NEW YORK AMERICAN INN OF COURT

ZILLY ZONKA'S LEGAL FACTORY

Timed Agenda & CLE Written Materials

June 15, 2022

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NEW YORK AMERICAN INN OF COURT

TIMED AGENDA

INTRODUCTORY REMARKS AND SCENE 1: 10 minutes

SCENE 2 – New York Rule of Professional Conduct 7.1 and mottos used by lawyers that imply the ability to obtain results: 9 minutes

SCENE 3 – Britney Spears Conservatorship: 8 minutes

SCENE 4 – In re Purdue Pharma: 8 minutes

SCENE 5 – Elizabeth Holmes & Theranos: 8 minutes

SCENE 6 – Sarah Palin v. New York Times: 8 minutes

SCENE 7 – People v. Sorokin: 8 minutes

SCENE 8 – McDonald's "Hot Coffee" Lawsuit: 7 minutes

SCENE 9 – U.S. v. Michael Avenatti: 7 minutes

SCENE 10 – Audet v. Fraser (Cryptocurrency): 7 minutes

CONCLUSION (WITH TIME FOR QUESTIONS): 10 minutes

PROGRAM MATERIALS

(Available on Inn website)

Rule 7.1(d), (e), N.Y. Rules of Professional Conduct (https://tinyurl.com/2xtwu2ah)

Alexander v. Cahill, 598 F.3d 79 (2d Cir 2010) (https://tinyurl.com/3b6yjzv5)

L. Zammiello, "Don't You Know That Your Law Is Toxic? Britney Spears and Abusive Guardianship: A Revisionary Approach to the Uniform Probate Code, California Probate Code, and Texas Estates Code to Ensure Equitable Outcomes," 13 Est. Plan. & Community Prop. L.J. 587, 588 (2021) (https://tinyurl.com/4zzub827)

In re Purdue Pharma, L.P., 635 B.R. 26 (S.D.N.Y. 2021), *certificate of appealability granted*, No. 21-CV-07532 (CM), 2022 WL 121393 (S.D.N.Y. Jan. 7, 2022) (https://casetext.com/case/in-re-purdue-pharma-11)

B. Sutton, "Elizabeth A. Sackler Supports Nan Goldin in Her Campaign Against OxyContin," Hyperallergic (Jan. 22, 2018) (https://tinyurl.com/yhf4jh4s)

United States v. Holmes, No. 18-CR-00258 (EJD), 2021 WL 2044470 (N.D. Cal. May 22, 2021)

Palin v. New York Times Co., No. 17-CV-04853 (JSR), 2022 WL 599271 (S.D.N.Y. Mar. 1, 2022) (https://tinyurl.com/2s488swp)

Covington, "Anna Delvey Has Lived Many Lives. After Inventing Anna, This Is Where She Is Now," Esquire (Mar. 16, 2022) (https://www.esquire.com/entertainment/tv/a39033776/anna-delvey-where-is-she-now/)

N. Marder, "Juries and Damages: A Commentary," 48 DePaul L. Rev. 427 (1998) (https://via.library.depaul.edu/law-review/vol48/iss2/14/)

United States v. Avenatti, No. 19-CR-00374 (JMF), 2022 WL 457315, at *2 (S.D.N.Y. Feb. 15, 2022)

Audet v. Fraser, No. 16-CV-00940 (MPS), 2020 WL 2113620, at *7 (D. Conn. May 4, 2020)

Audet v. Fraser, No. 16-CV-00940 (MPS), 2022 WL 1912866 (D. Conn. June 3, 2022)

Paul Weiss Client Advisory, "Federal Jury Finds Cryptocurrency Products Not Securities In Landmark Verdict" (Nov. 18, 2021) (https://tinyurl.com/mtbddp4u)

RULE 7.1

ADVERTISING

(a) A lawyer or law firm shall not use or disseminate or participate in the use or dissemination of any advertisement that:

(1) contains statements or claims that are false, deceptive or misleading; or

(2) violates a Rule.

(b) Subject to the provisions of paragraph (a), an advertisement may include information as to:

(1) legal and nonlegal education; degrees and other scholastic distinctions; dates of admission to any bar; areas of the law in which the lawyer or law firm practices, as authorized by these Rules; public offices and teaching positions held; publications of law-related matters authored by the lawyer; memberships in bar associations or other professional societies or organizations, including offices and committee assignments therein; foreign language fluency; and bona fide professional ratings;

(2) names of clients regularly represented, provided that the client has given prior written consent;

(3) bank references; credit arrangements accepted; prepaid or group legal services programs in which the lawyer or law firm participates; nonlegal services provided by the lawyer or law firm or by an entity owned and controlled by the lawyer or law firm; the existence of contractual relationships between the lawyer or law firm and a nonlegal professional or nonlegal professional service firm, to the extent permitted by Rule 5.8, and the nature and extent of services available through those contractual relationships; and

(4) legal fees for initial consultation; contingent fee rates in civil matters, when accompanied by a statement disclosing the information required by paragraph (p); range of fees for legal and nonlegal services, provided that there be available to the public free of charge a written statement

clearly describing the scope of each advertised service, hourly rates, and fixed fees for specified legal and nonlegal services.

(c) An advertisement shall not:

(1) include a paid endorsement of, or testimonial about, a lawyer or law firm without disclosing that the person is being compensated therefor;

(2) include the portrayal of a fictitious law firm, the use of a fictitious name to refer to lawyers not associated together in a law firm, or otherwise imply that lawyers are associated in a law firm if that is not the case;

(3) use actors to portray a judge, the lawyer, members of the law firm, or clients, or utilize depictions of fictionalized events or scenes, without disclosure of same;

(4) be made to resemble legal documents.

(d) An advertisement that complies with paragraph (e) may contain the following:

(1) statements that are reasonably likely to create an expectation about results the lawyer can achieve;

(2) statements that compare the lawyer's services with the services of other lawyers;

(3) testimonials or endorsements of clients, and of former clients; or

(4) statements describing or characterizing the quality of the lawyer's or law firm's services.

(e) It is permissible to provide the information set forth in paragraph (d) provided:

(1) its dissemination does not violate paragraph (a);

(2) it can be factually supported by the lawyer or law firm as of the date on which the advertisement is published or disseminated; and

(3) it is accompanied by the following disclaimer: "Prior results do not guarantee a similar outcome"; and

(4) in the case of a testimonial or endorsement from a client with respect to a matter still pending, the client gives informed consent confirmed in writing.

(f) Every advertisement other than those appearing in a radio, television or billboard advertisement, in a directory, newspaper, magazine or other periodical (and any web sites related thereto), or made in person pursuant to Rule 7.3(a)(1), shall be labeled "Attorney Advertising" on the first page, or on the home page in the case of a web site. If the communication is in the form of a self-mailing brochure or postcard, the words "Attorney Advertising" shall appear therein. In the case of electronic mail, the subject line shall contain the notation "ATTORNEY ADVERTISING."

(g) A lawyer or law firm shall not utilize meta-tags or other hidden computer codes that, if displayed, would violate these Rules.

(h) All advertisements shall include the name, principal law office address and telephone number of the lawyer or law firm whose services are being offered.

(i) Any words or statements required by this Rule to appear in an advertisement must be clearly legible and capable of being read by the average person, if written, and intelligible if spoken aloud. In the case of a web site, the required words or statements shall appear on the home page.

(j) A lawyer or law firm advertising any fixed fee for specified legal services shall, at the time of fee publication, have available to the public a written statement clearly describing the scope of each advertised service, which statement shall be available to the client at the time of retainer for any such service. Such legal services shall include all those services that are recognized as reasonable and necessary under local custom in the area of practice in the community where the services are performed.

(k) All advertisements shall be pre-approved by the lawyer or law firm, and a copy shall be retained for a period of not less than three years following its initial dissemination. Any advertisement contained in a computer-accessed communication shall be retained for a

period of not less than one year. A copy of the contents of any web site covered by this Rule shall be preserved upon the initial publication of the web site, any major web site redesign, or a meaningful and extensive content change, but in no event less frequently than once every 90 days.

(l) If a lawyer or law firm advertises a range of fees or an hourly rate for services, the lawyer or law firm shall not charge more than the fee advertised for such services. If a lawyer or law firm advertises a fixed fee for specified legal services, or performs services described in a fee schedule, the lawyer or law firm shall not charge more than the fixed fee for such stated legal service as set forth in the advertisement or fee schedule, unless the client agrees in writing that the services performed or to be performed were not legal services referred to or implied in the advertisement or in the fee schedule and, further, that a different fee arrangement shall apply to the transaction.

(m) Unless otherwise specified in the advertisement, if a lawyer publishes any fee information authorized under this Rule in a publication that is published more frequently than once per month, the lawyer shall be bound by any representation made therein for a period of not less than 30 days after such publication. If a lawyer publishes any fee information authorized under this Rule in a publication that is published once per month or less frequently, the lawyer shall be bound by any representation made therein until the publication of the succeeding issue. If a lawyer publishes any fee information authorized under this Rule in a publication that has no fixed date for publication of a succeeding issue, the lawyer shall be bound by any representation made therein for a reasonable period of time after publication, but in no event less than 90 days.

(n) Unless otherwise specified, if a lawyer broadcasts any fee information authorized under this Rule, the lawyer shall be bound by any representation made therein for a period of not less than 30 days after such broadcast.

(o) A lawyer shall not compensate or give anything of value to representatives of the press, radio, television or other communication medium in anticipation of or in return for professional publicity in a news item.

(p) All advertisements that contain information about the fees charged by the lawyer or law firm, including those indicating that in the absence of a recovery no fee will be charged, shall comply with the provisions of Judiciary Law § 488(3).

(q) A lawyer may accept employment that results from participation in activities designed to educate the public to recognize legal problems, to make intelligent selection of counsel or to utilize available legal services.

(r) Without affecting the right to accept employment, a lawyer may speak publicly or write for publication on legal topics so long as the lawyer does not undertake to give individual advice.

Comment

Advertising

[1] The need of members of the public for legal services is met only if they recognize their legal problems, appreciate the importance of seeking assistance, and are able to obtain the services of competent legal counsel. Hence, important functions of the legal profession are to educate people to recognize their problems, to facilitate the process of intelligent selection of lawyers, and to assist in making legal services fully available.

[2] The public's need to know about legal services can be fulfilled in part through advertising. People of limited means who have not made extensive use of legal services in many instances rely on advertising to find appropriate counsel. While a lawyer's reputation may attract some clients, lawyers may also make the public aware of their services by advertising to obtain work.

[3] Advertising by lawyers serves two principal purposes: first, it educates potential clients regarding their need for legal advice and assists them in obtaining a lawyer appropriate for those needs. Second, it enables lawyers to attract clients. To carry out these two purposes and because of the critical importance of legal services, it is of the utmost importance that lawyer advertising not be false, deceptive or misleading. Truthful statements that are misleading are prohibited by this Rule. A truthful statement is misleading if it omits a fact necessary to make the lawyer's communication, considered as a whole, not materially misleading. A truthful statement is also misleading if there is a substantial likelihood that it will lead a reasonable person to formulate a specific

conclusion about the lawyer or the lawyer's services, or about the results a lawyer can achieve, for which there is no reasonable factual foundation. For example, a lawyer might truthfully state, "I have never lost a case," but that statement would be misleading if the lawyer settled virtually all cases that the lawyer handled. A communication to anyone that states or implies that the lawyer has the ability to influence improperly a court, court officer, governmental agency or government official is improper under Rule 8.4(e).

[4] To be effective, advertising must attract the attention of viewers, readers or recipients and convey its content in ways that will be understandable and helpful to them. Lawyers may therefore use advertising techniques intended to attract attention, such as music, sound effects, graphics and the like, so long as those techniques do not render the advertisement false, deceptive or misleading. Lawyer advertising may use actors or fictionalized events or scenes for this purpose, provided appropriate disclosure of their use is made. Some images or techniques, however, are highly likely to be misleading. So, for instance, legal advertising should not be made to resemble legal documents.

[5] The "Attorney Advertising" label serves to dispel any confusion or concern that might be created when nonlawyers receive letters or emails from lawyers. The label is not necessary for advertising in newspapers or on television, or similar communications that are self-evidently advertisements, such as billboards or press releases transmitted to news outlets, and as to which there is no risk of such confusion or concern. The ultimate purpose of the label is to inform readers where they might otherwise be confused.

[6] Not all communications made by lawyers about the lawyer or the law firm's services are advertising. Advertising by lawyers consists of communications made in any form about the lawyer or the law firm's services, the primary purpose of which is retention of the lawyer or law firm for pecuniary gain as a result of the communication. However, noncommercial communications motivated by a not-for-profit organization's interest in political expression and association are generally not considered advertising. Of course, all communications by lawyers, whether subject to the special rules governing lawyer advertising or not, are governed by the general rule that lawyers may not engage in conduct involving dishonesty, fraud, deceit or misrepresentation, or knowingly make a material false statement of fact or law. By definition, communications to existing clients are excluded from the Rules governing advertising. A client who is a current client in any matter is an existing client for all purposes of these

Rules. (Whether a client is a current client for purposes of conflicts of interest and other issues may depend on other considerations. Generally, the term "current client" for purposes of the advertising exemption should be interpreted more broadly than it is for determining whether a client is a "current client" for purposes of a conflict of interest analysis.)

[7] Communications to former clients that are germane to the earlier representation are not considered to be advertising. Likewise, communications to other lawyers, including those made in bar association publications and other publications targeted primarily at lawyers, are excluded from the special rules governing lawyer advertising even if their purpose is the retention of the lawyer or law firm. Topical newsletters, client alerts, or blogs intended to educate recipients about new developments in the law are generally not considered advertising. However, a newsletter, client alert, or blog that provides information or news primarily about the lawyer or law firm (for example, the lawyer or law firm's cases, personnel, clients or achievements) generally would be considered advertising. Communications, such as proposed retainer agreements or ordinary correspondence with a prospective client who has expressed interest in, and requested information about, a lawyer's services, are not advertising. Accordingly, the special restrictions on advertising and solicitation would not apply to a lawyer's response to a prospective client who has asked the lawyer to outline the lawyer's qualifications to undertake a proposed retention or the terms of a potential retention.

[8] The circulation or distribution to prospective clients by a lawyer of an article or report published about the lawyer by a third party is advertising if the lawyer's primary purpose is to obtain retentions. In circulating or distributing such materials the lawyer should include information or disclaimers as necessary to dispel any misconceptions to which the article may give rise. For example, if a lawyer circulates an article discussing the lawyer's successes that is reasonably likely to create an expectation about the results the lawyer will achieve in future cases, a disclaimer is required by paragraph (e)(3). If the article contains misinformation about the lawyer's qualifications, any circulation of the article by the lawyer should make any necessary corrections or qualifications. This may be necessary even when the article included misinformation through no fault of the lawyer or because the article is out of date, so that material information that was true at the time is no longer true. Some communications by a law firm that may constitute marketing or branding are not necessarily advertisements. For example, pencils, legal pads, greeting cards, coffee mugs, T-shirts or the like with the law firm name, logo, and contact

information printed on them do not constitute "advertisements" within the definition of this Rule if their primary purpose is general awareness and branding, rather than the retention of the law firm for a particular matter.

Recognition of Legal Problems

[9] The legal professional should help the public to recognize legal problems because such problems may not be self-revealing and might not be timely noticed. Therefore, lawyers should encourage and participate in educational and public-relations programs concerning the legal system, with particular reference to legal problems that frequently arise. A lawyer's participation in an educational program is ordinarily not considered to be advertising because its primary purpose is to educate and inform rather than to attract clients. Such a program might be considered to be advertising if, in addition to its educational component, participants or recipients are expressly encouraged to hire the lawyer or law firm. A lawyer who writes or speaks for the purpose of educating members of the public to recognize their legal problems should carefully refrain from giving or appearing to give a general solution applicable to all apparently similar individual problems, because slight changes in fact situations may require a material variance in the applicable advice; otherwise, the public may be misled and misadvised. Talks and writings by lawyers for nonlawyers should caution them not to attempt to solve individual problems on the basis of the information contained therein.

[10] As members of their communities, lawyers may choose to sponsor or contribute to cultural, sporting, charitable or other events organized by not-for-profit organizations. If information about the lawyer or law firm disseminated in connection with such an event is limited to the identification of the lawyer or law firm, the lawyer's or law firm's contact information, a brief description of areas of practice, and the fact of sponsorship or contribution, the communication is not considered advertising.

Statements Creating Expectations, Characterizations of Quality, and Comparisons

[11] Lawyer advertising may include statements that are reasonably likely to create an expectation about results the lawyer can achieve, statements that compare the lawyer's services with the services of other lawyers, or statements describing or characterizing the quality of the lawyer's or law firm's services, only if they can be factually supported by the lawyer or law firm as of the date on which the advertisement is published or disseminated and are accompanied by the following disclaimer: "Prior

results do not guarantee a similar outcome." Accordingly, if true and accompanied by the disclaimer, a lawyer or law firm could advertise "Our firm won 10 jury verdicts over $1,000,000 in the last five years," "We have more Patent Lawyers than any other firm in X County," or "I have been practicing in the area of divorce law for more than 10 years." Even true factual statements may be misleading if presented out of the context of additional information needed to properly understand and evaluate the statements. For example, a truthful statement by a lawyer that the lawyer's average jury verdict for a given year was $100,000 may be misleading if that average was based on a large number of very small verdicts and one $10,000,000 verdict. Likewise, advertising that truthfully recites judgment amounts would be misleading if the lawyer failed to disclose that the judgments described were overturned on appeal or were obtained by default.

[12] Descriptions of characteristics of the lawyer or law firm that are not comparative and do not involve results obtained are permissible even though they cannot be factually supported. Such statements are understood to be general descriptions and not claims about quality, and would not be likely to mislead potential clients. Accordingly, a law firm could advertise that it is "Hard-Working," "Dedicated," or "Compassionate" without the necessity to provide factual support for such subjective claims. On the other hand, descriptions of characteristics of the law firm that compare its services with those of other law firms and that are not susceptible of being factually supported could be misleading to potential clients. Accordingly, a lawyer may not advertise that the lawyer is the "Best," "Most Experienced," or "Hardest Working." Similarly, some claims that involve results obtained are not susceptible of being factually supported and could be misleading to potential clients. Accordingly, a law firm may not advertise that it will obtain "Big $$$," "Most Money," or "We Win Big."

Bona Fide Professional Ratings

[13] An advertisement may include information regarding bona fide professional ratings by referring to the rating service and how it has rated the lawyer, provided that the advertisement contains the "past results" disclaimer as required under paragraphs (d) and (e). However, a rating is not "bona fide" unless it is unbiased and nondiscriminatory. Thus, it must evaluate lawyers based on objective criteria or legitimate peer review in a manner unbiased by the rating service's economic interests (such as payment to the rating service by the rated lawyer) and not subject to improper influence by lawyers who are being evaluated. Fur-

ther, the rating service must fairly consider all lawyers within the pool of those who are purported to be covered. For example, a rating service that purports to evaluate all lawyers practicing in a particular geographic area or in a particular area of practice or of a particular age must apply its criteria to all lawyers within that geographic area, practice area, or age group.

Meta-Tags

[14] Meta-tags are hidden computer software codes that direct certain Internet search engines to the web site of a lawyer or law firm. For example, if a lawyer places the meta-tag "NY personal injury specialist" on the lawyer's web site, then a person who enters the search term "personal injury specialist" into a search engine will be directed to that lawyer's web page. That particular meta-tag is prohibited because Rule 7.4(a) generally prohibits the use of the word "specialist." However, a lawyer may use an advertisement employing meta-tags or other hidden computer codes that, if displayed, would not violate a Rule.

Advertisements Referring to Fees and Advances

[15] All advertisements that contain information about the fees or expenses charged by the lawyer or law firm, including advertisements indicating that in the absence of a recovery no fee will be charged, must comply with the provisions of section 488(3) of the Judiciary Law. However, a lawyer or law firm that offers any of the fee and expense arrangements permitted by section 488(3) must not, either directly or in any advertisement, state or imply that the lawyer's or law firm's ability to advance or pay costs and expenses of litigation is unique or extraordinary when that is not the case. For example, if an advertisement promises that the lawyer or law firm will advance the costs and expenses of litigation contingent on the outcome of the matter, or promises that the lawyer or law firm will pay the costs and expenses of litigation for indigent clients, then the advertisement must not say that such arrangements are "unique in the area," "unlike other firms," available "only at our firm," "extraordinary," or words to that effect, unless that is actually the case. However, if the lawyer or law firm can objectively demonstrate that this arrangement is unique or extraordinary, then the lawyer or law firm may make such a claim in the advertisement.

Retention of Copies; Filing of Copies; Designation of Principal Office

[16] Where these Rules require that a lawyer retain a copy of an advertisement or file a copy of a solicitation or other information, that obligation may be satisfied by any of the following: original records, photocopies, microfilm, optical imaging, and any other medium that preserves an image of the document that cannot be altered without detection.

[17] A law firm that has no office it considers its principal office may comply with paragraph (h) by listing one or more offices where a substantial amount of the law firm's work is performed.

desirable effect of creating an incentive for an individual involved in a criminal enterprise to "rid[ ] himself of his ill-gotten gains to avoid the forfeiture sanction." *Hall*, 434 at 59.

Notwithstanding appellants' arguments to the contrary, this Court's decision in *United States v. Robilotto*, 828 F.2d 940 (2d Cir.1987), supports our view. In *Robilotto*, in the context of interpreting the RICO forfeiture provision, 18 U.S.C. § 1963, we concluded that the statute "imposes forfeiture directly on an individual as part of a criminal prosecution rather than in a separate proceeding *in rem*." 828 F.2d at 948 (internal quotation marks omitted). In other words, the forfeiture constitutes "a sanction against the individual defendant rather than a judgment against the property itself." *Id.* Consequently, criminal forfeiture need not be traced to identifiable assets in a defendant's possession. *Id.* at 949. The same is true in this context.[5] In fact, this Court has previously noted that the statutory provision governing forfeitures under RICO and criminal forfeiture orders imposed pursuant to § 853 "are so similar in legislative history and plain language as to warrant similar interpretation." *DSI Assoc. LLC v. United States*, 496 F.3d 175, 183 n. 11 (2d Cir.2007) (quoting *United States v. Ribadeneira*, 105 F.3d 833, 835 n. 2 (2d Cir.1997)).

The statute at issue in this case instructs that we interpret its terms "liberally." 21 U.S.C. § 853(*o*). As the district court and other courts of appeal that have addressed this issue have reasoned, section 853 "does not contain any language limiting the amount of money available in a forfeiture order to the value of the assets a defendant possesses at the time the order is issued." *Vampire Nation*, 451 F.3d at 201; *accord Baker*, 227 F.3d at 970. Thus, our interpretation of the criminal forfeiture provision "ensur[es] that all eligible criminal defendants receive the mandatory forfeiture sanction Congress intended" and ensures that there is a mechanism by which the government may "disgorge their ill-gotten gains, even those already spent." *Casey*, 444 F.3d at 1074.

CONCLUSION

We have reviewed all of appellants' arguments and find them to be without merit. Accordingly, for the foregoing reasons, the district court's opinion and order of October 24, 2007, holding that a defendant who is convicted of a violation under the Controlled Substances Act, 21 U.S.C. § 801 *et seq.*, punishable by a term of imprisonment of more than a year, is subject to the forfeiture provision of 21 U.S.C. § 853, irrespective of his assets at the time of sentencing, is hereby AFFIRMED.

James L. ALEXANDER, Alexander & Catalano LLC, and Public Citizen, Inc., Plaintiffs–Appellees–Cross–Appellants,

v.

Thomas J. CAHILL, in his official capacity as Chief Counsel for the Departmental Disciplinary Committee for the Appellate Division of the New

5. We are aware of the thorough discussion and contrary interpretation advanced in *United States v. Surgent*, No. 04–CR–364 (JG)(SMG), 2009 WL 2525137 (E.D.N.Y. Aug. 17, 2009), upon which appellant Awad relies heavily. In the end, however, we find it unpersuasive.

York Court of Appeals, First Department, Diana Maxfield Kearse, in her official capacity as Chief Counsel for the Grievance Committee for the Second and Eleventh Judicial Districts, Gary L. Casella, in his official capacity as Chief Counsel for the Grievance Committee for the Ninth Judicial District, Rita E. Adler, in her official capacity as Chief Counsel for the Grievance Committee for the Tenth Judicial District, Mark S. Ochs, in his official capacity as Chief Attorney for the Committee on Professional Standards for the Appellate Division of the New York Court of Appeals, Third Department, Anthony J. Gigliotti, in his official capacity as acting Chief Counsel for the Grievance Committee for the Fifth Judicial District, Daniel A. Drake, in his official capacity as acting Chief Counsel for the Grievance Committee for the Seventh Judicial District and Vincent L. Scarsella, in his official capacity as acting Chief Counsel for the Grievance Committee for the Eight Judicial District, Defendants–Appellants–Cross–Appellees.

