Andrew J. Entwistle and Alix R. Rubin

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### **Broad Arbitration Agreement Authorizes Arbitrator To Sanction a Party's Bad-Faith Conduct With Fee Award**



*ReliaStar Life Ins. Co. of N.Y. v. EMC Nat'l Life Co.*, 564 F.3d 81 (2d Cir. 2009)

In a decision that could expand arbitrators' authority to award attorneys' and arbitrators' fees, the Second Circuit recently upheld an arbitration panel's award of such fees under the bad-faith exception to the American rule that parties bear the costs of their own attorneys' fees.

Plaintiff insurance company entered into two coinsurance agreements with the defendant insurance company. Both agreements contained a broad arbitration clause that included a section in which each party agreed to bear the expense of its own arbitrator and related outside attorneys' fees. After various disputes arose between the parties, defendant sought an arbitration proceeding to declare the agreements terminated and for a terminal accounting. The arbitration panel found that the agreements remained in force and awarded the plaintiff damages for amounts past due. The panel also awarded attorney's and arbitrator's fees to the plaintiff, explaining that it viewed defendant's actions during the arbitration "as lacking good faith."

Plaintiff petitioned the district court to confirm the final arbitration award. Defendant counter-petitioned to vacate that portion of the award granting fees, arguing that the panel had exceeded its authority under the arbitration clause. The district court agreed with the defendant and vacated the fee award. Plaintiff appealed.

### **Second Circuit Analysis**

A split panel of the Court of Appeals reversed the district court's judgment and remanded the case with directions to confirm the arbitration award in all respects. The court held that the parties' arbitration clause was broad enough to confer inherent authority on the arbitrators to sanction a party's bad-faith conduct, including an award of attorney's and arbitrator's fees. The Second Circuit cited the Ninth Circuit's recognition of a bad-faith exception to the general American rule that each party bears the expense of its own attorney's fees. The underlying purpose of arbitration, i.e., to swiftly and efficiently resolve disputes without litigation, "could not be achieved but for good faith arbitration by the parties," the court reasoned.

Therefore, the court rejected defendant's interpretation of the arbitration clause as limiting the arbitrators' sanction authority to exclude awards of attorney's or arbitrator's fees. The section related to fees, the court held, simply stated the American rule that each party bears the expense of its own attorney's fees and reflected the parties' agreement as to how fees were to be borne "in the expected context of *good faith* dealings." Nothing in that section signaled the parties' intent to limit the arbitrators' inherent authority to sanction bad-faith conduct in the arbitration, the court noted. "As sophisticated commercial entities, the parties were certainly capable of stating clearly any intent to exclude attorney's and arbitrator's fees from the broad range of sanctions generally available to arbitrators upon an identification of bad faith," the court stated.

The Second Circuit emphasized that its holding did not preclude parties from limiting the scope of an arbitrator's sanction authority to exclude awards for attorneys' and arbitrators' fees. Parties who wish to do so need only "explicitly and clearly state that intent as part of their agreement to arbitrate," the court stated.

## **Absent Class Members Not Entitled to Full Access to Attorney's Files**

*Wyly v. Milberg Weiss Bershad & Shulman, LLP*, 12 N.Y.3d 400, 908 N.E.2d 888 (2009)

The New York Court of Appeals recently declined to extend to absent class members in class actions the presumptive right of access to their attorneys' files after termination of the representation.

Almost one year following court approval of a settlement in consolidated federal securities fraud class actions, plaintiff, a major investor and unnamed or absent class member, claimed that the class settlement had been procured by fraud. Plaintiff filed a motion in federal court to vacate the final settlement on the grounds of new evidence, misconduct and fraud upon the court. In support of his motion, plaintiff requested expedited discovery. In the meantime, plaintiff also requested of defendants, class counsel, access to all documents related to their pre-trial investigations, discovery requested and produced, and all other material they had created in relation to the class actions. Plaintiff claimed he was entitled to these documents because he had an attorney-client relationship with the defendants as a substantial member of the settlement class. Defendants objected to this request.

### **State Court Special Proceeding**

While the motion to vacate the settlement was pending in district court, plaintiff commenced a special proceeding in New York state court seeking a judgment directing the defendants to turn over the class action files related to the representation of plaintiff and other class members. Defendants argued that plaintiff's claims were barred by the attorney work-product privilege. The trial court granted plaintiff's petition and ordered defendants to turn over the class action files, reasoning that the plaintiff's relationship with the defendants was "sufficiently similar to a traditional attorney-client relationship so as to create a presumption in favor of affording him access to [the law firm's] files" in accord with the holding in *Sage Realty Corp. v. Proskauer Rose Goetz & Mendelsohn L.L.P.*, 91 N.Y.2d 30, 689 N.E.2d 879, 666 N.Y.S.2d 985 (1997).