Docket Nos. 07–3677–cv (L), 07–3900–cv (XAP).

United States Court of Appeals, Second Circuit.

Argued: Jan. 22, 2009.

Decided: March 12, 2010.

Background: Attorney, law firm and nonprofit corporation sought declaratory judgment that certain provisions of New York's amended rules on attorney advertising violated First Amendment, and requesting permanent injunction prohibiting their enforcement. The United States District Court for the Northern District of New York, Frederick J. Scullin, J., ruled that most of the rules were unconstitutional, 634 F.Supp.2d 239, and parties appealed.

Holdings: The Court of Appeals, Calabresi, Circuit Judge, held that:

(1) rules regulated commercial speech protected by the First Amendment;

(2) rules imposing content-based restrictions on attorney advertising that was irrelevant, unverifiable, and non-informational did not materially advance substantial state interests;

(3) rule establishing a 30-day moratorium on attorney advertising soliciting accident victims or their families furthered substantial state interest; and

(4) moratorium rule was narrowly tailored to further state interest.

Affirmed in part and reversed in part.

1. Attorney and Client ⚿32(9)
Constitutional Law ⚿2049

New York's amended rules governing attorney advertising, imposing content-based restrictions on advertising that was irrelevant, unverifiable, and non-informational, regulated commercial speech protected by the First Amendment. U.S.C.A. Const.Amend. 1; 22 NYCRR 1200.50(c).

2. Attorney and Client ⚿32(9)
Constitutional Law ⚿2049

New York rule governing attorney advertising, as interpreted to prohibit lawyers from different firms from giving the misleading impression that they were from the same firm, did not regulate commercial speech protected by the First Amendment; provision addressed only attorney advertising techniques that were actually misleading. U.S.C.A. Const.Amend. 1; 22 NYCRR 1200.50(c)(3).

3. Constitutional Law ⚿1038

The party seeking to uphold a restriction on commercial speech carries the burden of justifying it. U.S.C.A. Const. Amend. 1.

4. Constitutional Law ⚿1541

Requirement that the state identify a substantial interest in support of its regulations restricting commercial speech in action challenging such restrictions under the First Amendment does not permit courts to supplant the precise interests put forward by the state with other suppositions. U.S.C.A. Const.Amend. 1.

5. Constitutional Law ⚿1539

States have a generally unfettered right to prohibit inherently or actually misleading commercial speech. U.S.C.A. Const.Amend. 1.

6. Attorney and Client ⚿32(9)
Constitutional Law ⚿2049

New York rules imposing content-based restrictions on attorney advertising that was irrelevant, unverifiable, and non-informational furthered substantial state interests in protecting public from attorney advertisements containing deceptive or misleading content and protecting the legal profession's image and reputation, as required to satisfy First Amendment limitations on regulation of commercial speech. U.S.C.A. Const.Amend. 1; 22 NYCRR 1200.50(c).

7. Constitutional Law ⚿1541

A regulation impinging upon commercial expression must directly advance the state interest involved; the regulation may not be sustained if it provides only ineffective or remote support for the government's purpose. U.S.C.A. Const.Amend. 1.

8. Constitutional Law ⚿1541

State's burden with respect to requirement that a regulation impinging upon commercial expression directly advance the state interest involved is not satisfied by mere speculation or conjecture; rather, a governmental body seeking to sustain a restriction on commercial speech must demonstrate that the harms it recites are real and that its restrictions will in fact alleviate them to a material degree. U.S.C.A. Const.Amend. 1.

9. Attorney and Client ⚿32(9)
Constitutional Law ⚿2049

New York rule prohibiting attorney advertising containing testimonials from current clients did not materially advance state's interest in preventing misleading advertising, as required to satisfy First Amendment limitations on regulation of commercial speech; although testimonials could mislead if they suggested that past results indicate future performance, not all testimonials would do so, especially if they included a disclaimer. U.S.C.A. Const. Amend. 1; 22 NYCRR 1200.50(c)(1).

10. Attorney and Client ⚿32(9)
Constitutional Law ⚿2049

New York rule prohibiting attorney advertising containing the portrayal of a judge did not materially advance the State's interest in preventing misleading advertising, as required to satisfy First Amendment limitations on regulation of commercial speech. U.S.C.A. Const. Amend. 1; 22 NYCRR 1200.50(c)(3).

11. Attorney and Client ⚿32(9)
Constitutional Law ⚿2049

New York rule prohibiting attorney advertising containing attention-getting techniques unrelated to attorney competence did not materially advance state's interest in preventing misleading advertising, as required to satisfy First Amendment limitations on regulation of commercial speech; there was no evidence that the sorts of irrelevant advertising components proscribed by the provision were, in fact, misleading. U.S.C.A. Const.Amend. 1; 22 NYCRR 1200.50(c)(5).

12. Attorney and Client ⚿32(9)
Constitutional Law ⚿2049

New York rule prohibiting attorney advertising utilizing a nickname, moniker, motto or trade name implying an ability to obtain results did not materially advance the State's interest in preventing misleading advertising, as required to satisfy First Amendment limitations on regulation of commercial speech; there was no evidence that the prohibition was needed when the names used were akin to, and no more than, the kind of puffery commonly seen and expected in commercial advertisements generally. U.S.C.A. Const.Amend. 1; 22 NYCRR 1200.50(c)(7).

13. Constitutional Law ⚿1541

Laws restricting commercial speech need only be tailored in a reasonable manner to serve a substantial state interest in order to survive First Amendment scrutiny. U.S.C.A. Const.Amend. 1.

14. Constitutional Law ⚿1624

Restrictions upon potentially deceptive speech may be no broader than reasonably necessary to prevent the deception. U.S.C.A. Const.Amend. 1.

15. Constitutional Law ⚿1541

Existence of numerous and obvious less-burdensome alternatives to restriction on commercial speech is a relevant consideration in determining whether the fit between ends and means is reasonable under the First Amendment. U.S.C.A. Const. Amend. 1.

16. Attorney and Client ⚿32(9)
Constitutional Law ⚿2049

Even if New York rules prohibiting attorney advertising containing testimonials from current clients, containing the portrayal of a judge, containing attention-getting techniques unrelated to attorney competence, or utilizing a nickname, moniker, motto or trade name implying an ability to obtain results furthered a state interest in preventing misleading advertising, rules were not narrowly tailored to further that interest, as required to satisfy First Amendment limitations on regulation of commercial speech; each rule wholly prohibited a category of advertising speech that was potentially misleading, but was not inherently or actually misleading in all cases. U.S.C.A. Const.Amend. 1; 22 NYCRR 1200.50(c).

17. Attorney and Client ⚿32(9)
Constitutional Law ⚿2049

New York rule establishing a 30-day moratorium on attorney advertising soliciting accident victims or their families furthered substantial state interest in protecting privacy and tranquility of personal injury victims and their loved ones against intrusive, unsolicited contact by lawyers, as required to satisfy First Amendment limitations on regulation of commercial speech. U.S.C.A. Const.Amend. 1; 22 NYCRR 1200.52(b).

18. Attorney and Client ⚿32(9)
Constitutional Law ⚿2049

New York rule establishing a 30-day moratorium on attorney advertising soliciting accident victims or their families was narrowly tailored to further state interest in protecting privacy and tranquility of personal injury victims and their loved ones, as required to satisfy First Amendment limitations on regulation of commercial speech, although the rule extended the moratorium to television, radio, newspaper, and Internet solicitations. U.S.C.A. Const.Amend. 1; 22 NYCRR 1200.52(b).

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Before: WALKER and CALABRESI, Circuit Judges.[1]

CALABRESI, Circuit Judge:

New York's Appellate Division adopted new rules prohibiting certain types of attorney advertising and solicitation, which were to take effect February 1, 2007. The new rules barred, *inter alia*, testimonials from clients relating to pending matters, portrayals of judges or fictitious law firms, attention-getting techniques unrelated to attorney competence, and trade names or nicknames that imply an ability to get results. The amendments also established a thirty-day moratorium for targeted solicitation following a specific incident, including targeted ads on television or in other media. Plaintiffs, a New York attorney, along with his law firm and a not-for-profit public interest organization, challenged these provisions as violating the First Amendment. The District Court agreed in part—it declared most of the content-based rules unconstitutional, while upholding the thirty-day moratorium. Both Plaintiffs and Defendants timely appealed from portions of the District Court's decision adverse to them. For the reasons that follow, we conclude that the District Court properly granted summary judgment to Plaintiffs with respect to the content-based advertising restrictions, with the exception of the prohibition on portrayals of fictitious law firms. We likewise conclude that the District Court properly granted summary judgment to Defendants with respect to the thirty-day moratorium. Accordingly, we affirm the District Court's opinion in large part, and reverse in part.

BACKGROUND

A. The Parties

The Plaintiffs–Appellees–Cross–Appellants ("Plaintiffs") are an individual (James Alexander), a law firm (Alexander & Catalano), and a not-for-profit consumer rights organization (Public Citizen). Alexander is the managing partner of Alexander & Catalano, a personal injury law firm with offices in Syracuse and Rochester. Alexander & Catalano use various broadcast and print media to advertise. Prior to the adoption of New York's new attorney advertising rules, the firm's commercials often contained jingles and special effects, including wisps of smoke and blue electrical currents surrounding the firm's name. Firm advertisements also featured drama-

1. The Honorable Sonia Sotomayor, originally a member of the panel, was elevated to the Supreme Court on August 8, 2009. The two remaining members of the panel, who are in agreement, have determined the matter. *See* 28 U.S.C. 46(d); Local Rule 0.14(d); *United States v. Desimone,* 140 F.3d 457 (2d Cir. 1998).

tizations, comical scenes, and special effects-for instance, depicting Alexander and his partner as giants towering above local buildings, running to a client's house so quickly they appear as blurs, and providing legal assistance to space aliens. Another advertisement depicted a judge in the courtroom and stated that the judge is there "to make sure [the trial] is fair." The firm's ads also frequently included the firm's slogan, "heavy hitters," and phrases like "think big" and "we'll give you a big helping hand." To date, no disciplinary actions have been brought against the firm or its lawyers based on firm advertising. The new rules, however, caused the firm to halt its advertisements for fear of such action.

Plaintiff Public Citizen is a D.C. not-for-profit corporation, with approximately 100,000 members nationwide, including roughly 10,000 in New York. Public Citizen Litigation Group is a division of Public Citizen that conducts, *inter alia, pro bono* constitutional litigation in state and federal courts on behalf of its clients. These organizations maintain a website and various blogs, and participate in distributing educational materials on various legal issues to the public.

Defendants–Appellants–Cross–Appellees ("Defendants") are the chief counsels or acting chief counsels of the disciplinary committees whose jurisdiction lies within each of the four Judicial Departments of the New York Supreme Court, Appellate Division. The Appellate Division is authorized to discipline attorneys for professional misconduct. *See* N.Y. Judiciary Law § 90(2) (McKinney 2009). Pursuant to this authority, the four presiding justices of each of New York's four departments are responsible for adopting disciplinary rules, which set the parameters for professional conduct and provide for the discipline of attorneys violating the rules. The departments have, in turn, appointed the disciplinary committees of which Defendants are a part. These committees undertake investigations into complaints of attorney misbehavior. Following an investigation, Defendants are empowered to take a number of actions with respect to a complaint, including issuing a letter of caution or recommending that formal disciplinary proceedings be started. When formal disciplinary proceedings are deemed warranted, Defendants begin such proceedings in the Appellate Division. Accordingly, Defendants are responsible for enforcing the New York Code of Professional Responsibility and the attorney disciplinary rules promulgated thereunder.

B. The Appellate Division's Adoption of the New Rules

In June 2006, the presiding justices of the four departments of the Appellate Division approved for comment draft amendments to the then-existing rules. A press release explained that the new rules were designed to protect consumers "against inappropriate solicitations or potentially misleading ads, as well as overly aggressive marketing," and to "benefit the bar by ensuring that the image of the legal profession is maintained at the highest possible level." Following a comment period, the presiding justices issued final rules. These rules were set to take effect on February 1, 2007.

We consider below a subset of these final rules, which we subdivide into two categories. The first group of amendments imposes a series of content-based restrictions:

> N.Y. Comp.Codes R. & Regs., tit. 22, § 1200.50(c):
>
> (c) An advertisement shall not:
>
> (1) include an endorsement of, or testimonial about, a lawyer or law firm

from a client with respect to a matter that is still pending . . .

(3) include the portrayal of a judge, the portrayal of a fictitious law firm, the use of a fictitious name to refer to lawyers not associated together in a law firm, or otherwise imply that lawyers are associated in a law firm if that is not the case . . .

(5) rely on techniques to obtain attention that demonstrate a clear and intentional lack of relevance to the selection of counsel, including the portrayal of lawyers exhibiting characteristics clearly unrelated to legal competence . . .

(7) utilize a nickname, moniker, motto or trade name that implies an ability to obtain results in a matter.[2]

The second group of amendments imposes a thirty-day moratorium on certain communications following a personal injury or wrongful death event:

N.Y. Comp.Codes R. & Regs., tit. 22, § 1200.52: Solicitation and Recommendation of Professional Employment

(b) For purposes of this Rule, "solicitation" means any advertisement initiated by or on behalf of a lawyer or law firm that is directed to, or targeted at, a specific recipient or group of recipients, or their family members or legal representatives, the primary purpose of which is the retention of the lawyer or law firm, and a significant motive for which is pecuniary gain. It does not include a proposal or other writing prepared and delivered in response to a specific request of a prospective client.

(e) No solicitation relating to a specific incident involving potential claims for personal injury or wrongful death shall be disseminated before the 30th day after the date of the incident, unless a filing must be made within 30 days of the incident as a legal prerequisite to the particular claim, in which case no unsolicited communication shall be made before the 15th day after the date of the incident.

N.Y. Comp.Codes R. & Regs., tit. 22 § 1200.36: Communication after Incidents Involving Personal Injury or Wrongful Death

(a) In the event of a specific incident involving potential claims for personal injury or wrongful death, no unsolicited communication shall be made to an individual injured in the incident or to a family member or legal representative of such an individual, by a lawyer or law firm, or by any associate, agent, employee or other representative of a lawyer or law firm representing actual or potential defendants or entities that may defend and/or indemnify said defendants, before the 30th day after the date of the incident, unless a filing must be made within 30 days of the incident as a legal prerequisite to the particular claim, in which case no unsolicited communication shall be made before the 15th day after the date of the incident.

(b) An unsolicited communication by a lawyer or law firm, seeking to represent an injured individual or the legal

2. At the time this action was argued, these provisions appeared at N.Y. Comp.Codes R. & Regs., tit. 22, § 1200.6(c). They appear at their present location without change.

An attorney "advertisement" is defined by N.Y. Comp.Codes R. & Regs., tit. 22, § 1200.0(a) as "any public or private communication made by or on behalf of a lawyer or law firm about that lawyer or law firm's services, the primary purpose of which is for the retention of the lawyer or law firm. It does not include communications to existing clients or other lawyers."

representative thereof under the circumstance described in paragraph (a) shall comply with [§ 1200.52(e)].[3]

C. The Present Action and District Court Decision

Plaintiffs filed their complaint on February 1, 2007, the date on which the new rules were to take effect. They sought declaratory and injunctive relief from several of the new rules, including all those set forth above. Plaintiffs contended that these rules infringed their First Amendment rights because the rules prohibited "truthful, non-misleading communications that the state has no legitimate interest in regulating." Plaintiffs moved for a preliminary injunction against enforcement of the rules, and Defendants moved to dismiss the complaint for, *inter alia*, lack of standing. The District Court (Scullin, *J.*) reserved decision on Plaintiffs' motion and denied Defendants' cross-motion. *Alexander v. Cahill*, No. 5:07–cv–117, 2007 WL 1202402, 2007 U.S. Dist. LEXIS 29823 (N.D.N.Y. Apr. 23, 2007). Thereafter, the parties stipulated to a set of facts and exhibits that became the basis for competing motions for summary judgment.

On July 23, 2007, the District Court filed its Memorandum–Decision and Order granting partial summary judgment to Plaintiffs and partial summary judgment to Defendants. *Alexander v. Cahill*, 634 F.Supp.2d 239 (N.D.N.Y.2007). Principally, the District Court found unconstitutional the disputed provisions of § 1200.50(c) set forth above, while concluding that the thirty-day moratorium provisions survived constitutional scrutiny.[4]

Throughout its opinion, the District Court applied the test for commercial speech set forth in *Central Hudson*, which considers whether (1) the speech is protected by the First Amendment; (2) there is a substantial state interest to be achieved by the restriction; (3) the restriction materially advances the state interest; and (4) the restriction is narrowly drawn. *See Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of N.Y.*, 447 U.S. 557, 564–66, 100 S.Ct. 2343, 65 L.Ed.2d 341 (1980). The District Court rejected Defendants' claim that "the State of New York could ban attorney advertising that was 'irrelevant, unverifiable, [and] non-informational' without reference to the *Central Hudson* test." *Alexander*, 634 F.Supp.2d at 246 n. 4. It concluded: "Defendants have provided no legal support for this proposition, and the Court finds none. Although these characteristics may be evidence that an advertisement is misleading, they do not by themselves constitute a justification for banning commercial speech in the form of attorney advertising." *Id.*

Turning to the amendments that restricted potentially misleading advertisements, including the disputed provisions of § 1200.50(c), the District Court found that Defendants' stated interest in protecting

3. At the time this action was argued, these provisions appeared at N.Y. Comp.Codes R. & Regs., tit. 22, §§ 1200.8 and 1200.41, respectively. Former § 1200.8 appears unchanged at § 1200.52. Former § 1200.41, which now appears at § 1200.36, has changed by shifting between subsections (a) and (b) the class of lawyers and law firms it addresses. The parties have not briefed the relevance, if any, of this change. We accordingly read the change to be immaterial to this appeal.

4. The District Court made several additional rulings that are not at issue in these appeals. Most importantly, the District Court accepted a narrowing construction of the amendments as inapplicable to non-commercial attorney communications. On this basis, the District Court granted Defendants' summary judgment motion as to Plaintiffs' claims regarding application of the rules to non-commercial speech. *Alexander*, 634 F.Supp.2d at 255–56.

consumers from misleading attorney advertisements was a substantial one. *Id.* at 247–48. Under *Central Hudson*'s penultimate prong, which requires that the regulation materially advance the state's interest, however, the District Court concluded that the record was "notably lacking." *Id.* at 248. The District Court gave considerable weight to Defendants' reliance on the New York State Bar Association's Task Force Report on Lawyer Advertising, but concluded that the Report provided sufficient support only for two amendments: the prohibition on the portrayal of judges in attorney advertisements, and the prohibition on the use of trade names that imply an ability to get results. *Id.* at 248–49. As to the remaining disputed portions of § 1200.50(c), the District Court emphasized that the Task Force Report had recommended disclosure and invigorated enforcement of existing rules, rather than any new content-based restrictions. *Id.* at 249. Finally, the District Court found that the two amendments that materially advanced New York's interest in preventing misleading advertising did not do so in a sufficiently narrowly tailored fashion. The District Court criticized Defendants for failing "to produce any evidence that measures short of categorical bans would not have sufficed to remedy the perceived risks of such advertising being misleading." *Id.* at 250. The District Court therefore concluded that all of the disputed portions of § 1200.50(c) failed the *Central Hudson* test.

With regard to the thirty-day moratorium on contacting victims, the District Court reached the opposite conclusion. The District Court recognized that New York's moratorium is broader than the Florida moratorium sustained by the Supreme Court in *Florida Bar v. Went For It, Inc.*, 515 U.S. 618, 115 S.Ct. 2371, 132 L.Ed.2d 541 (1995). Florida's moratorium was limited to direct-mail solicitation, while New York's provisions "extend by their plain language to television, radio, newspaper, and website solicitations that are directed to or targeted at a specific recipient or group of recipients." *Alexander*, 634 F.Supp.2d at 253. Nonetheless, the District Court concluded that New York's moratorium materially advanced state interests in protecting the privacy of citizens and guarding against the indignity of being solicited for legal services immediately following a personal injury or a wrongful death event, and did so in a reasonably proportionate manner. *Id.* at 253–55. The District Court relied on "an emerging consensus among authorities, state and federal, regarding the desirability of some form of moratorium," citing the Task Force Report's review of direct-mail moratoria in Florida and eight other states, the federal airline disaster moratorium (which prohibits not only direct-mail solicitation, but "unsolicited communications" generally for a forty-five day period, 49 U.S.C. § 1136), and the Supreme Court's opinion in *Florida Bar. Alexander*, 634 F.Supp.2d at 254. The District Court also noted "the existence of 'ample alternative channels' for the public to receive information concerning legal services during the moratorium period—namely, general advertisements in any media, provided they do not reference a specific tragedy." *Id.* (quoting *Florida Bar*, 515 U.S. at 633–34, 115 S.Ct. 2371).

DISCUSSION

This case calls on us once again to assess the scope of First Amendment protection accorded to commercial speech, and the measure of evidence a state must present in regulating such speech. Because this action was resolved on summary judgment, we review the District Court's decision *de novo*, drawing all factual inferences in favor of the non-moving party. *Miller*

v. Wolpoff & Abramson, L.L.P., 321 F.3d 292, 300 (2d Cir.2003).

The Supreme Court has established a four-part inquiry for determining whether regulations of commercial speech are consistent with the First Amendment:

> [1] whether the expression is protected by the First Amendment. For commercial speech to come within that provision, it at least must concern lawful activity and not be misleading. Next, we ask [2] whether the asserted governmental interest is substantial. If both inquiries yield positive answers, we must determine [3] whether the regulation directly advances the governmental interest asserted, and [4] whether it is not more extensive than is necessary to serve that interest.

Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of N.Y., 447 U.S. 557, 566, 100 S.Ct. 2343, 65 L.Ed.2d 341 (1980).[5]

A. The Disputed Provisions Regulate Commercial Speech Protected by the First Amendment

[1] Defendants' appeal challenges the District Court's threshold conclusion as to the first prong of this inquiry—that the First Amendment protects advertising that is irrelevant, unverifiable, and non-informational. Although they do not dispute that New York's thirty-day moratorium provisions regulate protected commercial speech, Defendants argue strenuously to us that New York's content-based restrictions regulate speech that is not entitled to First Amendment protection at all.

The Supreme Court first recognized attorney advertising as within the scope of protected speech in *Bates v. State Bar of Arizona*, 433 U.S. 350, 97 S.Ct. 2691, 53 L.Ed.2d 810 (1977), in which the Court invalidated a ban on price advertising for what the Court deemed "routine" legal services. In so doing, the Court reserved the question of whether similar protection would extend to "advertising claims as to the quality of services [that] are not susceptible of measurement or verification." *Id.* at 383, 97 S.Ct. 2691.

In the years since *Bates*, the Supreme Court has offered differing, and not always fully consistent, descriptions as to what constitutes protected commercial speech, particularly with respect to attorney advertising. Speaking generally, the Supreme Court has said that states may impose regulations to ensure that "the stream of commercial information flow[s] cleanly as well as freely." *Va. Bd. of Pharmacy v. Va. Citizens Consumer Council*, 425 U.S. 748, 772, 96 S.Ct. 1817, 48 L.Ed.2d 346 (1976). But this Court has nonetheless observed that there are "doctrinal uncertainties left in the wake of Supreme Court decisions from which the modern commercial speech doctrine has evolved. In particular, these decisions have created some uncertainty as to the degree of protection for commercial advertising that lacks precise informational content." *Bad Frog Brewery, Inc. v. N.Y. State Liquor Auth.*, 134 F.3d 87, 94 (2d Cir.1998)

5. The Supreme Court has variously described the *Central Hudson* test as having three or four prongs, depending on whether the preliminary inquiry into whether the content to be regulated is protected is counted as a prong. *Compare 44 Liquormart, Inc. v. Rhode Island.*, 517 U.S. 484, 500 n. 9, 116 S.Ct. 1495, 134 L.Ed.2d 711 (1996) (describing the test as having four prongs), *with Florida Bar v. Went For It, Inc.*, 515 U.S. 618, 624, 115 S.Ct. 2371, 132 L.Ed.2d 541 (1995) (describing the test as having three prongs). Defendants' appeal focuses, among other things, on whether certain commercial speech is entitled to First Amendment protection at all. Because the three-part locution of the *Central Hudson* test assumes such an inquiry, we adopt the four-part locution throughout.

In the end, we agree with the District Court that, with one exception discussed below, the content-based restrictions in the disputed provisions of § 1200.50(c) regulate commercial speech protected by the First Amendment. In almost every instance, descriptions of the first prong of the *Central Hudson* test are phrased in the negative, and the only categories that *Central Hudson*, and its *sequellae*, clearly excludes from protection are speech that is false, deceptive, or misleading, and speech that concerns unlawful activities. *See, e.g., Florida Bar*, 515 U.S. at 623–24, 115 S.Ct. 2371 ("[T]he government may freely regulate commercial speech that concerns unlawful activity or is misleading. Commercial speech that falls into neither of those categories ... may be regulated if the government satisfies [*Central Hudson*'s remaining three prongs]." (citation omitted)); *Ibanez v. Fl. Dep't of Bus. & Prof'l Regulation, Bd. of Accountancy*, 512 U.S. 136, 142, 114 S.Ct. 2084, 129 L.Ed.2d 118 (1994) ("[O]nly false, deceptive, or misleading commercial speech may be banned."). The Supreme Court has also emphasized that "States may not place an absolute prohibition on certain types of potentially misleading information ... if the information also may be presented in a way that is not deceptive." *In re R.M.J.*, 455 U.S. 191, 203, 102 S.Ct. 929, 71 L.Ed.2d 64 (1982); *see also, e.g., Peel v. Attorney Registration & Disciplinary Comm'n of Ill.*, 496 U.S. 91, 100–01, 110 S.Ct. 2281, 110 L.Ed.2d 83 (1990); *Shapero v. Ky. Bar Ass'n*, 486 U.S. 466, 479, 108 S.Ct. 1916, 100 L.Ed.2d 475 (1988); *Zauderer v. Office of Disciplinary Counsel of the Supreme Court of Ohio*, 471 U.S. 626, 644, 105 S.Ct. 2265, 85 L.Ed.2d 652 (1985). We conclude from these precedents that the *Central Hudson* analysis applies to regulations of commercial speech that is only *potentially* misleading.[6]

The speech that Defendants' content-based restrictions seeks to regulate—that which is irrelevant, unverifiable, and non-informational—is not inherently false, deceptive, or misleading. Defendants' own press release described its proposed rules as protecting consumers against "*potentially* misleading ads." This is insufficient to place these restrictions beyond the scope of First Amendment scrutiny.[7]

[2] There is one exception to this conclusion. Subsection 1200.50(c)(3) prohibits "the portrayal of a fictitious law firm, the use of a fictitious name to refer to lawyers not associated together in a law firm, or

6. Moreover, in this Court's lead opinion on the matter, we have stated generally, in the context of product advertising, that "minimal information, conveyed in the context of a proposal of a commercial transaction, suffices to invoke the protections for commercial speech, articulated in *Central Hudson*." *Bad Frog Brewery*, 134 F.3d at 97.

7. Defendants contend that their relevance and verifiability requirements were, in fact, adopted by the Supreme Court by way of summary dismissal. *Comm. on Professional Ethics & Conduct of the Iowa State Bar Assoc. v. Humphrey*, 355 N.W.2d 565 (Iowa 1984), *vacated and remanded*, 472 U.S. 1004, 105 S.Ct. 2693, 86 L.Ed.2d 710 (1985), *after remand*, 377 N.W.2d 643 (Iowa 1985), *appeal dismissed for want of a substantial federal question*, 475 U.S. 1114, 106 S.Ct. 1626, 90 L.Ed.2d 174 (1986). We do not find the Iowa Supreme Court's analysis in *Humphrey* persuasive. And we comment on *Humphrey* also to draw attention to the well-established limits on the precedential value of summary dismissals of this kind. The Supreme Court has long recognized that the precedential value of a summary dismissal is limited to "the precise issues presented and necessarily decided by" the dismissal. *Mandel v. Bradley*, 432 U.S. 173, 176, 97 S.Ct. 2238, 53 L.Ed.2d 199 (1977). Accordingly, we need not conclude that New York's content-restrictions are permissible simply because the Iowa Supreme Court upheld Iowa's regulations summarily following an earlier remand.

otherwise imply that lawyers are associated in a law firm if that is not the case." N.Y. Comp.Codes R. & Regs., tit. 22, § 1200.50(c)(3). The District Court invalidated § 1200.50(c)(3) in its entirety. *Alexander*, 634 F.Supp.2d at 249. Plaintiffs acknowledge, however, that they intended to challenge only the first clause of this subsection—prohibiting portrayals of judges—and they do not oppose Defendants' appeal seeking reinstatement of the prohibition on fictitious firms.

The provision prohibiting advertisements including fictitious firms is susceptible to more than one interpretation. But we need not decide whether it would be constitutional to prohibit dramatizations in which an advertising law firm portrays itself arguing against a fictitious opposing counsel. At oral argument, the Attorney General, representing the Defendants, suggested a narrower interpretation of this regulation. He asked that we construe this language as applying only to situations in which lawyers from different firms give the misleading impression that they are from the same firm (i.e., "The Dream Team"). (Oral Arg. ~ 12:38:25) We accept this interpretation. So read, this portion of § 1200.50(c)(3) addresses only attorney advertising techniques that are actually misleading (as to the existence or membership of a firm), and such advertising is not entitled to First Amendment protection. *See Florida Bar*, 515 U.S. at 623–24, 115 S.Ct. 2371. Accordingly, and subject to the above-mentioned construction, we reverse the District Court's invalidation of that portion of § 1200.50(c)(3) that prohibits advertisements that include fictitious firms.

[3] Having concluded that the remainder of the disputed regulations falls within the zone of protected commercial speech, we turn to the rest of the *Central Hudson* test. The Supreme Court has explained that "[c]ommercial speech that is not false or deceptive and does not concern unlawful activities may be restricted only in the service of a substantial governmental interest, and only through means that directly advance that interest." *Shapero*, 486 U.S. at 472, 108 S.Ct. 1916 (quotation marks and alteration omitted). "The party seeking to uphold a restriction on commercial speech carries the burden of justifying it." *Edenfield v. Fane*, 507 U.S. 761, 770, 113 S.Ct. 1792, 123 L.Ed.2d 543 (1993) (quotation marks and alteration omitted). We apply the three remaining prongs of *Central Hudson*, in turn, to each of the two categories of regulations set forth above.

B. Central Hudson *and the Content–Based Regulations*

1. Substantial Interest

[4–6] Under the second prong of *Central Hudson*, the State must identify "a substantial interest in support of its regulation[s]." *Florida Bar*, 515 U.S. at 624, 115 S.Ct. 2371. "[T]he *Central Hudson* standard does not permit us to supplant the precise interests put forward by the State with other suppositions." *Id.* at 624, 115 S.Ct. 2371 (quotation marks omitted). Before the District Court and again on appeal, Defendants proffered a state interest in "prohibiting attorney advertisements from containing deceptive or misleading content." (Appellants' Br. 32) The report by the New York State Bar Association's Task Force on Lawyer Advertising (hereinafter, the "Task Force Report" or "Report"), which the State considered in formulating its new rules and which constitutes the bulk of the record on appeal, indicates that this is a proper and genuinely asserted interest. The Task Force Report identified protecting the public "by prohibiting advertising and solicitation practices that disseminate false or mis-

leading information" as one of its key concerns. (Task Force Report 1–2) This state interest is substantial—indeed, states have a generally unfettered right to prohibit inherently or actually misleading commercial speech. *See, e.g., Edenfield*, 507 U.S. at 769, 113 S.Ct. 1792 ("[T]here is no question that [the State's] interest in ensuring the accuracy of commercial information in the marketplace is substantial."); *In re R.M.J.*, 455 U.S. at 207, 102 S.Ct. 929 ("States retain the authority to regulate advertising that is inherently misleading or that has proved to be misleading in practice."). The disputed regulations codified at § 1200.50(c) therefore survive the second prong of the *Central Hudson* analysis.[8]

Defendants also assert an interest in "protecting the legal profession's image and reputation." (Appellants' Reply 30) In *Florida Bar*, the Supreme Court recognized a substantial interest "in preventing the erosion of confidence in the [legal] profession." *Florida Bar*, 515 U.S. at 635, 115 S.Ct. 2371. Defendants explain that their interest in preventing misleading attorney advertising is "inextricably linked to its overarching interest" in maintaining attorney professionalism and respect for the bar. (Appellants' Reply 30) This interest also supports the disputed regulations.[9]

2. Materially Advanced

[7, 8] "The penultimate prong of the *Central Hudson* test requires that a regulation impinging upon commercial expression 'directly advance the state interest involved; the regulation may not be sustained if it provides only ineffective or remote support for the government's purpose.' " *Edenfield*, 507 U.S. at 770, 113 S.Ct. 1792 (quoting *Central Hudson*, 447 U.S. at 564, 100 S.Ct. 2343). The state's burden with respect to this prong "is not satisfied by mere speculation or conjecture; rather, a governmental body seeking to sustain a restriction on commercial speech must demonstrate that the harms it recites are real and that its restrictions will in fact alleviate them to a material degree." *Florida Bar*, 515 U.S. at 626, 115 S.Ct. 2371 (quotation marks omitted). Moreover, "[i]f the protections afforded commercial speech are to retain their force, we cannot allow rote invocation of the words 'potentially misleading' to supplant" this burden. *Ibanez*, 512 U.S. at 146, 114 S.Ct. 2084 (internal quotation marks and citation omitted).

Invalidating a regulation of commercial speech for lack of sufficient evidence under this prong of *Central Hudson* does not

8. Defendants at times assert an interest in "ending attorney advertising that is potentially deceptive or misleading." (Appellants' Br. 36) It is not clear, however, that a state has a substantial interest in prohibiting *potentially* misleading advertising, as opposed to inherently or actually misleading advertising. "If the protections afforded commercial speech are to retain their force, we cannot allow rote invocation of the words 'potentially misleading' to supplant" the State's burden. *Ibanez*, 512 U.S. at 146, 114 S.Ct. 2084 (internal quotation marks and citation omitted). Moreover, it is unclear what harm *potentially* misleading advertising creates, and the state bears the burden of proving "that the harms it recites are real and that its restrictions will in fact alleviate them to a material degree." *Florida Bar*, 515 U.S. at 626, 115 S.Ct. 2371 (quotation marks omitted). We need not resolve this issue in order to decide this case, and so we leave it for a future case.

9. In defending the restriction on testimonials by clients with pending matters, Defendants assert a state interest in preserving the integrity of the attorney-client relationship. (Appellants' Br. 39–40) Defendants did not assert this interest before the District Court, however, and so we do not consider it on appeal. *See Virgilio v. City of New York*, 407 F.3d 105, 116 (2d Cir.2005) ("In general we refrain from passing on issues not raised below.") (quotation marks omitted).

foreclose a similar regulation being enacted validly in the future. Rather, such invalidation returns the matter to the applicable legislating body and "forces [that body] to take a 'second look' with the eyes of the people on it." Guido Calabresi, *Foreward: Antidiscrimination and Constitutional Accountability (What the Bork–Brennan Debate Ignores),* 105 Harv. L. Rev. 80, 104 (1991); *see also Benjamin v. Jacobson,* 172 F.3d 144, 190 (2d Cir. 1999) (en banc) (Calabresi, *J.,* concurring in the result).

In defending the disputed § 1200.50(c) provisions, Defendants rely on three sources of evidence: (1) "history, consensus, and simple common sense," *Florida Bar,* 515 U.S. at 628, 115 S.Ct. 2371 (quotation marks omitted), including regulations of attorney advertising in other states; (2) existing and unchallenged rules already in New York's Code of Professional Responsibility targeting advertising similar to that targeted by the new amendments; and (3) the New York State Bar Association's Task Force Report. Defendants have not submitted any statistical or anecdotal evidence of consumer problems with or complaints of the sort they seek to prohibit. Nor have they specifically identified any studies from other jurisdictions on which the state relied in implementing the amendments. *See Alexander,* 634 F.Supp.2d at 248. Against this background, we test each of the disputed § 1200.50(c) provisions.

a. Subsection 1200.50(c)(1): Client Testimonials

[9] This subsection prohibits advertisements that include "an endorsement of, or testimonial about, a lawyer or law firm from a client with respect to a matter that is still pending." N.Y. Comp.Codes R. & Regs., tit. 22, § 1200.50(c)(1). The Task Force Report observed that testimonials can be misleading because they may suggest that past results indicate future performance. (Task Force Report 26–27) The Task Force Report, however, did not recommend outright prohibitions of all testimonials on this basis. Instead, as the District Court observed, the Task Force Report "recommended a different approach." *Alexander,* 634 F.Supp.2d at 249. The Report suggested "strengthening the rules governing testimonials to prohibit the use of an actor or spokesperson who is not a member or employee of the advertising lawyer or law firm *absent disclosure thereof.*" (Task Force Report 27) (emphasis added). The Task Force noted, moreover, that "it would be an improper restriction on a client's free speech rights to prohibit client testimonials outright." (*Id.*) The Task Force Report therefore does not support Defendants' assertion that prohibiting testimonials from current clients will materially advance an interest in preventing misleading advertising. Indeed, the Report "contradicts, rather than strengthens, the Board's submissions." *Edenfield,* 507 U.S. at 772, 113 S.Ct. 1792.

Nor does consensus or common sense support the conclusion that client testimonials are inherently misleading. Testimonials may, for example, mislead if they suggest that past results indicate future performance—but not all testimonials will do so, especially if they include a disclaimer. The District Court properly concluded that Defendants failed to satisfy this prong of *Central Hudson* with respect to client testimonials.

b. Subsection 1200.50(c)(3): Portrayal of a Judge

[10] This subsection prohibits "the portrayal of a judge." N.Y. Comp.Codes R. & Regs., tit. 22, § 1200.50(c)(3).[10] The Task

10. Subsection 1200.50(c)(3) also includes the prohibition on fictitious law firms discussed

Force Report observes that "a communication that states or implies that the lawyer has the ability to influence improperly a court" is "likely to be false, deceptive, or misleading." (Task Force Report, App. I, 11) The District Court found this comment to be persuasive evidence that a ban on portrayals of judges would materially advance the State's interest in preventing misleading advertising. We disagree. Although it seems plainly true that implying an ability to influence a court is likely to be misleading, Defendants have failed to draw the requisite connection between that common sense observation and portrayals of judges in advertisements generally. The advertisement in which Alexander & Catalano use the portrayal of a judge, for instance, depicts a judge in the courtroom and states that the judge is there "to make sure [the trial] is fair." This sort of advertisement does not imply an ability to influence a court improperly. It is not misleading; an advertisement of this sort may, instead, be informative. We believe the Task Force Report fails to support Defendants' prohibition on portrayals of judges [11] and conclude that Defendants have not met their burden with respect to the wholesale prohibition of portrayals of judges. This prohibition consequently must fall.

c. Subsection 1200.50(c)(5): Irrelevant Techniques

[11] This subsection prohibits advertisements that "rely on techniques to obtain attention that demonstrate a clear and intentional lack of relevance to the selection of counsel, including the portrayal of lawyers exhibiting characteristics clearly unrelated to legal competence." N.Y. Comp.Codes R. & Regs., tit. 22, § 1200.50(c)(5). Defendants note that the New York Code of Professional Responsibility has long declared that the purpose of attorney advertising is to "educate the public to an awareness of legal needs and to provide information relevant to the selection of the most appropriate counsel." (Appellants' Br. 33–34) (quotation marks omitted) Defendants contend that their rule excluding attention-getting techniques unrelated to attorney competence reflects this principle and so materially advances "New York's interest in factual, relevant attorney advertisements." (Appellants' Br. 35)

A rule barring irrelevant advertising components certainly advances an interest in keeping attorney advertising factual and relevant. But this interest is quite different from an interest in preventing misleading advertising. Like Defendants' claim that the First Amendment does not protect irrelevant and unverifiable components in advertising, Defendants here appear to conflate *irrelevant* components of advertising with *misleading* advertising. These are not one and the same. Questions of taste or effectiveness in advertising are generally matters of subjective judgment. Moreover, as the Task Force Report acknowledged, "Limiting the information that may be advertised ... assumes that the bar can accurately forecast the kind of information that the public would regard as relevant." (Task Force Report, App. I, 8)

in section *A* above.

11. New York's existing rule prohibiting attorneys from stating or implying that they are able "to influence improperly or upon irrelevant grounds any tribunal, legislative body, or public official," N.Y. Comp.Codes R. & Regs., tit. 22, § 1200.58(e)(1), does not support the new rule. On the contrary, this rule mirrors the Task Force Report's remarks, and does not suggest that any and all portrayals of judges imply the capacity to exercise improper influence over a court or other government body.

Defendants have introduced no evidence that the sorts of irrelevant advertising components proscribed by subsection 1200.50(c)(5) are, in fact, misleading and so subject to proscription. Significantly, the Task Force Report expressly recognized that "communications involving puffery and claims that cannot be measured or verified" were not specifically addressed in its proposed rules, although such communications would already be prohibited "to the extent that they are false, deceptive or misleading." (Task Force Report, App. I, 9) Insofar as the Task Force Report touched on style and advertising gimmicks designed to draw attention, its recommendations were hortatory only. (*See* Task Force Report 70) (quoting the Monroe County Bar Association Project exhorting—but not requiring—lawyers and firms to include only "factually accurate and objectively verifiable" information in their advertisements, and to minimize devices such as puffery in favor of information "relevant to the thoughtful selection of counsel").

Moreover, the sorts of gimmicks that this rule appears designed to reach—such as Alexander & Catalano's wisps of smoke, blue electrical currents, and special effects—do not actually seem likely to mislead. It is true that Alexander and his partner are not giants towering above local buildings; they cannot run to a client's house so quickly that they appear as blurs; and they do not actually provide legal assistance to space aliens. But given the prevalence of these and other kinds of special effects in advertising and entertainment, we cannot seriously believe—purely as a matter of "common sense"—that ordinary individuals are likely to be misled into thinking that these advertisements depict true characteristics. Indeed, some of these gimmicks, while seemingly irrelevant, may actually serve "important communicative functions: [they] attract[ ] the attention of the audience to the advertiser's message, and [they] may also serve to impart information directly." *Zauderer*, 471 U.S. at 647, 105 S.Ct. 2265. Plaintiffs assert that they use attention-getting techniques to "communicate ideas in an easy-to-understand form, to attract viewer interest, to give emphasis, and to make information more memorable." (Appellees' Br. 36) Defendants provide no evidence to the contrary; nor do they provide evidence that consumers have, in fact, been misled by these or similar advertisements. Absent such, or similar, evidence, Defendants cannot meet their burden for sustaining subsection 1200.50(c)(5)'s prohibition under *Central Hudson*.

d. Section 1200.50(c)(7): Nicknames, Mottos, and Trade Names

[12] This subsection bars advertisements "utiliz[ing] a nickname, moniker, motto or trade name that implies an ability to obtain results in a matter." N.Y. Comp. Codes R. & Regs., tit. 22, § 1200.50(c)(7). We conclude, once again, that the evidence on which Defendants rely fails to support this regulation.

There is a compelling, commonsense argument that, given the uncertainties of litigation, names that imply an ability to obtain results are usually misleading. The Task Force Report made precisely this observation, stating in its recommendations that "the use of dollar signs, the terms 'most cash' or 'maximum dollars,' or like terms that suggest the outcome of the legal matter" is "likely to be false, deceptive or misleading." (Task Force Report, App. I, 11–12) Like its recommendations on irrelevant advertising techniques, however, the Task Force Report did not recommend outright prohibition of all such trade names or mottos—it simply acknowledged that such names are often misleading. Defendants' rule, by contrast, goes

further and prohibits such descriptors—including, according to the Attorney General, Alexander & Catalano's own "Heavy Hitters" motto—even when they are not actually misleading. The Task Force Report therefore fails to support Defendants' considerably broader rule.

Nor are we persuaded as to this rule's constitutionality by reference to *Friedman v. Rogers,* 440 U.S. 1, 99 S.Ct. 887, 59 L.Ed.2d 100 (1979), in which the Supreme Court upheld a prohibition on optometrist trade names. There is doubt as to *Friedman*'s continued vitality. *Friedman* preceded *Central Hudson* by nine years and did not employ *Central Hudson*'s multifactor First Amendment analysis. As this Court previously observed in *Bad Frog Brewery,* subsequent Supreme Court precedent has undermined *Friedman* and moved in the direction of greater First Amendment protection for "a logo or a slogan that conveys no information, other than identifying the source of the product, but that serves, to some degree, to 'propose a commercial transaction.' " 134 F.3d at 96 (quoting *Posadas de Puerto Rico Assocs. v. Tourism Co. of P.R.,* 478 U.S. 328, 340, 106 S.Ct. 2968, 92 L.Ed.2d 266 (1986)). Accordingly, we decline to rely solely on *Friedman* to uphold § 1200.50(c)(7) given the subsequent precedential developments establishing more specific and demanding burdens of evidence on the state.

Moreover, in *Friedman* itself, the state marshaled substantially stronger and more specific evidence supporting its prohibition on trade names than was done in this case. *See, e.g., Friedman,* 440 U.S. at 13–15, 99 S.Ct. 887. There is a dearth of evidence in the present record supporting the need for § 1200.50(c)(7)'s prohibition on names that imply an ability to get results when the names are akin to, and no more than, the kind of puffery that is commonly seen, and indeed expected, in commercial advertisements generally. Defendants have once again failed to provide evidence that consumers have, in fact, been misled by the sorts of names and promotional devices targeted by § 1200.50(c)(7), and so have failed to meet their burden for sustaining this prohibition under *Central Hudson.*

3. Narrowly Tailored

[13–15] The final prong of *Central Hudson* asks whether the "fit" between the goals identified (the state's interests) and the means chosen to advance these goals is reasonable; the fit need not be perfect. *Florida Bar,* 515 U.S. at 632, 115 S.Ct. 2371. As this Court has explained, " 'laws restricting commercial speech ... need only be tailored in a *reasonable manner* to serve a substantial state interest in order to survive First Amendment scrutiny.' " *N.Y. State Ass'n of Realtors v. Shaffer,* 27 F.3d 834, 842 (2d Cir.1994) (quoting *Edenfield,* 507 U.S. at 767, 113 S.Ct. 1792). Nonetheless, "restrictions upon [potentially deceptive speech] may be no broader than reasonably necessary to prevent the deception." *In re R.M.J.,* 455 U.S. at 203, 102 S.Ct. 929. "[T]he existence of numerous and obvious less-burdensome alternatives to the restriction on commercial speech is certainly a relevant consideration in determining whether the 'fit' between ends and means is reasonable." *Florida Bar,* 515 U.S. at 632, 115 S.Ct. 2371 (quotation marks and alteration omitted). More precisely, the Supreme Court has emphasized that "States may not place an absolute prohibition on certain types of potentially misleading information ... if the information also may be presented in a way that is not deceptive." *In re R.M.J.,* 455 U.S. at 203, 102 S.Ct. 929. And the Supreme Court has also affirmed that a state may not impose a prophylactic ban on potentially misleading speech merely to spare itself the trouble of "distinguishing

the truthful from the false, the helpful from the misleading, and the harmless from the harmful." *Zauderer*, 471 U.S. at 646, 105 S.Ct. 2265.

[16] On this basis, even if we were to find that all of the disputed Section 1200.50(c) restrictions [12] survived scrutiny under *Central Hudson*'s third prong, each would fail the final inquiry because each wholly prohibits a category of advertising speech that is *potentially* misleading, but is not inherently or actually misleading in all cases. Contrary to Defendants' assertions, the fact that New York's rules do also permit substantial information in attorney advertising does not render the disputed provisions any less categorical. Significantly, *Zauderer* deemed a rule barring illustrations a "blanket ban." *Zauderer*, 471 U.S. at 648, 105 S.Ct. 2265. And New York's rules prohibiting, *inter alia*, all testimonials by current clients, all portrayals of judges, and all depictions of lawyers exhibiting characteristics unrelated to legal competence are similarly categorical. Because these advertising techniques are no more than potentially misleading, the categorical nature of New York's prohibitions would alone be enough to render the prohibitions invalid.