Defendants appealed. The Appellate Division reversed, holding that *Sage Realty* was distinguishable because that case involved the attorney-client relationship in the traditional sense of a single client, which differed fundamentally from the relationship between class counsel and an absent class member. The Appellate Division declined to allow the plaintiff to use this special proceeding "as a vehicle to launch a fishing expedition" and "reject[ed] a blanket extension of *Sage Realty's* presumptive-entitlement right to absent class members[.]" The intermediate appellate court "f[ound] that the better practice [was] to require absent class members to establish their entitlement to class counsel's file on a case-by-case basis." Plaintiff appealed.

### **Court of Appeals Analysis**

The New York Court of Appeals affirmed. The court held that the plaintiff did not possess a presumptive right of access to these documents and the Appellate Division had not abused its discretion when it denied plaintiff access to the requested file. The court noted that two general propositions emerge from existing case law: "class counsel do not possess a traditional attorney-client relationship with absent class members"; and yet "they represent the interests of and owe a fiduciary duty to the entire class[.]" The court also reasoned that the "unusually high degree of judicial involvement and responsibility" reduces an absent class member's need for access to class counsel's file.

The Court of Appeals provided New York's trial courts with a two-step process for considering an absent class member's request for access to class counsel's file after termination of the representation. First, the court must consider how much the absent class member has at stake. If, as in *Wyly*, the absent class member has a substantial financial interest in the class action's outcome, then the court must decide if the absent class member has a legitimate need for the documents. Therefore, not all absent class members will be denied access to class counsel's file. If an absent class member can prove that he has: (1) a substantial stake in the outcome of the class action; and (2) a legitimate need for the requested documents and cannot obtain them any other way, he will likely be granted access.

In *Wyly*, the plaintiff had not made an adequate showing to compel defendants to produce their files because the federal court had previously granted plaintiff access to the twenty-three boxes that had initially triggered his suspicions of fraud.

### **Intentional Spoliation of Evidence May Form Basis for Fraud Claims**

*IDT Corp. v. Morgan Stanley Dean Witter & Co.*, 63 A.D.3d 583 (1st Dep't 2009)

Although the New York courts do not recognize an independent cause of action for negligent spoliation, a New York appellate court recently upheld a plaintiff's claim of fraudulent concealment and misrepresentation based upon intentional spoliation of evidence.

Plaintiff, a telecommunications company, entered into a contract with a fiber-optic cable company for a submarine fiber-optic cable encircling Latin America. Both plaintiff and the cable company were clients of the defendant investment bank. Plaintiff alleged that defendant had supplied the cable company with confidential and proprietary business and financial information about the plaintiff to induce the cable company to delay performance and eventually breach its contract with plaintiff so as to enter into a similar deal with another client of the defendant.

### ***The Arbitration and Subpoena***

Plaintiff commenced an arbitration proceeding against the cable company for breach of contract. The arbitration panel found in favor of the plaintiff. Although defendant was not a party to the arbitration, plaintiff had subpoenaed defendant, seeking all documents related to any advice provided to the cable company about the cable deal. During discovery in this action, plaintiff learned that the documents defendant had produced constituted only a small percentage of the relevant documents and that the excluded documents contained crucial "smoking gun" information. These documents, plaintiff argued, would have allowed it to prove that the cable company had breached the contract as much as a year earlier than the panel had determined, thus substantially increasing plaintiff's damages award.

Plaintiff amended its complaint to add causes of action for fraudulent concealment and misrepresentation based on the intentional concealment of evidence. Defendant moved to dismiss, relying on the New York Court of Appeals' decision in *Ortega v. City of New York*, 9 N.Y.3d 69, 876 N.E.2d 1189, 845 N.Y.S.2d 773 (2007), which held that New York does not recognize the tort of negligent spoliation of evidence. The trial court granted defendant's motion, reasoning that plaintiff's framing of the issue as a fraud claim "[did] not take it out of the rules regarding spoliation of evidence claims." Plaintiff appealed.

### ***The First Department's Decision***

The appellate court held that *Ortega* did not require plaintiff's claims of fraud and fraudulent concealment to be dismissed simply because the fraudulent conduct was based on concealment of evidence. The court noted four ways in which *Ortega* was distinguishable: (1) it involved a claim for negligent, not intentional, spoliation of evidence; (2) the defendant had no fiduciary duty to the plaintiff or other connection to the underlying litigation; (3) the content of the lost evidence was unknown, leading to speculation as to causation and damages; and (4) public policy was served by not permitting a claim of negligent spoliation to proceed against a municipality.

Moreover, the *IDT* court stated: "There is no indication in *Ortega* that the court would reject an already recognized common-law tort claim simply because the claim was based on the spoliation of evidence." Therefore, under *IDT*, so long as the elements of the tort alleged are properly pled, New York courts will permit the claim to proceed, even if it is based on the spoliation of evidence.

### **About the Authors**

**Andrew J. Entwistle** is a partner of Entwistle & Cappucci LLP, New York, New York. He can be reached at 212-894-7200 or [aentwistle@entwistle-law.com](mailto:aentwistle@entwistle-law.com). **Alix R. Rubin** is a partner in the firm's Florham Park, New Jersey and New York, New York offices. She can be reached at 973-236-0666 or [arubin@entwistle-law.com](mailto:arubin@entwistle-law.com).