Moreover, "nowhere does the State cite any evidence or authority of any kind for its contention that the potential abuses associated with the [disputed provisions] cannot be combated by any means short of a blanket ban." *Zauderer*, 471 U.S. at 648, 105 S.Ct. 2265; *see also Peel*, 496 U.S. at 109, 110 S.Ct. 2281 (noting that the mere potential for misleading "does not satisfy the State's heavy burden of justifying a categorical prohibition"). As the District Court observed, the State could have, for example, required disclaimers similar to the one already required for fictional scenes. *Alexander*, 634 F.Supp.2d at 250; *see* N.Y. Comp.Codes R. & Regs., tit. 22, § 1200.50(c)(4) (fictional scenes). Nothing in the record suggests that such disclaimers would have been ineffective.

The materials in the record show, instead, that disclaimers and other regulations short of content-based bans were in fact suggested. The Task Force "agreed at the outset to deal in practical solutions (*i.e.*, generally strengthening existing disclaimers and requiring further disclosures) without adding content-based restrictions." (Task Force Report 2) Nearly all of the Report's recommendations followed this general rule. And in comments responding to New York's draft rules, the Federal Trade Commission, "which has a long history of reviewing claims of deceptive advertising," *Peel*, 496 U.S. at 105, 110 S.Ct. 2281, similarly stated its belief that New York could adequately protect consumers "using less restrictive means such as requiring clear and prominent disclosure of certain information." (Letter from the FTC's Office of Policy Planning, Bureau of Consumer Protection, and Bureau of Economics to Michael Colodner, Office of Court Administration (Sept. 14, 2006))

Defendants have failed to carry their burden with respect to *Central Hudson*'s final prong. We therefore conclude, like the District Court, that the disputed portions of subsections 1200.50(c)(1), (3), (5), and (7) are unconstitutional. In so doing, we return this matter to the Appellate Division, where that body may "take a 'second look' with the eyes of the people on it." Calabresi, *Foreward*, *supra*, at 104.

C. Central Hudson *and the Moratorium Provisions*

Plaintiffs' cross-appeal challenges the District Court's decision upholding New

12. Excepting, of course, the prohibition on fictitious firms, which, as explained in section *A* above, addresses inherently misleading advertising that need not be scrutinized under the remaining *Central Hudson* prongs.

York's time-limited moratorium on solicitation of accident victims or their families. "In cases where a legal filing is required within thirty days, the moratorium is limited to a fifteen-day cooling off period." *Alexander*, 634 F.Supp.2d at 253. New York's moratorium provisions apply to all media through which an attorney might initiate communication "directed to, or targeted at, a specific recipient or group of recipients." N.Y. Comp.Codes R. & Regs., tit. 22, § 1200.52(b).

Consistent with the regulations as written and with counsel's concessions at oral argument, we construe the moratorium provision as inapplicable to (a) broad, generalized mailings (Oral Arg. ~ 12:06:18); (b) general advertisements conveying an attorney's experience in handling personal-injury suits, even when these advertisements appear near news stories in a newspaper that the attorney knows will be filled with coverage of a particular accident (Oral Arg. ~ 12:02:38–12:03:00) [13]; or (c) advertisements informing readers of an attorney's past experience with a particular product where that product has caused repeated personal-injury problems (as with the Dalkon Shield advertisement at issue in *Zauderer*). (Oral Arg. ~ 12:04:11)

We turn now to the remaining *Central Hudson* inquiries relevant to the moratorium provision.

13. It is unclear whether the moratorium provisions apply to "meta tagging," a process by which one can insert non-visible HTML code into a website or web advertisement. By use of a meta tag, for example, a lawyer can design a general advertisement that appears when one searches for information regarding a specific incident. The parties have not briefed whether the moratorium provisions prohibit meta tagging, or if they do prohibit meta tagging, whether the prohibition is constitutional. Accordingly, we express no opinion on either question.

1. State Interest

[17] In *Florida Bar*, the Supreme Court recognized as a substantial state interest "protecting the privacy and tranquility of personal injury victims and their loved ones against intrusive, unsolicited contact by lawyers." *Florida Bar*, 515 U.S. at 624, 115 S.Ct. 2371. That case considered a thirty-day moratorium on direct-mail solicitation of accident victims (or their families). This case similarly involves a moratorium on contacting accident victims (and their families). The Task Force Report, which Defendants considered, recommended a limited moratorium because "the cooling off requirement would be beneficial in removing a source of annoyance and offense to those already troubled by an accident or similar occurrence." (Task Force Report 62–63) *Florida Bar* makes clear that Defendants' stated interest is substantial, and the Task Force Report indicates that that interest is genuinely asserted. The moratorium provisions thus meet the requirements of *Central Hudson*'s substantial interest prong.

2. Materially Advanced

Florida Bar upheld Florida's moratorium rule, which is similar to the New York provisions before us. Several other states have since adopted analogous regulations prohibiting targeted solicitation of accident victims for specific periods of time.[14] The

14. *See, e.g.*, Ariz. Rules of Prof'l Conduct R. 7.3(b)(3) (prohibiting "written, recorded or electronic communication or by in-person, telephone or real-time electronic" solicitation where "the solicitation relates to a personal injury or wrongful death and is made within thirty (30) days of such occurrence"); Conn. Rules of Prof'l Conduct R. 7.3(b)(5) (imposing a forty-day moratorium on "written or electronic communication concern[ing] an action for personal injury or wrongful death"); Ga. Rules of Prof'l Conduct R. 7.3(a)(3) (imposing a thirty-day moratorium on "written communication concern[ing] an action for personal

Task Force Report, based in part on the practices of these states, recommended a fifteen-day "cooling-off period" during which direct-mail solicitation of accident victims would be prohibited. (Task Force Report, App. I, 4) New York's moratorium provisions seek to address the same harms that the *Florida Bar* Court recognized in upholding a thirty-day ban on direct-mail solicitations. And the New York provisions seek to address those harms through similar means—a time-limited moratorium on targeted solicitation of potential clients. *Florida Bar* makes clear that such means materially advance the state's interest. We conclude, therefore, that Defendants have met their burden under this prong of *Central Hudson*. *See Moore v. Morales*, 63 F.3d 358, 361–62 (5th Cir.1995) (relying largely on *Florida Bar* in upholding a rule prohibiting attorneys, physicians, and other professionals from soliciting accident victims within thirty days following the accident).

3. Narrowly Tailored

[18] Were New York's moratorium provisions limited to direct-mail solicitation, there would be little question as to their constitutionality. *See Falanga v. State Bar of Georgia*, 150 F.3d 1333, 1340–41 (11th Cir.1998). But New York's moratorium is not so limited. As the District Court recognized, "The moratorium provisions in this case extend by their plain language to television, radio, newspaper, and website solicitations that are directed to or targeted at a specific recipient or group of recipients." *Alexander*, 634 F.Supp.2d at 253.

The Supreme Court has in some circumstances favored a technology-specific approach to the First Amendment. *See United States v. Playboy Entm't Group, Inc.*, 529 U.S. 803, 813, 120 S.Ct. 1878, 146 L.Ed.2d 865 (2000) ("Cable television, like broadcast media, presents unique problems, which inform our assessment of the interests at stake, and which may justify restrictions that would be unacceptable in other contexts."); *Reno v. ACLU*, 521 U.S. 844, 868, 117 S.Ct. 2329, 138 L.Ed.2d 874 (1997) ("[E]ach medium of expression may present its own problems." (quotation marks and alteration omitted)); *FCC v. League of Women Voters of Ca.*, 468 U.S. 364, 377, 104 S.Ct. 3106, 82 L.Ed.2d 278 (1984) ("[W]e have recognized that 'differences in the characteristics of new media justify differences in the First Amendment standards applied to them.' " (quoting *Red Lion Broad. Co. v. FCC*, 395 U.S. 367, 386, 89 S.Ct. 1794, 23 L.Ed.2d 371 (1969))).[15]

injury or wrongful death''); La. Rules of Prof'l Conduct R. 7.3(b)(iii)(C) (imposing a thirty-day moratorium on communication ''concern[ing] an action for personal injury or wrongful death''); Mo. Rules of Prof'l Conduct 7.3(c)(4) (prohibiting written solicitation, including by e-mail, ''concern[ing] an action for personal injury or wrongful death ... if the accident or disaster occurred less than 30 days prior to the solicitation''); Tenn. Rules of Prof'l Conduct R. 7.3(b)(3) (prohibiting solicitation of ''professional employment from a potential client by written, recorded, or electronic communication or by in-person, telephone, or real-time electronic contact'' if ''the communication concerns an action for personal injury, worker's compensation, wrongful death, or otherwise relates to an accident or disaster involving the person to whom the communication is addressed ... unless the accident or disaster occurred more than thirty (30) days prior to the mailing or transmission of the communication'').

15. *See also Bolger v. Youngs Drug Prods. Corp.*, 463 U.S. 60, 74, 103 S.Ct. 2875, 77 L.Ed.2d 469 (1983) (''[T]he special interest of the federal government in regulation of the broadcast media does not readily translate into a justification for regulation of other means of communication.''); *FCC v. Pacifica Found.*, 438 U.S. 726, 748, 98 S.Ct. 3026, 57 L.Ed.2d 1073 (1978) (''We have long recognized that each medium of expression presents special First Amendment problems.''); *S.E. Promotions, Ltd. v. Conrad*, 420 U.S. 546,

Different media may present unique attributes that merit a tailored First Amendment analysis. *But see* Jim Chen, *Conduit–Based Regulation of Speech,* 54 Duke L.J. 1359, 1360 (2005) ("[A] constitutional jurisprudence that minimizes reliance on conduit-based distinctions best protects free speech.").

But the differences among media may or may not be relevant to the First Amendment analysis depending on the challenged restrictions. *Compare Sable Commc'ns of Ca., Inc. v. FCC,* 492 U.S. 115, 128, 109 S.Ct. 2829, 106 L.Ed.2d 93 (1989) ("Unlike an unexpected outburst on a radio broadcast, the message received by one who places a call to a dial-a-porn service is not so invasive or surprising that it prevents an unwilling listener from avoiding exposure to it."), *with Reno,* 521 U.S. at 875–76, 117 S.Ct. 2329 (likening regulations seeking to protect minors from harmful material on the Internet to regulations on obscene commercial telephone recordings), *and Sable Commc'ns,* 492 U.S. at 125, 109 S.Ct. 2829 (likening obscene commercial telephone recordings to obscene commercial mailings); *cf. Shapero v. Ky. Bar Ass'n,* 486 U.S. 466, 473, 108 S.Ct. 1916, 100 L.Ed.2d 475 (1988) ("Our lawyer advertising cases have never distinguished among various modes of written advertising to the general public.").

In the context before us, we eschew a technology-specific approach to the First Amendment and conclude that New York's moratorium provisions—as we construe them—survive constitutional scrutiny notwithstanding their applicability across the technological spectrum. We focus first on the potential differences among media as to the degree of affirmative action needed to be taken by the targeted recipient to receive the material Plaintiffs seek to send. For many media forms, it is about the same. Thus, to us, the affirmative act of walking to one's mailbox and tearing open a letter seems no greater than walking to one's front step and picking up the paper or turning on a knob on a television or radio.

It is true that the Internet may appear to require more affirmative acts on the part of the user in order to recover content (and is therefore perhaps entitled to greater First Amendment protection insofar as users are soliciting information, rather than being solicited). But regardless of whether this characterization was once accurate, it no longer is so. E-mail has replaced letters; newspapers are often read online; radio streams online; television programming is broadcast on the Web; and the Internet can be connected to television. *See* Christopher S. Yoo, *The Rise and Demise of the Technology–Specific Approach to the First Amendment,* 91 Geo. L.J. 245, 248 (2003) ("[T]he impending shift of all networks to packet switched technologies promises to cause all of the distinctions based on the means of conveyance and the type of speech conveyed to collapse entirely."). Furthermore, Internet searches do not bring a user immediately to the desired result without distractions. Advertisements may appear with the user's search results; pop-up ads appear on web pages; and Gmail (Google's e-mail service) creates targeted advertising based on the keywords used in one's e-mail. In such a context, an accident victim who describes her experience in an e-mail might very well find an attorney advertisement targeting victims of the specific accident on her computer screen.[16]

557, 95 S.Ct. 1239, 43 L.Ed.2d 448 (1975) ("Each medium of expression ... must be assessed for First Amendment purposes by standards suited to it....").

16. At present, Gmail's algorithm for placing

States are increasingly responding to these expanded and expanding roles of the Internet. Several already apply existing attorney professional responsibility rules to electronic and Internet advertisements and solicitations. *See* Amy Haywood & Melissa Jones, *Navigating a Sea of Uncertainty: How Existing Ethical Guidelines Pertain to the Marketing of Legal Services over the Internet,* 14 Geo. J. Legal Ethics, 1099, 1113 (2001) ("[I]t can be assumed that Internet use in the context of legal marketing will generally invoke all ethics rules relating to advertising and solicitation.").[17] Texas and Florida have also added language to their disciplinary rules specifically to address attorney solicitation via the Internet.[18] The New York Task Force Report reached the same conclusion. The Report repeatedly stated that "on-line advertisements and websites are not materially different than typical" printed advertisements, and that the rules should be enforced equally across media. (Task Force Report 54–55) In so doing, the Report "demonstrate[d] that the harms it recites are real and its restriction will in fact alleviate them to a degree." *Florida Bar,* 515 U.S. at 626, 115 S.Ct. 2371 (quotation marks omitted).

Accordingly, we conclude that even acknowledging that differences among media may be significant in some First Amendment analyses, they are not so in this case. Three aspects of the Supreme Court's analysis in *Florida Bar* are of particular relevance to our determination that the harms identified in that case, and put forth by Defendants in this case, are just as compelling with respect to targeted attorney advertisements on television, radio, newspapers, and the Internet as they are in justifying a ban on targeted mailings of attorney advertisements.

a. Porcelain Hearts

The Supreme Court has recognized the particular sensitivity of people to targeted (plaintiff's) attorney advertisements during periods of trauma. To the extent that the attorney advertisements, regardless of the media through which they are communicated, are directed toward the same sensitive people, there is no reason to distinguish among the mode of communication. Depending on the individual recipient, the printed word may be a likely to offend as images on a screen or in newspapers.

In *Florida Bar,* the Court recognized the state's "substantial interest . . . in protecting injured Floridians from invasive conduct by lawyers." 515 U.S. at 635, 115 S.Ct. 2371. As the dissent in *Florida Bar* pointed out, the primary distinction between the targeted letters at issue in *Florida Bar* and the untargeted letters at issue in *Shapero v. Kentucky Bar Association,* 486 U.S. 466, 108 S.Ct. 1916, 100 L.Ed.2d 475 (1988), was that "victims or their families will be offended by receiving a [targeted] solicitation during their grief and trauma." *Florida Bar,* 515 U.S. at 638, 115

targeted advertisements next to e-mail messages omits such ads where an e-mail message mentions a catastrophic event or tragedy. *See* More on Gmail and Privacy, Jan. 2007, http://mail.google.com/mail/help/about_privacy.html. It is by no means certain, however, (a) that Google will continue such a policy, (b) that the algorithm runs without flaws, or (c) that other e-mail providers will exercise similar good taste.

17. *See, e.g.,* S.C. Ethics Op. 99–04 (1999) (advertising); Mass. Ethics Op. 98–2 (1998) (advertising and solicitation); Iowa Ethics Op. 96–1 (1996) (advertising); Pa. Ethics Op. 96–17 (1996) (advertising).

18. *See* Amendments to Rules Regulating the Florida Bar—Advertising Rules, 762 So.2d 392 (Fla.1999); Tex. Disciplinary Rules of Prof'l Conduct, Interpretive Cmt. 17 (1996, rev. May 2003).

S.Ct. 2371. The dissent argued that the majority should not "allow restrictions on speech to be justified on the ground that the expression might offend the listener." *Id.*

But the majority of the Supreme Court in *Florida Bar* held otherwise. It focused on a subset of the public in analyzing the First Amendment: essentially, a First Amendment analogue to tort law's thin-skull plaintiffs, those who have a "porcelain heart." Some accident victims and their families might welcome targeted solicitations that inform them of their legal rights immediately after the accident (particularly when insurance companies may already be knocking on their doors). Other accident victims and their families might be perturbed—but not outraged—by the targeted solicitations. The Supreme Court, however, tailored First Amendment law, in the context of attorney solicitations, to the most sensitive members of the public. It is with these porcelain hearts in mind that we must evaluate New York's moratorium.

b. Wemmick's Castle[19]

In addition to a heightened concern for public sensitivity to potentially offensive attorney communications, the Court in *Florida Bar* upheld the moratorium in part because of its belief that people should be given more of an option to avoid offensive speech in the privacy of their homes. *See Florida Bar*, 515 U.S. at 625, 115 S.Ct. 2371 ("[W]e have consistently recognized that the State's interest in protecting the well-being, tranquility, and privacy of the home is certainly of the highest order in a free and civilized society." (quotation marks and alterations omitted)).

In this respect, the Court was adhering to a long-held position:

> One important aspect of residential privacy is protection of the unwilling listener. Although in many locations, we expect individuals simply to avoid speech they do not want to hear, the home is different. "That we are often 'captives' outside the sanctuary of the home and subject to objectionable speech . . . does not mean we must be captives everywhere." *Rowan v. U.S. Post Office Dep't*, 397 U.S. 728, 738, 90 S.Ct. 1484, 1491, 25 L.Ed.2d 736 (1970). Instead, a special benefit of the privacy all citizens enjoy within their own walls, which the State may legislate to protect, is an ability to avoid intrusions. Thus, we have repeatedly held that individuals are not required to welcome unwanted speech into their own homes and that the government may protect this freedom.

Frisby v. Schultz, 487 U.S. 474, 484–85, 108 S.Ct. 2495, 101 L.Ed.2d 420 (1988) (some internal citations omitted); *Rowan v. U.S. Post Office Dep't*, 397 U.S. 728, 737, 90 S.Ct. 1484, 25 L.Ed.2d 736 ("The ancient concept that 'a man's home is his castle' into which 'not even the king may enter' has lost none of its vitality, and none of the recognized exceptions includes any right to communicate offensively with another."). In *Rowan*, the Supreme Court "categorically reject[ed] the argument that a vendor has a right under the Constitution or otherwise to send unwanted material into the home of another," and held that "[t]he asserted right of a mailer . . . stops at the outer boundary of every person's domain." *Id.* at 738, 90 S.Ct. 1484.

Yet, a letter in a mailbox is no more intrusive than the newspaper in the mailbox, the e-mail in one's inbox, the televi-

19. In Charles Dickens' "Great Expectations," the character of Mr. Wemmick has a home that is literally his castle, complete with a drawbridge and moat that are used to separate his lives inside and outside the home.

sion in the living room, the radio in the kitchen, or the Internet in the study. Arguably, mail is directly targeted at a residence, whereas television, radio, and the Internet may be viewed outside the home. But the Court has seemingly not focused on this distinction, and, instead, has held that the home should be protected from offensive language that disturbs domestic tranquility through the airwaves:

> Patently offensive, indecent material presented over the airwaves confronts the citizen, not only in public, but also in the privacy of the home, where the individual's right to be left alone plainly outweighs the First Amendment rights of an intruder. Because the broadcast audience is constantly tuning in and out, prior warnings cannot completely protect the listener or viewer from unexpected program content. To say that one may avoid further offense by turning off the radio when he hears indecent language is like saying that the remedy for an assault is to run away after the first blow. One may hang up on an indecent phone call, but that option does not give the caller a constitutional immunity or avoid a harm that has already taken place.

FCC v. Pacifica Found., 438 U.S. 726, 748–49, 98 S.Ct. 3026, 57 L.Ed.2d 1073 (1978) (internal citation omitted) (upholding the FCC's regulation of radio broadcast); *cf. Rowan*, 397 U.S. at 736–37, 90 S.Ct. 1484 ("[A] mailer's right to communicate must stop at the mailbox of an unreceptive addressee."). Once again, we find no reason to distinguish among these media for our First Amendment analysis.

c. Lawyers' Reputations

Finally, *Florida Bar* recognized the state's "substantial interest . . . in preventing the erosion of confidence in the [legal] profession that . . . repeated invasions [of privacy by lawyers] have engendered." 515 U.S. at 635, 115 S.Ct. 2371. The *Florida Bar* court distinguished between two kinds of direct-mail advertisements: (1) those that cause offense to the recipient and whose harm can "be eliminated by a brief journey to the trash can," *id.* at 631, 115 S.Ct. 2371; *see also Bolger*, 463 U.S. 60, 103 S.Ct. 2875, 77 L.Ed.2d 469 (rejecting federal ban on direct-mail advertisements for contraceptives), and (2) those whose harmful effects extend beyond the recipient by, for example, tarnishing the reputation of a professional group. *See Florida Bar*, 515 U.S. at 631, 115 S.Ct. 2371 ("The Bar is concerned not with citizens' 'offense' in the abstract, but with the demonstrable detrimental effects that such 'offense' has on the profession it regulates. Moreover, the harm posited by the Bar is as much a function of simple receipt of targeted solicitations within days of accidents as it is a function of the letters' contents. Throwing the letter away shortly after opening it may minimize the latter intrusion, but it does little to combat the former." (internal citations omitted)). A solicitation that offends is not likely to be any less detrimental to the reputation of lawyers when spoken aloud, displayed on a computer screen, or conveyed by television.

Accordingly, we conclude that ads targeting certain accident victims that are sent by television, radio, newspapers, or the Internet are more similar to direct-mail solicitations, which can properly be prohibited within a limited time frame, than to "an untargeted letter mailed to society at large," which "involves no willful or knowing affront to or invasion of the tranquility of bereaved or injured individuals and simply does not cause the same kind of reputational harm to the profession" as direct mail solicitations. *Florida Bar*, 515 U.S. at 630, 115 S.Ct. 2371.

Moreover, we do not find constitutional fault with the 30–day time period during which attorneys may not solicit potential clients in a targeted fashion. As with *Florida Bar*'s "short temporal ban," New York's moratorium permits attorneys to advertise to the general public their expertise with personal injury or wrongful death claims. It thereby fosters reaching the accident victims, so long as these victims are not specifically targeted. It further allows accident victims to initiate contact with attorneys even during the thirty days following an accident. *See Florida Bar,* 515 U.S. at 633, 115 S.Ct. 2371. In fact, as *amici* New York State Bar Association point out, New York's moratorium is more narrowly tailored than that of *Florida Bar* insofar as it incorporates the Task Force Report's fifteen-day black-out period, which shortens the moratorium period to fifteen days where an attorney or law firm must make a filing within thirty days of an incident as a legal prerequisite to a particular claim. N.Y. Comp.Codes R. & Regs., tit. 22, §§ 1200.52(e), 1200.36(a), 1200.36(b). No doubt the statute could have been more precisely drawn, but it need not be "perfect" or "the least restrictive means" to pass constitutional muster. *Bd. of Trustees of State Univ. of N.Y. v. Fox,* 492 U.S. 469, 480, 109 S.Ct. 3028, 106 L.Ed.2d 388 (1989).

New York's moratorium provisions prohibit targeted communications by lawyers to victims, their families, or their representatives as to a specific personal injury or wrongful death event, where such communications occur within thirty days of the incident in question. Where a legal filing is required within thirty days, the moratorium is limited to fifteen days. These provisions, although they reach a broader range of advertisements than those proscribed by the moratorium in *Florida Bar,* do not impose barriers inconsistent with the First Amendment. We conclude that the moratorium provisions, as construed, are sufficiently narrowly tailored to survive constitutional scrutiny.

CONCLUSION

The thorough and well-reasoned opinion of the District Court is AFFIRMED, except as to N.Y. Comp.Codes R. & Regs., tit. 22, § 1200.50(c)(3)'s ban on "the portrayal of a fictitious law firm, the use of a fictitious name to refer to lawyers not associated together in a law firm, or otherwise imply[ing] that lawyers are associated in a law firm if that is not the case." With respect to this portion of § 1200.50(c)(3) only, the judgment of the District Court is REVERSED.

Marino DE LA ROSA, Petitioner,

v.

Eric H. HOLDER, Jr., Attorney General, Respondent.

Docket No. 09–3099–ag.

United States Court of Appeals,
Second Circuit.

Argued: Dec. 21, 2009.

Decided and Amended: Feb. 25, 2010.

Background: Alien, a citizen of the Dominican Republic and a lawful permanent resident of the United States, petitioned for review of the reversal, by the Board of Immigration Appeals (BIA), of the grant of his application for deferral of removal under the Convention Against Torture (CAT), and of the BIA's affirmance of a subsequent order for his removal.

DON'T YOU KNOW THAT YOUR LAW IS TOXIC? BRITNEY SPEARS AND ABUSIVE GUARDIANSHIP: A REVISIONARY APPROACH TO THE UNIFORM PROBATE CODE, CALIFORNIA PROBATE CODE, AND TEXAS ESTATES CODE TO ENSURE EQUITABLE OUTCOMES

by Lisa Zammiello[*]

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[*] J.D. Candidate, Texas Tech University School of Law, 2022; B.S., Texas State University, 2017. I would like to thank Gabrielle Griffith and Macie Alcoser for their teachings, feedback, and editorial contributions. I would also like to give a special thanks to my parents, David and Cindy, and my brother Joey, for the love and support over my lifetime.

I. INTRODUCTION

September 2001.[1] Awards season kicks off with the MTV Music Video Awards.[2] Britney Spears is performing at the award ceremony, creating an iconic moment in pop culture history.[3] This night is remembered for Britney delivering dance moves while wrapped in a python.[4] Almost twenty years later, Britney is still making headlines—but for other reasons.[5] The world had a front row seat to Britney Spears's life taking a less than glamorous turn towards conservatorship.[6] The emotional stress of fame led to her infamous 2007 public breakdown, and conservatorship followed shortly after in 2008.[7] Britney's father, Jamie Spears, and lawyer Andrew Wallet, obtained conservatorship over Britney's person and property.[8] Britney's conservators

1. *See* Megan Riedlinger, *MTV Video Music Awards: Most Buzz-worthy Moments of VMAs Past*, MSN ENT. (Aug. 30, 2020), https://www.msn.com/en-us/music/awards/mtv-video-music-awards-most-buzz-worthy-moments-of-vmas-past/ss-BB18mnnT#image=5 [perma.cc/CV47-QMSR].

2. *Id.*

3. Leon Sánchez, *Britney Spears – I'm a Slave 4 U Live / 2001 MTV VMAs*, YOUTUBE (Feb. 20, 2021), https://www.youtube.com/watch?v=q01yoGp9Dik [perma.cc/K53F-DRUM].

4. *Id.*

5. *See* Riedlinger, *supra* note 1.

6. *Id.*

7. Elyse Johnson, *Truth About Britney Spears Mental Health in 2020*, GOSSIP COP (Aug. 10, 2020, 5:00 PM), https://www.gossipcop.com/truth-about-britney-spears-mental-health-in-2020/2552140 #:~:text=Britney%20Spears%20has%20been%20very%20open%20about%20her,herself%20into%20a%20mental%20health%20facility%20after%20 [perma.cc/Q9SC-L9XN].

8. Korin Miller, *The Full Timeline of Britney Spears' Conservatorship Spans More Than a Decade*, WOMEN'S HEALTH MAG. (Feb. 11, 2021), https://www.womenshealthmag.com/life/a33336398/britney-spears-conservatorship-timeline/ [perma.cc/5FA6-ENYQ].

exercise total control over her life, such as who she can see and how she can spend her money.[9]

Conservatorship, known in some states as guardianship, is a "fiduciary relationship between a guardian and a ward or other incapacitated person, whereby the guardian assumes the power to make decisions about the ward's person or property."[10] Further, "a guardianship is almost always an involuntary procedure imposed by the state on the ward."[11] The very nature of the relationship between conservator and conservatee lends itself to the risk of abuse of the conservatee by the conservator, because the ward loses all autonomy and decision-making power.[12]

Conservatorship is typically reserved for individuals with conditions rendering them incapable of caring for themselves or their property.[13] Such conditions may include, but are not limited to, dementia or mental infirmity due to age.[14] Once conservatorship is implemented, it proves difficult to undo.[15] A person is deemed legally incapacitated if the probate court finds by a preponderance of the evidence either that, "(1) the proposed ward is totally without capacity to care for himself [or herself] and manage his [or her] property, or (2) the proposed ward lacks the capacity to do some, but not all, of the tasks necessary to care for himself [or herself] and manage his [or her] property."[16] The court exercises discretion to dictate the scope of conservatorship based on the necessity of assistance required to aid the ward in daily living (limited conservatorship, or full-authority conservatorship).[17] A ward retains all civil rights and powers not specifically granted to the guardian.[18]

Britney Spears's journey into conservatorship appeared warranted in the court of public opinion; the press captured Britney's struggle with mental health and the world watched.[19] Initially, the public enjoyed the entertainment.[20] But, as the story progressed, it became clear that Britney seriously struggled with mental health and drug abuse issues.[21] Conservatorship seemed fitting because it was clear she was "out of control,"

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9. *Britney Spears' Sister Jamie Lynn Seeks Control of Singer's Finances*, BBC ENT. & ARTS (Aug. 27, 2020), https://www.bbc.com/news/entertainment-arts-53930167 [hereinafter *Jamie Lynn Seeks Control*] [perma.cc/N2KJ-SRP6].

10. *Guardianship*, BLACK'S LAW DICTIONARY (11th ed. 2019).

11. *Id.*

12. *See* Jennifer Moye, *Guardianship and Conservatorship*, IN EVALUATING COMPETENCIES FORENSIC ASSESSMENTS & INSTRUMENTS 309, 309 (Springer ed. 2005), https://doi.org/10.1007/0-306-47922-2_8 [perma.cc/LND8-4LAP].

13. *Id.*

14. *Id.*

15. *See Jamie Lynn Seeks Control*, *supra* note 9.

16. Daves v. Daniels, 319 S.W.3d 938, 941 (Tex. App.—Austin 2010, pet. denied).

17. *Id.*

18. *Id.*

19. *See* Miller, *supra* note 8

20. *Id.*

21. *Id.*

evidenced by her custody battle and physical altercation with paparazzi.[22] More recently, headlines about the singer are about Britney fans' growing concern for the singer's legal trouble in attempting to remove the conservatorship.[23]

The #FreeBritney movement is based in the theory that Britney is "trapped" in her conservatorship, and that her father is exploiting his daughter by keeping her under his care.[24] The fan-led movement was birthed in 2019 on Twitter, and quickly started trending.[25] Followers of the movement express concern that Britney's autonomy is compromised of the greed of her father, and that she is being "held captive" by the legal arrangement.[26] Fans speculate that Britney no longer requires the conservatorship, and refer to her ability to work throughout the duration of the conservatorship as proof that she is not incapacitated.[27] Britney has released four albums since 2008, and scored a four year residency in Las Vegas at the MGM Grand.[28] Britney has since expressed her desire to end the conservatorship, and fans are convinced that Jamie is keeping her under his care for self-serving reasons.[29] Because Jamie is in charge of her care, he earns over $100,000 per year as compensation.[30] Additionally, Britney's net worth of $60 million is out of her reach; therefore, Britney lacks access to her fortune due to her legal status as a conservatee, and her conservator is the only one who has access to Britney's hard-earned money.[31]

Members of the #FreeBritney movement believe Jamie will wield his power over Britney in order to keep her under conservatorship, and that he has already exercised his power in an abusive manner:

> The unnamed source said, 'What is happening is disturbing, to say the least. Basically, Britney was in rehearsals for Domination. It came to [her father]

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22. *Id.*

23. *Id.*

24. Alyssa Newcomb, *Here's Why Britney Spears Fans are Fueling a #FreeBritney Movement on Social Media*, TODAY POP CULTURE (July 13, 2020, 3:45 PM), https://www.today.com/popculture/free-britney-2020-what-know-about-movement-spears-conservatorship-t186642 [perma.cc/SM3L-DUXQ].

25. Gil Kaufman, *#FreeBritney: Why the Movement Started and How Its Leading Voices Are Keeping It Going*, BILLBOARD (Sept. 10, 2020), https://www.billboard.com/articles/news/9445049/free-britney-spears-movement-started [perma.cc/UY9S-EF4P].

26. *Id.*

27. Isobel Lewis, *Britney Spears May Be Under Conservatorship For the Rest of Her Life, Former Estate Manager Claims*, THE INDEPENDENT (Oct. 6, 2020, 9:56 AM), https://www.independent.co.uk/arts-entertainment/music/news/britney-spears-conservatorship-andrew-wallet-jamie-free-b830686.html [perma.cc/VL9T-GHJR].

28. Karen Mizoguchi, *She's Back! Britney Spears Announces a New Residency in Vegas 9 Months After Piece of Me Show*, PEOPLE (Oct. 18, 2018, 10:24 PM), https://people.com/music/britney-spears-announces-new-vegas-residency/ [perma.cc/DM8W-EJDK].

29. *See* Newcomb, *supra* note 24.

30. Joseph Allen, *Britney Spears Filed Documents to Remove Her Dad as Sole Conservator of Her* Estate, DISTRACTIFY (Mar. 3, 2021, 5:10 PM), https://www.distractify.com/p/britney-spears-dad-net-worth [perma.cc/27UY-A2Z9].

31. *Id.*

> Jamie's attention that Britney was not taking her medication as prescribed. She was missing a lot of doses and just full-on not taking them.' The source then claimed that her father 'pulled the show' after Britney refused to take her medications, and that the singer had been in a mental health facility since 'mid-January' of 2019.[32]

During the September 2, 2020, court hearing on the conservatorship, Britney requested her conservatorship case be opened to the public after her father moved to seal the documents.[33] Jamie asserts that it is in Britney's best interest to keep the documents private as they contain personal information.[34] #FreeBritney movement members believe he has something to hide.[35] As of the time of this comment, Britney requested that her father be removed from the role as conservator on November 4, 2020.[36] On November 10, 2020, the court denied the request for removal, and the court noted, "that's the subject of another discussion down the road."[37] According to Britney's lawyer, Britney is afraid of her father and does not want to professionally perform while he is still her conservator.[38]

The issues raised by the #FreeBritney movement beg the question, why is such a high-functioning conservatee, who has expressed opposition to the conservatorship, still under the conservatorship?[39] If the rumors of Jamie's abuse are true, what protections are in place for Britney and others who find themselves in the same predicament?[40] If Britney wants out of the conservatorship, why is it virtually impossible to get out of the conservatorship once it has been established?[41]

Britney's story has drawn attention to the issues surrounding conservatorship, but she is not the only person who has suffered from such a

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32. Kaufman, *supra* note 25.

33. *Id.*

34. Andrew Dalton, *Britney Spears Shows Love for #FreeBritney in Court Filing*, ASSOCIATED PRESS (Sept. 3, 2020), https://apnews.com/article/entertainment-ap-top-news-ca-state-wire-85debe4cef319a3d713c660efd9a5b39 [perma.cc/C4ZK-4L68].

35. *Id.*

36. Abby Gardner, *The Britney Spears Conservatorship Situation, Fully Explained*, YAHOO!LIFE (Feb. 12, 2021), https://www.yahoo.com/lifestyle/britney-spears-conservatorship-situation-fully-1355215
43.html?guccounter=1&guce_referrer=aHR0cHM6Ly9zZWFyY2gueWFob28uY29tLw&guce_referrer_sig=QAAANtpxauazu-HvL_-OZ7Ex_sLM-KHy6osPRmP4Z2uegPiys51KTehuA-JYiytJYrgfq4S-YyFHOOKmviqwuJEFoJLD9dE_WkBJEsaw5GgjTVVShSIxCmL_yvGjxt9C3SqIUERtW rr2pkYObcihI81wZshzWU-xTG0YA_38dVaYSrg [perma.cc/D5E4-3VYT].

37. *Id.*

38. *Id.*

39. Maria Puente, *Why Does Britney Spears Still Have a Conservator? Legal Expert Says Her Case File Suggests Answers*, USA TODAY (Oct. 25, 2019, 9:53 AM), https://www.usatoday.com/story/entertainment/celebrities/2019/10/24/britney-spears-why-does-she-still-need-conservator/2288009001/ [perma.cc/K8T4-UJL5].

40. *Id.*

41. *Id.*

relationship.[42] While legal documentation of such abuse is scarce, anecdotes of conservatorship abuse occur all across the United States.[43]

This Comment examines what laws, if any, are in place to protect wards from abuse.[44] Next, this Comment examines the Uniform Probate Code and varying state laws for procedural safeguards and opportunities to challenge conservatorship, while sharing the stories of people who have suffered under conservatorship.[45] Lastly, this Comment proposes improvements to existing laws and argues the need for supportive services to ensure equitable enforcement of protective laws.[46]

II. A BRIEF HISTORY ON CONSERVATORSHIP

Conservatorships in America are rooted in the history of English law.[47] Conservatorships and guardianships began with a well-intentioned concern for the elderly's ability to care for and protect themselves; this idea extends to the mentally incapacitated.[48] Legal incapacity was created by the legislatures as the standard by which a court recognizes a state's ability to intrude on a person's rights.[49] The threshold of legal incapacity has changed dynamically as our understanding of the human mind has evolved.[50] Recent history spurred this evolution; the cultural revolution of the 1960s sparked discussion surrounding human rights.[51] Furthermore, psychology developed greatly in the 1960s as a well-accepted science that aided understanding of the human mind.[52] States responded to the need for legal protections by enacting statues in the wake of the disability rights movement.[53] Guidance on guardianship law such as the 1969 revision of Uniform Probate Code reflect

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42. *Id.*

43. *See Guardianship Education and Prevention*, AAAPG, https://aaapg.net (last visited Oct. 20, 2020) [perma.cc/XW6R-UGQ7].

44. *See* discussion *infra* Part III.

45. *See* discussion *infra* Parts IV, V.

46. *See* discussion *infra* Part VII.

47. *See* Gregory Atkinson, *Towards a Due Process Perspective in Conservatorship Proceedings for the Aged*, 18 J. FAM. L. 819, 820 (1979).

48. *See Guardianship Education and Prevention*, *supra* note 43.

49. *See* Kristin Booth Glen, *Changing Paradigms: Mental Capacity, Legal Capacity, Guardianship, and Beyond*, 44 COLUM. HUM. RTS. L. REV. 93, 95 (2012).

50. *Id.*

51. *See* Roland Burke, *'How Time Flies': Celebrating the Universal Declaration of Human Rights in the 1960s*, 38 THE INT'L HIST. REV. 394 (2016).

52. Kendra Cherry, *The Origins of Psychology from Philosophical Beginnings to the Modern Day*, VERYWELLMIND (June 25, 2020), https://www.verywellmind.com/a-brief-history-of-psychology-through-the-years-2795245 [perma.cc/BYB3-LK5V].

53. Gerard Quinn, NUI Galway, *Personhood & Legal Capacity: Perspectives on the Paradigm Shift of Article 12 CRPD*, Paper Presented at Harvard Law School HPOD Conference (Feb. 20, 2010), *reprinted in* CTR. FOR DISABILITY L. & POL'Y, app. 6, at 73 (Aug. 2011), https://www.nuigalway.ie/ media/centre fordisabilitylawandpolicy/files/archive/Submission-on-Legal-Capacity-to-the-Oireachtas-Committee-on-Justice,-Defence-&-Equality-(August,-2011).pdf [perma.cc/5X27-QFNH].

the new ideas the movement brought about.[54] In 1987, the Associated Press published a detailed six-part series of articles following a year-long investigation on guardianships.[55] The exposition spurred outcries for change, and thus began the new wave of guardianship reform.[56] Modern laws on guardianship that followed the Associated Press stories include the "clear and convincing evidence" standard of proof, and the requirement that the incapacitated person must be notified of the guardianship proceeding and be present if they so choose."[57]

Currently, courts must find a potential ward incapacitated to such a degree that warrants state intervention because the incapacitated person is no longer able to make medical, financial, or personal decisions.[58] A court may initiate conservatorship proceedings or may be petitioned by a person interested in the proposed ward's wellbeing.[59] Britney's father did not petition the court for conservatorship; rather, he was appointed by the court as a conservator after Britney was involuntarily committed under the California Welfare laws.[60] Once a court determines that a person is unable to understand and make decisions about their own person or property, the court will evaluate what type of legal protection is needed, and how much protection is necessary.[61] The court should address potential conservatorships on a case-by-case basis, because each person's set of circumstances is unique.[62] Conservatorships may be limited or unlimited.[63] The court will grant authority to a guardian only to the extent necessary to meet the ward's needs.[64] For example, the court may determine that a potential ward possesses the requisite capacity to make decisions about money management, but not healthcare decisions.[65] The guardian will have the authority to only make decisions about healthcare.[66] In comparison, if the court determines the ward does not retain the requisite capacity to make *any* decisions, then the guardian will obtain absolute decision-making power.[67] Britney's father currently has unlimited guardianship authority.[68]

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54. UNIF. PROB. CODE § 1-101 (amended 2019) (1969).

55. Emily Gurnon, *Guardianship Laws: Improving, But Problems Persist*, NEXT AVENUE (May 24, 2016), https://www.nextavenue.org/guardianship-laws-improving-problems-persist/ [perma.cc/R9F8-TF4C].

56. *Id.*

57. *Id.*

58. *Id.*

59. *In re* Conservatorship & Est. of Spears, No. B214749, 2011 WL 311102, at *1 (Cal. Ct. App. Feb. 2, 2011).

60. *See* discussion *infra* Part IV.

61. *See* discussion *infra* Part IV.

62. Meta S. David, *Legal Guardianship of Individuals Incapacitated by Mental Illness: Where Do We Draw the Line?*, 45 SUFFOLK U. L. REV. 465, 483 (2012).

63. *Id.* at 473–74.

64. *Id.* at 474.

65. *See id.*

66. *See id.*

67. *See id.*

68. Puente, *supra* note 39.

Conservatorships are designed to protect the ward from undue influence, exploitation of property, or both, as well as to provide the incapacitated with necessary daily care.[69] Britney's case is unique because of her fame and fortune, so the court must consider how Britney's position as a pop star will affect the protections needed in order to provide an efficient conservatorship.[70] Further, the court is compelled to consider the fact that Britney is worth $60 million as of this writing.[71] The value of her person and estate may cause a conservator to be ill-intentioned and driven by greed, which requires vigilant legal protections for Britney.[72]

A. Guardianship and Conservatorship

In some jurisdictions, guardianship refers to a guardian's legal duty to care for the health and welfare of the incompetent person while simultaneously safe keeping and managing the ward's property.[73] Other jurisdictions create two separate roles: one role looks after the ward's health and welfare (usually called a guardianship), and the other role looks after the ward's property (often called a conservatorship).[74] The Uniform Probate Code and California Probate Code treat "conservatorship" and "guardianship" as different concepts.[75] The Texas Estates Code uses the term "guardianship" to encompass both the person and person's property.[76] This comment will refer both to conservatorship and guardianship.[77]

Understanding the unintended consequences of conservatorship continues to enlighten the legal profession as time progresses.[78] Such consequences include revocation of an individual's constitutional rights.[79] Legal commentators note that the legal relationship between conservator and conservatee is not adequate in meeting the needs of the elderly or incapacitated.[80] Commentators argue that a lack of judicial oversight of the conservatorships results in substantial loss of liberty and property for many of the persons that these arrangements are intended to protect.[81]

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69. *Id.*
70. *Id.*
71. Allen, *supra* note 30.
72. *Id.*
73. TEX. EST. CODE ANN. § 1001.001.
74. UNIF. PROB. CODE §§ 5-301, 5-401 (amended 2019) (1969).
75. *Id.*; CAL. PROB. CODE § 1400 (West, Westlaw through Ch.10 of 2021 Reg. Sess.).
76. TEX. EST. CODE ANN. § 1001.001.
77. *See* discussion *infra* Part III.
78. *See* Paula L. Hannaford & Thomas L. Hafemeister, *The National Probate Court Standards: The Role of the Courts in Guardianship and Conservatorship Proceedings*, 2 ELDER L.J. 147, 148 (1994).
79. *Id.* at 157.
80. *Id.* at 148–49.
81. *Id.*

Due process concerns arise when a person is deemed legally incompetent by a judge.[82] When an individual is declared legally incompetent, they lose the legal right to marry, contract, and vote.[83] Because legally protected rights are at stake, substantial due process requires careful considerations throughout conservatorship proceedings.[84] Further, procedural due process concerns will arise if the incompetent person desires to hire their legal representation; but cannot contract with a lawyer for representation.[85]

The ramifications of conservatorship revert an adult to the legal status of a child.[86] The evolution of conservatorship has led legal experts, lawyers, and judges to reexamine the process, and some states have responded through legislative protections.[87] While the progress in conservatorship protection is positive, conservatorship law still has room for improvement in the area of high-functioning wards, such as Britney Spears.[88]

B. "High-Functioning" Wards

This Comment refers to a "high-functioning" ward as an individual who can care for themselves, generate income, and has the acuity to understand the nature of the conservatorship despite living with functional limitations.[89] Britney Spears is a high-functioning ward, evidenced by her ability to execute complicated performances to make a living throughout her conservatorship.[90] Britney can understand her conservatorship's nature and has expressed her desire to terminate her father as her conservator.[91] Furthermore, Britney's social media presence is a window into her daily life; onlookers witness her vibrancy.[92] Allowing fans insight into Britney's life is what sparked the #FreeBritney movement because Britney's social media posts are convincing her fans that she is, in fact, competent."[93]

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82. *Id.*

83. *See* Doe v. Rowe, 156 F. Supp. 2d 35, 46 (D. Me. 2001).

84. Hannaford & Hafemeister, *supra* note 78, at 148–49.

85. Chandra Bozelko, *Britney Spear's Conservatorship Can Be Both Legal and Quite Bad for Her. Many Are.* NBC NEWS (Nov. 14, 2020, 9:11 AM), https://www.nbcnews.com/think/opinion/britney-spears-conservatorship-can-be-both-totally-legal-quite-bad-ncna1247750 [https://perma.cc/6RCH-YMWF].

86. *Id.*

87. Hannaford & Hafemeister, *supra* note 78, at 12.

88. *See* Bozelko *supra* note 85.

89. Gallo v. Colvin, No. 13-CV-06528 MAT, 2014 WL 3901129 (W.D.N.Y. UG. 11, 2014).

90. *See* Bozelko, *supra* note 85.

91. *Id.*

92. Gil Kaufman, *#FreeBritney: Why the Movement Started and How Its Leading Voices Are Keeping It Going*, BILLBOARD (Sep. 10, 2020), https://www.billboard.com/articles/news/9445049/free-britney-spears-movement-started [https://perma.cc/64D9-WD5F].

93. *Id.*

High-functioning status may be considered on a case-by-case basis and is subjective to each ward's position.[94] If there is another feasible and less-restrictive means to provide for the ward's needs, the court should consider reviewing the situation and making reasonable modifications.[95] In comparison, persons who cannot care for themselves and completely depend on their guardian for survival are not considered high-functioning.[96]

This Comment is concerned with persons who toe the line of competence and incompetence.[97] The court must consider medical diagnosis and analysis from medical professionals to determine a person's level of functioning compared to an "average" person in similar circumstances.[98] A review process is necessary because courts are often busy and slow; an out-of-court review process will allow easier access and faster response times to request for review of the conservatorship.[99]

III. THE UNIFORM PROBATE CODE

The Uniform Probate Code (UPC) was enacted in 1969 to create a model standard of laws to address issues of wills, trust, and estates.[100] The UPC was intended to standardize the probate process in all fifty states; however, it has only been fully adopted by some of the states.[101] The section of the code that discusses guardianship was integrated by the Uniform Guardianship and Protective Proceedings Act of 1997/1998 and is now incorporated as Article V of the UPC.[102]

The 1997 revisions were created in response to the guardianship "revolution" of the 1980s.[103] The nation's legal scholars began understanding how guardianships, although rooted in assisting incapacitated persons, potentially pose risks to incapacitated persons' autonomy.[104] Individual state legislatures began implementing laws reflecting the need to facilitate the

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94. Karen Andreasian, *Revisiting S.C.P.a 17-a: Guardianship for People with Intellectual and Developmental Disabilities*, 18 CUNY L. REV. 287 (2015).

95. *Id.*

96. *See* discussion *infra* Part VII.

97. *See* discussion *infra* Part VII.

98. Lawrence A. Frolik, *Promoting Judicial Acceptance and Use of Limited Guardianship*, 31 STETSON L. REV. 735 (2002).

99. Kenneth Rosenau & Evan Greenstein, *Guardianship and Conservatorship: Frequently Asked Questions*, LAWHELP.ORG, https://www.lawhelp.org/dc/resource/guardianship-and-conservatorship-frequently-a (last visited Jan. 19, 2021) [https://perma.cc/AUF9-E3MD].

100. *Uniform Probate Code Lawyers*, LEGAL MATCH, https://www.legalmatch.com/law-library/article/uniform-probate-code-lawyers.html#:~:text=There%20are%20currently%2018%20states %20that%20have%20adopted,North%20Dakota%2C%20South%20Carolina%2C%20South%20Dakota%2C%20and%20Utah (last visited Oct. 20, 2020) [https://perma.cc/8L2X-A2WN].

101. *Id.*

102. UNIF. PROB. CODE § 5-101 (amended 2019) (1969).

103. UNIF. PROB. CODE Art. V, refs & annos.

104. *Id.*

autonomy of incapacitated persons.[105] A two-year study by the A.B.A. Senior Lawyers Division Task Force on Guardianship Reform generated a report that created the foundation for the 1997 revisions in light of a new understanding of guardianship consequences.[106] The revisions emphasized limited guardianship and support for autonomy.[107]

With this in mind, the 1997 revision made substantial changes to guardianship law.[108] The improvements were made to view guardianship as a last result, and to foster a working relationship between the guardian and the ward in the decision-making process.[109] So far, eighteen states have fully adopted the UPC: Alaska, Arizona, Colorado, Florida, Hawaii, Idaho, Maine, Minnesota, Montana, Nebraska, New Mexico, North Dakota, South Carolina, South Dakota, and Utah.[110]

A. Incapacitated Persons Under the UPC

The Uniform Probate Code distinguishes between guardianship (protection of the person) and conservatorship (protection of the person's property).[111] By dividing the two concepts, the court has flexibility in establishing what level and type of care is needed for the proposed ward.[112] This Comment analyzes guardianship and conservatorship separately.[113]

B. Guardianship

Uniform Probate Code section 5-102(4) defines an incapacitated person as "an individual who, for reasons other than being a minor, is unable to receive and evaluate information or make or communicate decisions to such an extent that the individual lacks the ability to meet essential requirements for physical health, safety, or self-care, *even with appropriate technological assistance*." (emphasis added).[114] The revised definition is designed to take into consideration the development of assistive technology that may "enable the individual to receive and evaluate information or to make or communicate decisions" to potentially find that the person is not an incapacitated person.[115] By allowing technological assistance to play a role in determining a person's capacity to care for themselves, the UPC creates an avenue for persons who

105. *Id.*
106. *Id.*
107. *Id.*
108. *Id.*
109. UNIF. PROB. CODE Art. V, refs & annos.
110. *See Uniform Probate Code Lawyers*, *supra* note 100.
111. UNIF. PROB. CODE §§ 5-301, 5-401 (amended 2019) (1969).
112. *Id.*
113. *See* discussion *infra* Sections III.B, III.C.
114. UNIF. PROB. CODE § 5-102(4).
115. *See Uniform Probate Code Lawyers*, *supra* note 100, at 15.

are limited in their capacity, not to the degree of warranting a restriction of rights.[116] This option protects a person from unnecessary guardianship.[117] As technology progresses rapidly, the application of that technology to everyday life may encourage a broader application of this provision to find more persons able to care for themselves.[118]

1. Who May Become a Guardian?

Under UPC section 5-301, when an incapacitated person is under guardianship by court appointment, the guardian may be a parent, spouse, or a person appointed by the court.[119] The guardianship will continue until terminated, regardless of the location of the guardian or ward.[120] A person interested in the individual's wellbeing may petition the court to assess the individual's needs.[121] The court may determine the potential ward's incapacity and appoint a guardian upon review of the individual's needs and may install an unlimited or limited guardianship.[122] The burden of proof in establishing guardianship is clear and convincing evidence.[123]

a. Priorities of Who May Become a Guardian

Once the court finds a person incapacitated to the degree warranting a guardianship, the court must decide who may be a guardian to serve the ward's best interest.[124] UPC section 5-310 classifies potential guardians in an order of priority as follows:

> (1) A guardian, other than a temporary or emergency guardian, currently acting for the respondent in this state or elsewhere;
> (2) A person nominated as guardian by the respondent, including the respondent's most recent nomination made in a durable power of attorney, if at the time of the nomination the respondent has sufficient capacity to express a preference;
> (3) An agent appointed by the respondent or any individual nominated by will or other signed writing of a deceased spouse;
> (4) The spouse of the respondent or an individual nominated by will or other signed writing of a deceased spouse;
> (5) An adult child of the respondent;

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116. *See* UNIF. PROB. CODE. § 5-102 cmt.
117. *See Uniform Probate Code Lawyers*, *supra* note 100, at 15.
118. *See id.*
119. UNIF. PROB. CODE. § 5-301.
120. *Id.* § 5-301.
121. *Id.* § 5-304(a).
122. *Id.* § 5-301.
123. *Id.* §§ 5-311, 5-401.
124. *Id.* § 5-306 (a professional evaluation of the potential ward, at or before the hearing, may be ordered at the request of the potential ward to determine incapacity).

(6) A parent of the respondent, or an individual nominated by will or other signed writing of a deceased parent; and
(7) An adult with whom the respondent has resided for more than six months before the filing of the petition.[125]

This prioritized list offers guidance to the court when making this determination, but it is not binding.[126] The court has the discretion to appoint a guardian of equal priority or out of order if such a person is best qualified to become the ward's guardian.[127] This type of appointment is typically implicated when there is already an existing guardian.[128] Most cases that fall under the already existing guardian category involve transfers of guardianship between states.[129] Granting priority to a current guardian assures a smooth transition between jurisdictions and will deter forum shopping.[130] The UPC considers the proposed ward's preference in sections (2) and (3).[131] The official comment states, "[t]he agent is granted a preference on the theory that the agent is the person the respondent would most likely prefer to act."[132] The language used in subsection (6) intentionally added the phrase "with whom the respondent has resided for more than six months" to replace the previous versions' "domestic partner or companion" which limited the application of this section to a domestic partner, a spousal relationship, or both.[133] The current version was revised to encompass other types of relationships that offered the similar nature of a "close enduring relationship," which may be in the ward's best interest.[134] Moreover, the new version broadened this subsection's application to include close relationships outside of the romantic type.[135] Subsection (7) allows for a domestic partner, companion, or an individual who has a close, personal relationship with the respondent to serve as guardian; such priority is granted by applying a reasonableness standard so that priority is given to someone with a close, enduring relationship with the ward.[136]

The list of priorities allows the court to have a uniform approach to appointing guardians and reflects the consideration of who may serve as guardian in line with the best interest of the ward.[137]

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125. UNIF. PROB. CODE § 5-310.
126. *Id.* § 5-310(b).
127. *Id.* § 5-310.
128. *Id.*
129. *Id.*
130. *Id.*
131. UNIF. PROB. CODE § 5-310(a)(2)-(3).
132. *Id.* § 5-310 cmt.
133. *Id.* § 5-310(a)(6).
134. *Id.* § 5-304 cmt.
135. *Id.* § 5-304.
136. UNIF. PROB. CODE § 5-304(7).
137. *See* discussion *supra* Section III.B.1.a.

b. Proposed Vetting Under the UPC

The reader may consider that most protections in place for wards are reactionary.[138] The legislature should consider implementing proactive measures of protection to reduce the potential for harm to the ward, while also reducing the volume of cases before the probate court.[139]

While the court must decide based on the ward's best interest, the UPC does not create a vetting process for a proposed guardian.[140] Generally, the proposed guardian will be a person in close familial relation to the ward, which creates the illusion that the proposed guardian is the best person for the role.[141] In most instances, a family member or spouse will have the best intent for the proposed ward and will be the reasonable choice to care for the conservatee.[142]

Two issues may arise when a kindred gains legal status over the ward.[143] First, the guardian may not fully understand what they are getting into.[144] Once the court grants guardianship, the guardian is bound by a fiduciary relationship to care for the ward.[145] A fiduciary duty is defined as "a duty of utmost good faith, trust, confidence, and candor owed by a fiduciary to the beneficiary; a duty to act with the highest degree of honesty and loyalty toward another person and in the best interest of the other person."[146] The duty enumerated in UPC Section 5-314 states, "a guardian shall make decisions regarding the wards support, care, education, health and welfare."[147] Second, life changes rapidly, and circumstances may arise when the guardian is no longer able to serve in the ward's best interest.[148]

The complex nature of guardianship is best understood when a potential guardian is properly educated in matters of fiduciary duty and legal liability.[149] Some states, such as Texas, provide certification programs for potential guardians to help the guardian understand the undertaking of becoming a guardian for an incapacitated person.[150] Certification serves as a

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138. *See* discussion *supra* Section III.B.4.a.
139. *See* discussion *infra* Section VII.A.1.
140. UNIF. PROB. CODE § 5-310.
141. *Id.*
142. *See In re* Guardianship of Alabraba, 341 S.W.3d 577 (Tex. App.—Amarillo May 13, 2011).
143. *See id.*
144. *See id.*
145. Johnathan J. Bates. Colleen Elbe, Lynn Kamin, Hon. Stephani A. Walsh, R. Kevin Spencer, GUARDIANSHIP LAW IN TEXAS, Chapter 42, (Advanced Fam. L. 43-VIII, 2018).
146. *Duty*, BLACK'S LAW DICTIONARY (11th ed. 2019).
147. UNIF. PROB. CODE § 5-314 (amended 2019) (1969).
148. *Id.* § 5-310 cmt.
149. *Guardianship Certification Requirements*, TEXAS JURISPRUDENCE PLEADING AND PRACTICE FORMS § 131:34 (2d. ed.).
150. *Id.*

proactive measure in mitigating the risk of abuse or neglect of wards by guardians.[151]

Furthermore, some states require that guardians register in a data system in order to monitor ongoing guardianships.[152] The data collected by the registration system may provide lasting benefits as the need for guardianship in America is predicted to increase as the elderly population increases.[153] Data collected through the registration system will expand knowledge and understanding of guardianship issues which may be used to improve upon the institution.[154] Guardianship registration records will lay the foundation of a new wave in understanding how guardianship affects an individual's freedoms as well as utilizing collected data to educate future guardians more effectively.[155]

Legal processes are foreign and often intimidating to most people.[156] A guardian is bound by a fiduciary relationship, which creates a potential legal liability on behalf of the guardian.[157] The court should address the potential legal implications with a proposed guardian and ensure that said person is fully informed on the legal issues that may arise throughout the guardianship by requiring the guardian's certification.[158] A breach of duty may result in sanctions, suspension, or removal of the guardian.[159] The court will decide.[160] Certification will follow an educational course to prepare a proposed guardian.[161] The certified guardian is then presented with a document that states their status as a certified guardian.[162] Certification ensures that a proposed guardian is informed and equipped with the tools needed to care for their incapacitated loved one, including a community of other people in a similar situation by which the guardian may tap into when faced with difficult situations throughout the guardianship.[163] The guardian's certification process should establish a legal presumption that the breach of the fiduciary duty is made knowingly because the guardians acted adversely to the duty owed to the ward.[164] Failing to act in the ward's best interest, such as

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151. *Id.*

152. Thomas M. Featherston, Jr., Lisa H. Jamieson, Judge Steve M. King, Sarah Patel Pacheco, REGISTRATION OF GUARDIANS § 17:60 (Texas Practice Guide Probate, 2021).

153. *See* discussion *supra* Section VII.A.1.

154. *See* discussion *supra* Section VII.A.1.

155. *See* discussion *supra* Section VII.A.1.

156. Margaret Hagan, *The Legal System Needs to be Redesigned, By Normal People for Normal People*, OPEN L. LAB (Nov. 18, 2015), https://www.openlawlab.com/2015/11/18/the-legal-system-needs-to-be-redesigned-by-normal-people-for-normal-people/ [https://perma.cc/W8XD-RNLC].

157. UNIF. PROB. CODE § 5-314 (amended 2019) (1969).

158. *See* discussion *infra* Section VIII.A.1.

159. Mary F. Radford, *§ 5:31. Sanction, Suspension, or Removal of Conservator; Appointment of Temporary Substitute Conservator*, GA. GUARDIANSHIP & CONSERVATORSHIP (2020).

160. *Id.*

161. *See* discussion *supra* Section VIII.A.1.

162. *See* discussion *supra* Section VIII.A.1.

163. *See* discussion *infra* Section VIII.A.1.

164. *See* discussion *infra* Section VIII.A.1.

mishandling of money for self-dealing, is a breach of fiduciary duty.[165] The guardian is made aware of the duty via educational course and certification, so any conflict with that duty is an informed decision.[166]

2. Duties of the Guardian

Section 5-314 of the UPC details guardian's role and how the guardian should care for the ward.[167] The guardian, "at all times, shall act in the best interest and exercise reasonable care, diligence, and prudence."[168] Standards set forth for guardians were made to align with the ideals of autonomy and to "encourage the development of maximum self-reliance and independence of the incapacitated person and to make appointive and other orders only to the extent necessitated by the incapacitated persons mental and adaptive limitations."[169] A ward's values and expressed desires are given weight in the decision-making process, but only "to the extent known to the guardian."[170] Limiting language does not alleviate the guardian from making an effort to learn the ward's personal values and to inquire what the ward desires before the guardian makes decisions.[171] By establishing an expectation that a ward, while incapacitated, retains the ability to influence the guardian in decision making, the ward's best interest is better served.[172] Also, a ward will maintain a sense of dignity because their voice should be considered throughout the decision making process that directly affects their life.[173]

3. Powers of The Guardian

Powers expressly granted to the guardian under UPC section 5-315 include:

> (a) Except as otherwise limited by the court a guardian may:
> (1) apply for and receive money payable to the ward or the ward's guardian or custodian for the support of the ward under the terms of any statutory system of benefits or insurance or any private contract, devise, trust, conservatorship, or custodianship;

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165. *Breach of Fiduciary Duties*, HOFFMAN, https://www.hoffmanpa.com/practices/probate-guardianship-trusts-estates/guardianship-contests/breach-of-fiduciary-duties/ (last visited Jan. 26, 2021) [https://perma.cc/D3CX-5YMG].

166. *See* discussion *infra* Section VIII.A.1.

167. UNIF. PROB. CODE § 5-314 (amended 2019) (1969).

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.*

172. *Id.*

173. *See id*.

> (2) if otherwise consistent with the terms of any order by a court of competent jurisdiction relating to custody of the ward, take custody of the ward and establish the ward's place of custodial dwelling, but may only establish or move the ward's place of dwelling outside this state upon express authorization of the court;
> (3) if a conservator for the estate of the ward has not been appointed with existing authority, commence a proceeding, including an administrative proceeding, or take other appropriate action to compel a person to support the ward or to pay money for the benefit of the ward;
> (4) consent to medical or other care, treatment, or service for the ward;
> (5) consent to the marriage [or divorce] of the ward; and
> (6) if reasonable under all of the circumstances, delegate to the ward certain responsibilities for decisions affecting the ward's well-being
>
> (b) The court may specifically authorize the guardian to consent to the adoption of the ward.[174]

A guardian is granted a significant amount of power over the ward's life.[175] While the court must make decisions based on the best interests of the ward, a guardian has the potential to wield such power of the ward as to harm the ward.[176] Some states have limited the power by statute as to "prohibit a guardian from consenting to certain procedures . . . especially procedures which implicate the incapacitated persons constitutional rights."[177] Further, "[t]here may be similar requirements requiring a guardian's consent to electroconvulsive therapy (ECT) or other shock treatment, experimental treatment, sterilization, forced medication with psychotropic drugs, or abortion."[178] The court may limit the powers of the guardian as they see fit.[179] Granting excessive powers to a guardian is risky, and may allow a guardian to take advantage of the position bestowed upon them by the court.[180] Monitoring mechanisms are in place to allow the court continued review of guardianship and to readjust such guardianship as the relationship progresses over time.[181]

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174. *Id.* § 5-315.
175. *See* Gregory Atkinson, *Towards a Due Process Perspective in Conservatorship Proceedings for the Aged*, 18 J. FAM. L. 819, 829 (1979).
176. *See id*.
177. UNIF. PROB. CODE § 5-315 cmt.
178. *Id.*
179. *See id*. § 5-315.
180. Hannaford & Hafemeister, *supra* note 78, at 12.
181. UNIF. PROB. CODE § 5-315.

4. Monitoring the Guardianship

Once guardianship is implemented, the UPC creates a monitoring system for guardianships in section 5-317.[182] Within a thirty (30) day period after the guardian is appointed, the guardian must submit a report to the court containing information about the ward's condition and the ward's account(s) for money and assets which the guardian has possession or control by way of the guardianship.[183] The report must be in writing and the guardian must report to the court on an annual basis (or at any time the court orders a report).[184] The contents of the report must contain:

(1) the current mental, physical, and social condition of the ward;
(2) the living arrangements for all address of the ward during the reporting period;
(3) the medical, educational, vocational, and other services provided to the ward and the guardian's opinion as to the adequacy of the ward's care;
(4) a summary of the guardian's visit with the ward and the activates on the ward's behalf and the extent to which the ward has participated in the decision-making;
(5) if the ward is institutionalized, whether the guardian considers the current plan for care, treatment, or rehabilitation to be in the ward's best interest;
(6) plans for future care; and
(7) a recommendation as to the need for continued guardianship and any recommended changes in the scope of guardianship.[185]

The court should establish a way to monitor guardianships by means deemed necessary by the court, including the filing and review of reports.[186] Monitoring systems must contain mechanisms for assuring reports made on an annual basis are filed and reviewed in a timely manner.[187] Official comment for section 5-317 highlights that "[an] independent monitoring system is crucial for a court to adequately safeguard against abuses in the guardianship cases."[188] A court may appoint a person to review said report, and to make investigatory efforts if necessary.[189] The visitor appointed to investigate the guardianship by the court has a duty to investigate whether less restrictive alternatives to conservatorship exist and report to the court if

182. *Id.* § 5-317.
183. *Id.*
184. *Id.*
185. *Id.*
186. *Id.* § 5-317 cmt.
187. UNIF. PROB. CODE § 5-317 cmt.
188. *Id.*
189. *See id.*

such alternatives are a more feasible option for the ward.[190] The UPC's independent monitoring requirement is a retroactive protection that is needed to address harm that may go unseen by the court but for the reporting and ongoing monitoring of the guardianship.[191]

a. Termination or Modification of Guardianship

Under section 5-318 of the UPC, the guardianship is terminated upon the death of the ward.[192] The guardianship may also be terminated if the ward, guardian, or another person who is interested in the ward's welfare, petitions the court to terminate the guardianship—if it is determined that the ward no longer needs the assistance or protection of a guardian.[193] The probate judge is bound to make decisions that are in the best interest of the ward; therefore, the court may modify, rather than terminate, the guardianship if it is determined that the ward is still unable to care for themselves.[194] The court may alter the type of appointment or powers granted to the guardian if, after review, the court finds the extent of protection or assistance previously needed are no longer needed.[195] Moreover, the court will consider the ward's preferences and personal values when determining the terms of the guardianship.[196]

UPC section 5-314 list the duties of the guardian.[197] The guardian has a duty to report to the court if the ward's condition changes so significantly that the guardian believes that the ward is "capable of exercising rights previously removed."[198] If the guardian immediately reports changes in the ward's condition, the risk that the ward will be trapped in a guardianship longer than necessary is reduced because the ward will not have to wait to have their rights restored.[199] Enumerating the duty to immediately report any changes in the ward's condition gives the guardian proper notice of the duty, which leaves no room for excuses as to why the guardian did not immediately report any changed circumstances.[200] This bright line rule of liability for failure to immediately report furthers efforts to adequately protect the ward from unnecessary guardianship.[201] The guardian will be liable for

190. *See id.*
191. *See* discussion *infra* Section VIII.B.
192. UNIF. PROB. CODE § 5-318(a).
193. *Id.* § 5-318.
194. *Id.*
195. *Id.*
196. *Id.*
197. *Id.* § 5-314.
198. UNIF. PROB. CODE § 5-314(5).
199. *Id.* § 5-314 cmt.
200. *Id.* § 5-318 cmt.
201. *See* discussion *supra* Section VIII.A.1.

perpetuating guardianship for self-serving reasons,[202] for example, payment from the ward's estate to the guardian for services.[203]

If the court is petitioned for review and termination of the guardianship, the party petitioning the court must make a prima facie showing in order to terminate the guardianship.[204] The official comment of section 5-318 explains that the standard to establishing guardianship should be higher than the standard to terminate or modify guardianship.[205] The standard set forth is aligned with the intention to protect the ward from unnecessary guardianship.[206] Once the party has proven their case to the court, the burden shifts to the opposing party to prove by clear and convincing evidence that continuation of the guardianship is in the best interest of the ward.[207]

C. Conservatorship

Conservatorship under the UPC refers to the legal relationship between the incapacitated person's property and the person appointed by the court to oversee the conservatee's estate and affairs.[208] The court may simultaneously create a guardianship and conservatorship in the same person (like Jamie Spears oversees Britney Spears' person and property), or appoint different people for each role.[209] The court may also implement conservatorship over the proposed ward's property in conjunction with guardianship over the person depending on what the court determines is in the best interest of the proposed ward.[210] The court may also grant a limited or unlimited conservatorship as is available for guardianship.[211] Conservatorships under the UPC contain revisions which emphasize limiting assistance of an incapacitated person to allow such persons autonomy.[212]

If the court determines that a person is unable to manage property and business affairs themselves, the court will appoint a conservator under UPC section 5-401.[213] UPC section 5-401(2)(A) establishes that a court will determine:

> [b]y clear and convincing evidence, the individual is unable to manage property and business affairs because of an impairment in the ability to

202. *See* discussion *supra* Section VIII.A.1.
203. *See* discussion *supra* Section VIII.A.1.
204. UNIF. PROB. CODE § 5-318 cmt. (amended 2019) (1969).
205. *See id.*
206. *See id.*
207. *See id.*
208. *Id.* § 5-401.
209. UNIF. PROB. CODE §§ 5-401, 5-315.
210. *See id.* §§ 5-401, 5-315.
211. *Id.* § 5-401.
212. *Id.*
213. *Id.*

> receive and evaluate information or make decisions, even with the use of appropriate technological assistance . . .
> And;
> by a preponderance of the evidence, the individual's property that will be wasted or dissipated unless management is provided, or money is needed for the support, care, education, health, and welfare of the individual or of individuals who are entitled to the individual's support and that protection is necessary or desirable to obtain or provide money.[214]

UPC section 5-401(2) requires that the proposed ward is impaired as to warrant a status of "incapacitated" similar to the test for the appointment of a guardian under UPC section 5-102(4).[215] Further, the drafting committee took into consideration potential technological assistance for the proposed conservatee and determined that the importance of the proposed conservatee's rights required any technological assistance available to be a consideration regardless of the cost.[216] Such a provision was created in mind with assisting an incapacitated person by the least restrictive means.[217]

1. Who May Be a Conservator?

UPC section 5-413 lists persons who may be conservator of a conservatee's property in an order of priority—the list is nearly identical to UPC section 5-310.[218] Similar to who may become a guardian, the court determines whether a particular person as a conservator is in the best interest of the conservatee.[219] The court may use its discretion to appoint a person out of order of the priority list.[220] The proposed conservatee may nominate an individual to serve as the conservator, and if the nominee has sufficient capacity to express a preference, that person will be granted priority over the conservatee's relatives.[221] A conservatee with capacity to choose their conservator is granted this choice based on the theory that the appointed person is the person who conservatee would most likely prefer to act.[222] UPC section 5-413 provides that a relative or spouse has priority in consideration of becoming a conservator.[223] Having a close personal relationship with the conservatee may be an asset to the conservatee, but may also create risk due to the close nature of the relationship.[224] A guardian of close kinship to the

214. *Id.* § 5-401(2)(A).
215. UNIF. PROB. CODE § 5-401(2).
216. *Id.* § 5-401 cmt.
217. *Id.*
218. *Id.* § 5-413.
219. *Id.*
220. *Id.* § 5-413 cmt.
221. UNIF. PROB. CODE § 5-413 cmt.
222. *Id.*
223. *Id.*
224. *In re* Guardianship of Vesa, 892 S.W.2d 491, 579 (Ark. 1995).

ward may attempt to act in the best interest of the ward, but may have clouded judgement because of the relationship.[225] Courts should use the standard of reasonableness in applying a close relative or spouse as a conservator so that priority is given to someone with whom the conservatee has a close, enduring relationship with.[226]

This section of the UPC is similar to determining who has priority for proposed guardianship.[227] The same suggestions made in Section III above, proposed vetting, are also relevant and should be applied to conservatorships under the UPC.[228]

2. Protected Person's Interest in Inalienable Rights

UPC section 5-422 grants protections of the conservatee's property rights while under conservatorship.[229] Official comment of section 5-422 discusses the relationship between conservator and conservatee in regard to the conservatee's property, which is similar to a trustee relationship.[230] UPC section 5-422 grants protection of the conservatee's rights to the property and is intended to afford protections to the estate as well.[231] The intent behind this subsection should be expanded upon.[232] The theory of a fiduciary relationship as a trustee should extend to all sections of the UPC in respect to guardians and conservatorships.[233] Official comments are not binding law; the UPC may improve upon itself by establishing the duty of the conservator as one of a trustee.[234]

a. Best Interest of the Ward

Throughout the UPC, the court is bound to act "in the best interest of the ward."[235] However, the UPC does not create bright-line rules for determining what is in the best interest of the ward.[236] Creating a bright line rule may be difficult as each person's situation is unique and will require a

225. *See* UNIF. PROB. CODE § 5-413.
226. *Id.*
227. *Id.* § 5-413(c).
228. *See* discussion *supra* Section III.B.1.b.
229. UNIF. PROB. CODE § 5-422.
230. *Id.* § 5-422 cmt.
231. *Id.*
232. *Id.*
233. *Id.*
234. *Persuasive Authority*, CORNELL L. (May 2020), https://www.law.cornell.edu/wex/persuasive_authority (last visited Jan. 28, 2021) [https://perma.cc/CT7U-4T85].
235. *See, e.g.*, UNIF. PROB. CODE § 5-107 cmt. ("[t]he standard . . . is always the best interest of the ward.").
236. *See* discussion *supra* part III.

case-by-case analysis of what is in the best interest of the ward.[237] While no set of rules will fit perfectly to each situation, more explicit guidance from the UPC may prove to benefit the guardianship and conservatorship proceedings.[238] The UPC currently offers understanding of the ward's best interest by considering the proposed ward's preference of who may be a guardian (if sufficient capacity is found).[239] Also, the UPC expanded upon appointing a guardian that has a "close enduring relationship" to include persons with whom the ward has resided with for six months prior to the ward's incapacity (as opposed to the previous version of the code which limited the "close enduring relationship" to a spouse or domestic partner).[240] The UPC affords protection of the ward through mandatory accounting and reporting to the court to ensure the relationship is still in the best interest of the ward.[241]

What is best for the ward should be expanded to include guardians who are properly vetted, trained, and certified.[242] Incorporating the expectation of a fiduciary duty in context of guardianship and enumerating what causes of action may be brought for a breach of that fiduciary duty would further serve the best interest of the ward.[243]

Section 5-314 lists the duties of the guardian, but the repercussions for violating the duties are not listed.[244] Guardians should be put on notice of what a breach of fiduciary duty entails and what will happen if the duty is breached; such notice may serve as a proactive protection of the ward.[245]

The UPC should add a section "causes of action" under the code for breach of fiduciary duty and other claims for specific harms which may arise from the guardian-ward relationship. Adding this measure will ease access to the courts by way of an established case and controversy arising from the court appointed guardianship.

3. Challenging Guardianship Under the UPC

The UPC allows a petition by a "ward, guardian or another person interested in the wards welfare" to review or terminate guardianship.[246] If the UPC explicitly outlines the fiduciary duties and causes of action for breach of the duties, then an action challenging the guardianship or seeking to

237. Lawrence A. Frolik, *Promoting Judicial Acceptance and Use of Limited Guardianship*, 31 STETSON L. REV. 735 (2002).
238. *Id.*
239. UNIF. PROB. CODE § 5-310.
240. *Id.* § 5-310 cmt.
241. *Id.* § 5-317.
242. *See* discussion *infra* Section V.B.2.
243. *See* discussion *infra* Section V.B.2.
244. UNIF. PROB. CODE § 5-314.
245. *See* discussion *infra* Section V.B.2.
246. UNIF. PROB. CODE § 5-318.

terminate the guardianship will be strengthened by establishing a prima facie case for termination via breach of fiduciary duty and enumerated cause of action under this code.[247] As official comment of UPC section 5-414 states, "it is essential that the protected person have the right to petition for the appropriate relief."[248] This will put guardians on notice of their liability under the code while granting the ward proper means to bring a challenge of the guardianship through an established cause of action.[249]

IV. BRITNEY SPEARS IN CALIFORNIA

Britney Spears is under conservatorship in the state of California.[250] Spears's story began as her mental health issues unfolded in public.[251] Britney was in the middle of a divorce and child custody battle, was battling drug abuse, and was estranged from her parents.[252] On January 31, 2008, Britney was admitted to UCLA Medical Center under California Welfare & Institutions Code section 5150 "Dangerous or gravely disabled person; taking into custody procedures," and was placed on a psychiatric hold.[253] California law grants the state power to take a person into custody in emergency situations where a person, as a result of a mental health disorder, is a danger to themselves or others.[254] Concerning behavior by Britney, such as locking herself in a bathroom with one of her children, warranted the state to intervene by exercising its authority under California Welfare & Institutions Code section 5150.[255] The probate court instituted temporary conservatorship over the person and estate of Britney.[256] Britney's father, Jamie Spears, was appointed temporary conservator of Britney's person; Jamie and Andrew Wallet were appointed temporary conservators of the estate; and Samuel Ingham was Britney's court-appointed attorney.[257]

On February 4, 2008, the probate court held a hearing and extended both letters of conservatorship to February 14, 2008.[258] Upon hearing, the probate court determined Britney did not possess the capacity to retain counsel.[259]

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247. *See* discussion *infra* Section V.B.2.

248. UNIF. PROB. CODE § 5-414 cmt.

249. *See* discussion *infra* Section V.B.2.

250. Joanne Kavanaugh, *PROTECTED Britney Spears' Conservatorship: What is it and How Does it Work?* THE SUN (July 6, 2020), https://www.thesun.co.uk/tvandshowbiz/12046668/britney-spears-conservatorship/ [https://perma.cc/KPQ4-XHQA].

251. *Id.*

252. Lutfi v. Spears, No. B246253, 2015 WL 1088127 (Cal. Ct. App. Mar. 11, 2015).

253. CAL. WELF. & INST. CODE § 5150 (West 2021).

254. *Id.*

255. *See In re* Conservatorship & Est. of Spears, No. B214749, 2011 WL 311102, at *1 (Cal. Ct. App. Feb. 2, 2011).

256. *Id.*

257. *Id.*

258. *Id.*

259. *Id.*

Through various other court proceedings, such as the temporary restraining order against her manager Sam, it was brought to light that Britney was being taken advantage of; Britney's mother accused Sam of crushing up pills and drugging Britney.[260] Britney was at risk of harming herself and unable to protect herself against harm from others like Sam.[261] It was clear at the time that Britney needed help, and conservatorship of Britney's person and property functioned as the best choice for Britney at this time in her life as she began the journey towards recovery.[262]

A. California

California conservatorship laws differ from the UPC in that "guardianship" is reserved only for proceedings regarding minors,[263] while "conservatorship" is used in protective proceedings of a person and a person's estate.[264] Section 1800.3(b) of the California Probate Code states, "[n]o conservatorship of the person of the estate shall be granted by the court unless the court makes an express finding that the granting of the conservatorship is the *least restrictive* alternative needed for the protection of the conservatee."[265] The language used by the California Probate Code aligns with the UPC's intent to respect the conservatee's autonomy.[266]

1. Appointment: Standard of Proof

California Probate Code section 1801(a) states that a conservator may be appointed for "a person who is unable to provide properly for his or her personal needs for physical health, food, clothing, or shelter."[267] Further, subsection (b) continues to grant power over said person's estate when "a person who is substantially unable to manage his or own financial resources or resist fraud or undue influence."[268] The code grants the power of conservatorship over the person and estate in subsection (c).[269]

In 2008, the circumstances of Britney's life, such as her public meltdown, met the requirements set forth in the California Probate Code as she was unable to care for herself, her kids, or her finances.[270] Britney's

260. *Id.*
261. *Id.*
262. *Id.*
263. *See* CAL. PROB. CODE § 1419.5 (West 2021).
264. *Id.* § 1800.3.
265. *Id.* § 1800.3(b).
266. *Id.* § 1800.3.
267. *Id.* § 1801(a).
268. *Id.* § 1801(b).
269. CAL. PROB. CODE § 1801(c).
270. *See* CBS, *Timeline: Britney's Public Meltdown* CBS NEWS (Feb. 20, 2007), https://www.cbsnews.com/news/timeline-britneys-meltdown/ [https://perma.cc/4K8Q-YRTE].

manager allegedly exploited Britney according to a book written by Britney's mother, Lynn.[271] Moreover, people remember Britney's reckless behavior such as driving while holding her infant son in the driver's seat and publicly shaving her head.[272]

2. Assessment of Proposed Limited or General Conservatee

California Probate Code section 1827.5 provides that once the necessity of conservatorship is determined by the court, the court shall order an assessment at a regional center pursuant to Division 4.5 of the Welfare and Institute Code.[273] The regional center must deliver a copy of its findings to the proposed conservatee and their attorney if the proposed limited conservatee has one for the purpose of this court proceeding.[274] The regional center will report on "the specific areas, nature, and degree of disability of the proposed conservatee."[275] The court may find, based upon the report, that the proposed conservatee will best benefit from either a limited or unlimited conservatorship.[276] While the report lays a foundational understanding of the level of care the proposed conservatee needs, the report is not binding upon the court.[277]

B. Who May Become a Conservator?

California Probate Code section 1810 allows the proposed conservatee to nominate a person to be their conservator, if the proposed conservatee has sufficient capacity to express an "intelligent preference."[278] Similar to the UPC, the court is bound to appoint a nominee that is in the best interest of the proposed conservatee.[279] Further, if the proposed conservatee cannot form an intelligent preference, section 1811(a) allows, "the spouse, domestic partner, or an adult child, parent, brother or sister of the proposed conservatee may nominate a conservator in the petition."[280] Allowing a close family member to decide who will best serve in the role of conservator when the conservatee is unable to make an intelligent decision preserves the proposed conservatee's preference because a close family member is knowledgeable on the proposed conservatee's personality, preferences, likes, and dislikes.

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271. *See In re* Conservatorship & Est. of Spears, No. B214749, 2011 WL 311102, at *1 (Cal. Ct. App. Feb. 2, 2011).
272. *See* CBS, *supra* note 270.
273. CAL. PROB. CODE § 1827.5 (2008).
274. *Id.*
275. *Id.* § 1827.5(c)(1).
276. *Id.* § 1827.5.
277. *Id.*
278. *Id.* § 1810.
279. *See id.*
280. *Id.* § 1811(a).

While the court may honor the proposed conservatee's preference, the court will make the decision based on what is in the best interest of the proposed conservatee.[281] Section 1812 grants the court discretion to appoint a conservator in order of preference listed in the statute, or to select a conservator out of the order of preference based on the courts finding of what is in the best interest of the proposed conservatee.[282]

1. Duties of Conservator

California Probate Code section 1835 lists the duties, limitations, and responsibilities of the conservator.[283] Explicitly listing the duties of the conservator in the code binds the conservator to a standard of care expected of the conservator.[284] The legal standard listed in the code allows the court to hold the conservator legally responsible for any breach of duty the conservator owes to the conservatee.[285] The conservator has proper notice of the expectations of care as the fiduciary duties are explicit pursuant to the code.[286] Section 1835 states:

> (a) Every superior court shall provide all private conservators with written information concerning conservator's rights, duties, limitation, and responsibilities under this division.
> (b) The information to be provided shall include, but not be limited to, the following:
> (1) the rights, duties, limitations, and responsibilities of a conservator
> (2) the rights of the conservatee
> (3) how to assess the needs of the conservatee
> (4) how to use community-based services to meet the needs of the conservatee
> (5) how to ensure that the conservatee is provided with the least restrictive possible environment
> (6) the court procedures and processes relevant to conservatorships
> (7) the procedures for inventory and appraisal, and the filing of accounts[.][287]

California law is progressive because the law puts responsibility on the court to ensure that the court is diligent while selecting a conservator, but also ensures that the conservator is equipped with knowledge of the responsibility

281. CAL. PROB. CODE § 1810 cmt.
282. *Id.* § 1812.
283. *Id.* § 1835.
284. *Id.*
285. *Id.*
286. *Id.*
287. CAL. PROB. CODE § 1835.

and legal duty bound upon them.[288] The section continues by stating that: "(c) An information package shall be developed by the Judicial Council, after consultation with the following organizations or individuals."[289]

Again, the court has the responsibility to properly educate and inform new conservators.[290] The ward's best interest is substantively considered because the court has a duty to consult with various organizations by collecting information for the package to be given to the conservator.[291] The Judicial Council consults with:

> (1) The California State Association of Public Administrators, Public Guardians, and Public Conservators, or other comparable organizations
> (2) The State Bar
> (3) Individuals or organizations, approved by the Judicial Council, who represent court investigators, specialist with experience in performing assessments and *coordinating community-based services*, and legal services programs for the elderly.[292]

California takes a more holistic approach when considering conservatorships as the role of a conservator is researched and condensed through various entities.[293] A community-based approach allows the conservator-conservatee relationship to develop in a progressive manner because they will not be isolated and will be held to standards set forth by the community.[294]

2. Review of Conservatorship

California Probate Code section 1850 mandates the court to review the conservatorship.[295] Section 1850 refers to section 1851(a) of the code by ordering a court investigation pursuant to section 1851(a).[296] Six months after the appointment of the conservator, a court investigator must report to the court about the appropriateness of the conservatorship.[297] Further, the court investigator must determine if the conservator is still operating in the best interest of the conservatee.[298] Following this, the court must review the

288. *See id.* § 1835(c).
289. *Id.*
290. *Id.*
291. *Id.*
292. *Id.* (emphasis added)
293. *See id.* § 1835.
294. *See id.*
295. *Id.* § 1850.
296. *Id.* § 1851(a).
297. *Id.*
298. *Id.*

conservatee's placement, quality of care (physical and mental), and finances.[299] The court then has discretion to take action based on the findings of the investigation, such as to further review the conservatorship or to order an accounting from the conservator.[300]

Frequency of review depends on the court.[301] The court must review the conservatorship one year after the appointment of the conservator and, based off that report, may order review annually or biannually.[302] The subsequent review period is determined in lieu of what is in the conservatee's best interest.[303]

Review of the conservatorship is also available at the request of any "interested person."[304] Interested persons are, "generally proper parties and may be permitted to intervene in guardianship or conservatorship proceedings."[305] An example of an interested person is next of kin, and these individuals will be a proper party to the guardianship proceedings as a consequence of their interest in the guardianship.[306] An interested person may request review or accounting of the assets of the estate in accordance with California Probate Code section 2620.[307]

3. Termination of Conservatorship

Conservatorship is terminated upon death of the conservatee or by order of the court.[308] A court order subject to California Probate Code section 2476 grants the conservator powers in accordance with the terms of the conservatorship which are necessary to perform the conservator's duty.[309] Section 1860 does not apply to limited conservatorships.[310]

Termination of a limited conservatorship is subject to California Probate Code section 1860.5.[311] Section 1860.5 enumerates instances where termination is proper.[312] Ultimately, the limited conservatorship is terminated upon death of conservator or conservatee, or if the court finds that the conservatorship is no longer necessary for the limited conservatee.[313] An interested person, the limited conservator, or conservatee may petition the

299. *Id.* § 1850(a)(1).
300. *Id.* § 1850(a)(1)(A)–(B).
301. *Id.* § 1850.
302. *Id.*
303. *Id.* § 1850(b).
304. *Id.*
305. 57 C.J.S. Mental Health § 142.
306. *Id.*
307. CAL. PROB. CODE § 2620.
308. *Id.* § 1860.
309. *Id.* § 2467.
310. *Id.* § 1860(c).
311. *Id.* § 1860.5.
312. *Id.*
313. CAL. PROB. CODE § 1860.5.

court stating facts showing that the limited conservatorship is no longer necessary.[314]

V. TEXAS

Texas Estates Code section 1001.001 grants the state either full or limited authority over an incapacitated person.[315] Texas determines the level of authority granted to the guardian in proportion to the level of assistance the court finds is necessary to protect the well-being of the ward.[316] Texas' laws on guardianship are designed to promote maximum self-reliance and independence of the ward.[317] If an incapacitated person has the ability to make personal decisions in some areas of their life, then they retain the right to do so.[318] The purpose of guardianship, provided in section 1001.001, is congruous with the progressive movement towards preservation of individual freedoms of incapacitated persons.[319]

A. Creation of Guardianship—Standards of Proof

Before guardianship is implemented, Texas Estates Code section 1101.101 requires the court to find, by clear and convincing evidence, the proposed ward is incapacitated; the guardianship is in the best interest of the proposed ward; and all alternatives to guardianship were considered.[320] The current version of the statute, implemented in 2015, mandated the consideration of other less-restrictive alternatives to guardianship before finding—by clear and convincing evidence—that guardianship is necessary.[321] This additional requirement reflects the Texas Legislature's intent to preserve incapacitated persons' rights in decision-making.[322]

Section 1101.101 also requires the court to find—by a preponderance of the evidence—that the proposed guardian is eligible to become a guardian.[323] The preponderance of the evidence standard applies to subsection D which states:

> The proposed ward: (i) is totally without capacity as provided by this title to care for himself or herself and to manage his or her property; or (ii) lack

314. *Id.*
315. TEX. EST. CODE ANN. § 1001.001(a).
316. *Id.* § 1001.001.
317. *Id.* § 1001.001(b).
318. *Id.* § 1001.001.
319. *Id.*
320. TEX. EST. CODE ANN. § 1101.101)(a)(1)(A)–(E).
321. Amanda Kreshover, *2015 Legislative Update: Texas Guardianship Law*, HOUS. L., Sept./Oct. 2015, at 16.
322. *Id.*
323. TEX. EST. CODE ANN. § 1101.101(a)(2).

> the capacity to do some, but not all, of the tasks necessary to care for himself or herself or to manage his or her property.[324]

The clear and convincing evidence standard is slightly higher than preponderance of the evidence—the court must find that the person's incapacitation has a substantially greater than 50% likelihood of being true.[325] In comparison, preponderance of the evidence must show the guardian is at least 51% eligible to serve as a guardian.[326] The court must find more proof to implement guardianship but not so much as to who may be a guardian.[327] Determining who is eligible to be a guardian is just as, if not more, consequential when implementing the guardianship.[328] Wards in Texas may benefit from a more rigorous process when considering who is eligible to become a guardian.[329]

B. Appointment of a Guardian

Texas allows any person to commence a proceeding by filing an application in the proper court.[330] Guardianship may be sought over the person, property, or both.[331] Texas Estates Code section 1001.001 establishes that the applicant must consider alternatives to guardianship before the applicant becomes guardian.[332] Consideration of guardianship alternatives is not a dispositive factor but it evidences the intent that guardianship is the last resort for incapacitated persons.[333]

The court may exercise its authority to initiate guardianship proceedings if it "has probable cause to believe that a person domiciled or found in the court in which the court is located is an incapacitated person, and the person does not have a guardian in the state."[334] Probable cause may be determined by a letter to the court submitted by an interested person or a letter certified by a physician who believes the person is incapacitated.[335] The court will appoint a guardian ad litem or an investigator.[336] The role of a guardian ad

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324. *Id.* § 1101.101(D).

325. Ken LaMance, *What Is the Clear and Convincing Evidence Standard?*, LEGAL MATCH https://www.legalmatch.com/law-library/article/clear-and-convincing-evidence-standard.html (last visited Jan. 26, 2021) [https://perma.cc/B3E9-RMJV].

326. *Id.*

327. TEX. EST. CODE ANN. § 1101.101(a)(1)–(2).

328. *Ten Things to Think About: Choosing a Guardian*, FINDLAW (Nov. 18, 2018), https://www.findlaw.com/family/guardianship/ten-things-to-think-about-choosing-a-guardian.html [https://perma.cc/WJ2M-R66H].

329. *See* discussion *infra* Section VIII.A.1.

330. TEX. EST. CODE ANN. § 1101.001(a).

331. *Id.* § 1101.001(a)(3).

332. *Id.* § 1101.001.

333. *Id.*

334. *Id.* § 1102.001(a).

335. *Id.*

336. TEX. EST. CODE ANN. § 1102.001(b).

litem or court investigator is to assist in determining if guardianship is necessary for the potentially incapacitated person.[337]

1. Eligibility and Qualifications

Once the court determines guardianship is necessary, the court must select an appropriate person to serve as guardian.[338] A guardian may be a friend or family member of the ward, or a professional guardian.[339] The Texas Estates Code is similar to the UPC and California Probate Code, in that Texas will appoint a guardian in accordance to the circumstances and in consideration of the best interest of the ward.[340] Texas Estates Code section 1101.102 provides a list in the order of preference of who may serve as guardian if the court finds that two or more persons are equally qualified to be appointed guardian of the incapacitated person.[341] Texas gives preference to spouses and next of kin.[342] If two or more persons are in equal degree of kinship, the court will exercise its discretion to choose who will serve as guardian in the best interest of the incapacitated person.[343] The preference given to spouses and next of kin increases the likelihood that the guardian will be a non-professional guardian.[344]

2. Certification of Guardian

Texas differs from the UPC and California Probate Code because it requires registration and certification of professional guardians.[345] Texas Estates Code section 1104.251 mandates that professional guardians obtain certification under Subchapter C, Chapter 155, of the Government Code.[346] Professional guardians must also meet certain requirements such as a high school education, a bachelor's degree in a relevant field, and two plus years of experience in a field relevant to guardians.[347] Certification for professional guardians is a component of their education and training similar to holding a license to practice law.[348] Texas does not require certification of

337. *Id.* § 1102.001(b)(1).
338. *Id.* § 1104.001.
339. *Id.*
340. *Id.*
341. *Id.* § 1104.102.
342. TEX. EST. CODE ANN. § 1104.102..
343. *Id.*
344. *Id.*
345. *Id.* § 1104.251.
346. *Id.*
347. *Guardianship Certification*, TEX. CTS., (Mar. 11, 2021) https://www.txcourts.gov/jbcc/guardianship-certification/initial-certification/ [https://perma.cc/9E2F-EPAM].
348. *Id.*

non-professional guardians (friends, family) but offers optional provisional certification.[349]

However, certification should be mandatory for non-professional guardians as well.[350] Certification entails the study of guardianship law and the passing of an examination, with a limited number of chances.[351] Providing an educational component to guardianship will serve the best interest of the ward because an educated guardian will obtain the tools necessary to carry out their role in the most effective manner.[352] Non-professional guardians are most likely to be family or friends—people with little to no experience with guardianship.[353] Although no official statistics exists, it is believed that about eighty percent of guardians are relatives of the incapacitated person.[354] The responsibilities of guardianship are great and potentially cumbersome, therefore lay persons need certification before entering into the fiduciary role.[355]

Texas also mandates that each guardian, professional or not, must register with the state before undertaking the role of guardian.[356] Guardianship registration requires the potential guardian to complete an hour-long online training course.[357] As of the time of writing this comment, the Texas Guardianship Training includes: (1) "Understanding Why Guardianship May be Necessary;" (2) "Overview of Alternatives to Guardianship;" (3) "Types of Guardianships;" (4) "Process to Establish Guardianship;" (5) "Duties of the Guardian;" (6) "Reporting Requirements of the Guardian;" and (7) "Modifying, Terminating, or Closing a Guardianship."[358] Information provided to potential guardians through training and certification proves fundamental to understanding the role of guardianship and should be required for family and friends of the incapacitated person in order to facilitate a functional relationship between the guardian and ward.[359]

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349. TEX. EST. CODE ANN. § 1104.253.

350. *See* discussion *infra* Section VIII.A.1.

351. *See Guardian Certification*, *supra* note 347.

352. *See* discussion *infra* Section VIII.A.1.

353. *See* discussion *infra* Part VI.

354. Gurnon, *supra* note 55, at 9.

355. *See* discussion *infra* Section VII.A.1.

356. *Register a Guardianship*, TEX. CTS. (Jan. 15, 2021), https://www.txcourts.gov/jbcc/register-a-guardianship/ [https://perma.cc/58YH-7S6P].

357. *Texas Guardianship Training*, TEX. JUD. BRANCH, https://guardianship-txcourts.talentlms.com/catalog/info/id:144 (last visited Feb. 2, 2021) [https://perma.cc/Y63S-CM77].

358. *Id.*

359. *See id.*

C. Termination and Review of Guardianship

Guardianships must be reviewed on an annual basis.[360] Review encompasses the well-being of the ward, and the court shall reasonably determine whether a guardian is performing all the duties of the guardian in a diligent manner.[361] Upon review, the court may determine that the ward has retained sufficient capacity as to warrant termination or modification of the guardianship.[362]

D. Less Restrictive Alternatives to Guardianship

Texas guardianship laws include a progressive alternative to guardianship-supported decision making.[363] Texas Estates Code section 1357.003 states the purpose of supported decision making is to recognize a least restrictive alternative to guardianships.[364] Adults that are high-functioning are good candidates for supported decision making because the tool is designed for adults with disabilities who need help making daily decisions but who are not considered incapacitated so as to require a guardianship.[365] Texas is one of nine states to implement the less restrictive alternative to assist persons who retain decision-making capability but are still in need of some guidance in making life decisions.[366] Supported decision making allows high-functioning persons to retain autonomy while simultaneously carrying out the protection function that guardianship aims to preserve.[367]

1. Supports and Services

Texas guardianship law requires the court to consider supports and services available to a potential ward that may assist in daily living.[368] Sufficient supports and services aid a potentially incapacitated person in decision making.[369] Accounting for such assistance may allow a high functioning person to retain the requisite capacity to avoid guardianship.[370]

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360. TEX. EST. CODE ANN. § 1201.002(a).
361. *Id.*
362. *Id.* § 1201.052.
363. *Id.*§ 1357.001.
364. *Id.* § 1357.003.
365. *Id.* § 1357.003.
366. Zachary Allen & Dari Pogach, *More States Pass Supported Decision-Making Agreement Laws*, AMERICAN BAR ASS'N (Oct. 1, 2019) https://www.americanbar.org/groups/law_aging/publications/bifocal/vol-41/volume-41-issue-1/where-states-stand-on-supported-decision-making/ [https://perma.cc/V49T-LHRU].
367. TEX. EST. CODE ANN. § 1357.003.
368. *Id.* § 1101.101(a)(1)(E).
369. *Id.*
370. *Id.*

Consideration of supports and services is another mechanism in place to prevent a high functioning person from losing autonomy through guardianship.[371] In *Guardianship of N.P.*, the court defined supports and services as "including formal and informal resources and assistance that enable a person to make those particular decisions [regarding residence, voting, operation of motor vehicle, or marriage]."[372] The court must take a comprehensive approach when considering the assistance needed to support the potentially incapacitated person and what support is available on a case-by-case basis because each set of facts will be unique to each person.[373]

VI. POTENTIAL FOR ABUSE

The conservatorship of Britney Spears and the #FreeBritney movement turned a Twitter trend into a serious conversation about the complexities of conservatorship law.[374] Britney's case draws attention to abuse of wards because of her fame.[375] Britney's fame sets forth a unique set of circumstances for the court to consider when making decisions surrounding her conservatorship.[376] The legal community's concern of abusive guardianships is not new; however, because of the #FreeBritney movement, it is a rising issue for the general public.[377]

VII. STORIES OF ABUSE

Across the United States, millions of people find their lives have unexpectedly turned towards guardianship.[378] Further, those guardianships are stripping people of freedoms and subjecting them to the will of the court.[379]

Emily Gurnon, warns:

> [m]ost of us don't think we would ever end up in a nursing home against our will. We can't image having our hard-earned savings drained by someone assigned to take care of us. We would never believe that we might someday be kept away from the people we love the most. But those are the

371. *Id.*

372. Guardianship of N.P., No. 02-19-00233-CV, 2020 WL 7252322, *4 (Tex. App.—Fort Worth Dec. 10, 2020).

373. *Id.*

374. Newcomb, *supra* note 24, at 4.

375. *Id.*

376. *Id.*

377. Gregory Atkinson, *Towards a Due Process Perspective in Conservatorship Proceedings for the Aged*, 18 FAM. L. 819 (1979).

378. *See generally Guardianship Education and Prevention*, AAAPG, https://aaapg.net (last visited Oct. 20, 2020) [https://perma.cc/7GH6-D36Y] (a platform where persons share their stories of abusive guardianship to spread awareness of abusive guardianships).

379. *Id.*

> kinds of nightmares suffered everyday by some of the estimated 1 million to 2 million people who have been placed under guardianship or conservatorship in the United States.[380]

Take, for example, Marie Long, a woman living in Phoenix who managed to save $1.3 million over her lifetime.[381] Following a stroke, Marie Long was placed under guardianship.[382] A mere four years later, she lost almost every penny because of the mishandling of her funds by an unscrupulous guardianship agency.[383]

Similar to Marie Long is the case of Daniel Gross, who was hospitalized while visiting his daughter in Connecticut.[384] During his hospitalization, discourse broke out between his children regarding their father's care and control over his money.[385] Daniel Gross was then placed under conservatorship without being told of the hearing and found himself locked in a nursing home against his will.[386] While being held at the nursing home, Gross shared a room with a violent roommate.[387] He was later freed by a reviewing judge who described Daniel Gross' case as a terrible miscarriage of justice.[388]

The U.S. Government Accountability Office (GAO) conducted a study on guardianship cases of financial exploitation, neglect, and abuse of seniors in 2010.[389] The report found that there had been hundreds of allegations of abuse by guardians made across forty-five states and in the District of Columbia between 1990 and 2010.[390] The report enumerated common themes throughout the cases:

> In 6 of 20 cases, the courts failed to adequately screen potential guardians, appointing individuals with criminal convictions or significant financial problems to manage high-dollar estates. In 12 of 20 cases, the courts failed to oversee guardians once they were appointed, allowing the abuse of vulnerable seniors and their assets to continue. Lastly, in 11 of 20 cases, courts and federal agencies did not communicate effectively or at all with each other about abusive guardians, allowing the guardian to continue the abuse of victims and/or others.[391]

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380. Gurnon, *supra* note 55, at 9.
381. *Id.*
382. *Id.*
383. *Id.*
384. *Id.*
385. *Id.*
386. Gurnon, *supra* note 55, at 9.
387. *Id.*
388. *Id.*
389. *Cases of Financial Exploitation, Neglect, and Abuse of Seniors*, GAO.GOV (Sept. 2010), https://www.gao.gov/assets/gao-10-1046.pdf [https://perma.cc/F8U2-BY3D].
390. *Id.*
391. *Id.*

The report goes on to illustrate each case of abuse of ward in detail.[392] Anecdotes of abusive guardians are vast and continue to grow.[393] Britney's case is just one of many, but it stands out among them all due to her fame and the attention of the media.[394] Now that abusive guardianship is a topic of discussion, legal scholars must capitalize on this opportunity and use the momentum gained by the #FreeBritney movement to push for change.[395]

VIII. PROPOSALS

Guardianship law is mature, complex, and constructed from years of experience.[396] Proposing major change will not meet the goals of protecting wards from abuse, because current laws offer sufficient protections.[397] Courts possess the tools to protect wards but lack resources to maximize protections.[398] The best way to effect change is to promote equitable enforcement of the laws by directing resources to the court system.[399]

Because conservatorship law is state specific, as each state has the right to make laws surrounding property and estate planning, this comment will propose uniform suggestions similar to the UPC, and improvements upon existing laws.[400] Modern conservatorship law is a product of decades worth of experience and improvement upon latent mistakes only to be understood through failure.[401] As the science of psychology and humanity improves, so does our understanding of how the legal system must act in response to new information.[402] The law must take proactive measures to mitigate potential harm, as well as reactive measures to redress any harm a legal tool may inflict upon a person.[403]

A. Proactive Approach: Guidance on "Incapacitated"

Almost all 50 states require that a person be found "incapacitated" before the state's authority to implement guardianship kicks in.[404] However, states vary in the process determining a person's mental capacity.[405] Further, determination of a person's mental capacity is up to the sole discretion of the

392. *Id.*
393. *Id.*
394. Newcomb, *supra* note 24, at 4.
395. *Id.*
396. Hannaford & Hafemeister, *supra* note 78, at 12.
397. *Id.* at 149.
398. *Id.*
399. *Id.*
400. *See* discussion *supra* Parts III, IV, V.
401. *See* discussion *supra* Section II.A.
402. *See* discussion *supra* Section II.A.
403. *See* discussion *supra* Section III.B.1.b.
404. *See* discussion *supra* Section III.A.
405. David, *supra* note 62, at 10.

judge.[406] A potentially incapacitated person's autonomy is left in the hands of just one person with little to no statutory guidance on how to make such a determination.[407]

A judge will take into account many factors such as medical condition, diagnosis, and psychological evaluation in conjunction with living conditions of the person and the person's ability to manage their financial affairs.[408] While specific factors will not be uniformly dispositive in determining incapacity, creating some guidance may improve the court's ability to ensure fair and equal outcomes.[409] The court ultimately makes the decision by using its best judgement.[410] A judge shall exercise their discretion in guardianship cases because each set of circumstances is unique, and it is difficult to imagine that one set of rules may apply to each case.[411]

However, this approach allows for extreme and unpredictable outcomes.[412] Each case is subject to the judge's current disposition; what appears reasonable to one may be unreasonable to another.[413] The ambiguous standard of "incapacity" without a uniform approach in determining incapacity proves harmful to those who find themselves facing guardianship because the standard provides few guidelines as to what conduct ought to result in an involuntary guardianship. [414] Current guardianship laws create a specific standard of incapacity, but fail to illustrate how incapacity is met, which in turn "encourage[s] value judgment rather than neutral fact-finding."[415] A uniform approach to incapacity may take some discretion away from the judge when considering the unique facts of each case.[416] As no one set of facts will be identical, it may be difficult to create uniform guidelines.[417] Nonetheless, the uniform approach may be created in broad scope, allowing the judge to exercise discretion within the guidelines when reaching a decision.

Some states, such as Connecticut, provide factors enumerated in legislation which the judge must consider when evaluating guardianship petitions.[418] Other states list factors for consideration that are not statutorily required.[419]

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406. *Id.*
407. *Id.*
408. *Id.*
409. Hannaford & Hafemeister, *supra* note 78, at 12.
410. David, *supra* note 62, at 10.
411. *Id.*
412. *Id.*
413. *Id.*
414. Hannaford & Hafemeister, *supra* note 78, at 12.
415. *Id.*
416. David, *supra* note 62, at 10.
417. *Id.*
418. *Id.*
419. *Id.*

Daniel Gross' case might have been avoided if a uniform approach to determining incapacity existed.[420] Further, by enumerating a uniform approach to incapacity determination, reviewing attorneys and judges will use the base-line standards to support an argument against a finding of incapacity.[421]

Let us return to Britney's case, and think about how her case may be resolved in light of guidance on incapacity.[422] Britney may strengthen her argument when trying to dissolve her conservatorship if a uniform approach to incapacity is enforced; because she is high-functioning, her circumstances may not fall within the uniform guidelines of incapacity.[423] A uniform approach in determining incapacity will serve as a starting point in all guardianship cases, and will leave some discretion to the judge to factor in the unique set of facts of each case.[424]

1. Uniform Registration and Certification

Another proactive measure that should be uniformly adopted is a guardianship registration system. For example, Texas requires that all guardians register in a database, and mandates an hour-long training before a person is eligible to register in the database.[425] The purpose of a national guardianship database is threefold. First, registration in the system and the training requirement ensures that all guardians are properly equipped with knowledge and resources before taking on the responsibility of guardian.[426] Second, the registration system will serve a data collection function which will give insight into modern guardianships.[427] The data collected may be used as evidence to support changes in the law, and may reveal patterns of behavior which elude to potential abuse of a ward.[428] Third, the data base will enhance the court's ability to fulfill its monitoring requirement.[429] Currently, most courts rely on an annual reporting requirement, which is the responsibility of the guardian.[430] A registration system allows access to information which may be monitored by the court and interested persons, without depending on the guardian's annual reporting.

Allocation of monetary resources to implement a guardianship training program and registration database improves existing laws by educating

420. *See* discussion *supra* Part VII.
421. *See* discussion *infra* Part VII.A.1.
422. *See* discussion *infra* Part VII.A.
423. *See* discussion *infra* Part VII.A.
424. *See* discussion *infra* Part VII.A.
425. *See* discussion *supra* Section V.B.2.
426. *See* discussion *supra* Section V.B.2.
427. *See* discussion *supra* Part VIII.
428. *See* discussion *supra* Parts VI, VII.
429. *See* discussion *supra* Section III.B.4.
430. *See* discussion *supra* Section III.B.4.

potential guardians of their fiduciary duty.[431] The person chosen to serve as guardian is appointed because their service is in the best interest of the ward.[432] Typically, a family member or friend serving as a guardian is in the best interest of the ward because a family member or friend is someone the ward trusts.[433] The best interest of the ward is improved by the family member or friend properly preparing for undertaking the role of guardian.[434] The majority of guardianships last until the death of the ward, and a lifetime commitment to care for an incapacitated family member must not be entered into lightly.[435] By coupling the registration/training and the certification process of the potential guardian, the potential guardian will gain a better understanding of the gravity of the situation. Enlightenment through education may mitigate potential harm to wards by ensuring that a guardian is furnished with sufficient knowledge to act in the best interest of the ward.[436] If a guardian understands how a breach of their fiduciary duty will effect both the guardian and the ward, the guardian may be less likely to act in a harmful manner.[437] In Britney's case, if Jamie Spears had the proper tools to improve his relationship with his daughter, maybe she would not feel the need to request his removal as her conservator.

Furthermore, registration of guardianships in a nationwide database will generate statistical insight on modern guardianships. The data collected will prove an invaluable resource for legal scholars to consider when making adjustments to the law.[438] Statistical data may expose patterns of behavior as indicators of abuse or neglect of a ward, and potentially spark the next wave of legislative reform to guardianship law.[439]

Creating an easily accessible medium—an online database—will strengthen the court's monitoring requirement.[440] Details of the guardianship will be viewable on the registration platform, so not only can the court check in, but interested persons such as family may monitor the guardianship themselves. A self-serving guardian will not be able to hide behind obscurity, and the court will not be dependent on the annual report to the court.[441] Enhancing the monitoring requirement will protect the ward from abusive guardianship because transparent monitoring will deter a self-serving guardian from taking advantage of their ward, or will detect improper

431. *See* discussion *supra* Section III.B.1.b.
432. *See* discussion *supra* Section III.B.1.
433. *See* discussion *supra* Section III.B.1.b.
434. *See* discussion *supra* Section III.B.1.b.
435. *See* discussion *supra* Section III.B.4.a.
436. *See* discussion *supra* Section V.B.2.
437. *See* discussion *supra* Section V.B.2.
438. *See* discussion *supra* Section II.B.
439. *See* discussion *supra* Section II.B.
440. *See* discussion *supra* Section III.B.4.
441. *See* discussion *supra* Section III.B.4.

behavior of the guardian at an earlier time.[442] Because Britney's case is highly publicized, information available to the public is limited.[443] If Britney's case was part of the uniform registration system, members of her family or close friends would have access to the details of her conservatorship, which may perpetuate theories of abuse, or quell accusation of abuse.[444]

In reality, uniform registration may raise privacy and information concerns. Information shared on the registration system will only be available to those on a need-to-know basis, such as family members, close friends, and attorneys. Identification will be used through an assigned number or code name. Access to the system will be granted by obtaining a security code, and the code will be updated semi-regularly to ensure only a limited number of persons have access.

Further, a uniform approach to certification modeled after Texas's certification process may serve as another proactive measure to mitigating risk of abuse of wards.[445] Uniform certification should specifically enumerate the expectations of the guardian, similar to California Probate Code section 1835.[446] Texas law mandates that all professional guardians must become certified by passing a certifying exam, and that non-professional guardians may become provisionally certified if they so choose.[447] A uniform approach in application of a certification requirement should take it a step further and mandate that *all* guardians become certified before becoming a guardian.[448]

Additionally, certification should establish a legally binding duty of the guardian, and a legal presumption. The guardian should be required to enter into an agreement with the court as part of the certification process. Obtaining certification means that the guardian is aware of their fiduciary duty, and by accepting said duty, they accept potential legal liability. A certified guard will be required to sign a legally binding document which enumerates the duty of the guardian. Britney may be successful in removing her father as conservator if he is certified, and in agreement with the court to act in the best interest of Britney, if the facts elude to Jamie's behavior as adverse to the binding agreement.[449] Certification should establish a rebuttable presumption of a breach of fiduciary duty, and the burden may shift once the guardian has shown that the alleged breach was made in good faith and in the best interest of the ward. When Britney petitions the court for her father's removal, if she alleges abuse, Jamie then has to prove the abuse claims as false.[450] By putting the burden on Jamie, Britney does not have to accumulate enough evidence

442. *See* discussion *supra* Section III.B.4.
443. *See* discussion *supra* Part IV.
444. *See* discussion *supra* Part IV.
445. *See* discussion *supra* Section V.B.2.
446. *See* discussion *supra* Section IV.B.1.
447. *See* discussion *supra* Section V.B.2.
448. *See* discussion *supra* Section V.B.2.
449. *See* discussion *supra* Part IV.
450. *See* discussion *supra* Part IV.

to prove abuse is occurring.[451] Dissolving a guardianship is extremely difficult—almost impossible—so placing the burden on the certified guardian relieves some of the strife the ward faces when raising the issue of an abusive guardian.[452] High-functioning wards may have a better chance at challenging their guardianship if their access to the court is less restricted by the terms of their guardianship.[453]

While the dual process of mandatory registration and certification appears tedious, it is necessary due to the nature of the relationship between guardian and ward; a ward loses most of their rights and becomes dependent on the guardian to navigate daily living with little to no chance of repossessing their autonomy again.[454] Moreover, implementing preventative measures will serve as a screening system because a committed guardian will not be deterred by the cumbersome process.[455]

B. Reactive Approach: Mandatory Review Process

Once guardianship is established, mechanisms must be in place to ensure that guardianship is still serving its proper function.[456] Current laws, such as reviewing and accounting requirements, carry out a protective function.[457] Additions or changes to the current laws are not necessary, instead stricter enforcement and improved review will protect the ward from being trapped in an abusive guardianship.[458]

1. Funding to Create Review Board

As stated in Section VII, establishing a uniform approach to determining incapacity may provide consistent outcomes, as well as create a baseline for reviewing decisions made by judges.[459] However, the court system is notorious for moving at a glacial speed, and reviewing a potentially abusive guardianship is time sensitive. Petitioning the court to review a guardianship case may take weeks or months, and often are reviewed by a single judge. Review by a single judge exercising their sole discretion still presents the issues discussed in Section VII.[460]

Funding should be directed to the courts to create a guardianship review board. Congress may enact a statute to authorize the states to establish a

451. *See* discussion *supra* Part IV.
452. *See* discussion Section II.A.
453. *See* discussion Section II.B.
454. Hannaford & Hafemeister, *supra* note 78, at 12.
455. *Id.*
456. *See* discussion *supra* Section III.B.4.
457. *See* discussion *supra* Section III.B.4.
458. *See* discussion *supra* Section III.B.4.
459. *See* discussion *supra* Part VII.
460. *See* discussion *supra* Section III.B.4; *see* discussion *supra* Part VII.

review board and allocate money for this purpose. The board should consist of lawyers, judges, professors, psychologists, and social workers who serve on a rotating basis. The "community-based approach" of California law is an example of a comprehensive approach that should be mirrored in a review board.[461] The goal is to create an unbiased entity, with diverse understanding, whose sole responsibility is to review guardianships.[462] Extensive review of guardianships by qualified members protects the ward from unreasonable outcomes because the power to decide the ward's fate will not be vested in one person.[463] Review by multiple persons who contribute a unique understanding of guardianship as a result of their professional background offers a comprehensive review of each case and will yield an outcome that is truly in the best interest of the ward.[464] A majority of the panel must act in agreement on what is in the best interest of the ward, based on uniform standards. Each guardianship case deserves meticulous review because of the consequences which arise from abusive guardianships.[465] Guardianship is a uniquely complex legal issue because it is one of the only times the state can involuntarily strip a person of their freedoms; a lot is at stake for a potential ward so any guardianship case must be handled with the utmost care and consideration.[466]

A high-functioning ward such as Britney might have a better chance of effective change to the conservatorship if discretion is exercised by more than one judge.[467] The ambiguity inherent in the standard of incapacity may not act as a liability because a panel of experts will act together to determine what incapacity looks like in accordance with the particular circumstances of each case.[468] Delegation of decision making power to a review board may raise concerns of taking authority away from the judge.[469] It is a judge's job to make tough decisions.[470] While this is the way the legal system works, it is apparent a change needs to occur in the area of guardianship law based on the alarming amount of abusive guardianships.[471] The review board will supplement the judge's knowledge of what is in the best interest of the ward, and the judge will still be involved in the outcome of the case.[472]

Further, a review board allows easier access to challenge the terms of guardianship.[473] Currently, wards have restricted access to the court system

461. *See* discussion *supra* Section IV.A.1.
462. *See* discussion *supra* Section IV.A.1.
463. *See* discussion *supra* Part VII.
464. *See* discussion *supra* Part VII.
465. *See* discussion *supra* Part VII.
466. *See* discussion *supra* Part VI.
467. *See* discussion *supra* Parts IV, VI.
468. *See* discussion *supra* Part VI.
469. *See* discussion *supra* Part VI.
470. *See* discussion *supra* Part VI.
471. *See* discussion *supra* Part VII.
472. *See* discussion *supra* Part VI.
473. *See* discussion *supra* Sections II.A, B.

as a product of their conservatorship because the state may take away a ward's right to contract, which means a ward is unable to contract with an attorney to challenge their conservatorship.[474] High-functioning wards such as Britney should not be restrained by the terms of their conservatorship in their ability to challenge said conservatorship.[475]

A review board also serves to benefit the court system by relieving the court of the burden of reviewing guardianship cases. Shifting the workload of reviewing guardianships will free up the docket and allow the court to hear cases fractionally faster than the current rate.

Requesting the reallocation of money to the probate court to create a review board may be overly ambitious because there are so many other issues that require monetary solutions. However, the unique nature of guardianship—the stripping of rights and freedoms—and the long history of abuse demands immediate attention.[476] Guardianship issues raise human rights concerns which should be a priority of the government.[477]

XI. CONCLUSION

The #FreeBritney movement and Britney Spears' conservatorship case will remain in the headlines until Britney fans are confident that Britney is not trapped in an abusive conservatorship.[478] Currently, the law offers protections for wards but lacks equitable enforcement mechanisms.[479] Preventative measures like proper training of non-professional guardians like Jamie Spears and registration of guardians may enhance the courts ability to fulfill their purpose of protecting wards.[480] Close monitoring of conservatorships and sufficient review will improve response time to allegations of abuse.[481] Further, creating accountability through certification may reduce difficulties of challenging abusive guardianships.[482] By obtaining certification, the guardian will have the burden of rebutting the presumption of breach of the fiduciary duty, which makes it slightly easier for wards to have their cases seriously considered for review.[483] Additionally, guardianship law may be improved upon by directing funds to create a review board intended to consider guardianship cases in a comprehensive manner

474. *See* discussion *supra* Section II.A.
475. *See* discussion *supra* Section II.B; *see* discussion *supra* Part IV.
476. *See* discussion *supra* Section II.A.
477. *See* discussion *supra* Section II.A.
478. *See* discussion *supra* Part IV.
479. *See* discussion *supra* Part VIII.
480. *See* discussion *supra* Section VIII.A.1.
481. *See* discussion *supra* Section VIII.B.1.
482. *See* discussion *supra* Section VIII.A.1.
483. *See* discussion *supra* Section VIII.A.1.

and make determinations of what is in the best interest of the ward, rather than leave it up to the sole discretion of one judge.[484]

As of the time of this comment, Britney's latest petition to remove her father as conservator was denied.[485] Britney's struggle is not in vain because her case brings issues surrounding guardianship to the forefront of discussion.[486] Millions of Americans face similar challenges, and issues of guardianship are now gaining mainstream recognition because of the #FreeBritney movement.[487]

484. *See* discussion *supra* Section VIII.B.1.
485. *See* discussion *supra* Part IV.
486. *See* discussion *supra* Part IV.
487. *See* discussion *supra* Parts IV, VII.

ments, fixtures, general intangibles, instruments, equipment and inventory," including "all proceeds of such property." (Dkt. 4, Attach. 8 at 11.) For these reasons, and the others articulated in the Bankr. MDO, (Bankr. MDO at 13-22), Bankruptcy Court's determination of damages is affirmed.

O'Keefe makes additional contentions in the "statement of the case" of his brief, many of which he does not revisit in the argument section.[7] (Dkt. No. 12 at 2-10.) For many of these contentions, it is unclear how they relate to O'Keefe's appeal, but, to the extent these contentions are pertinent to O'Keefe's appeal regarding Bankruptcy Court's findings of malice, willfulness, and damages, for the reasons that are stated above and discussed in the Bankr. MDO, (*see generally* Bankr. MDO), Bankruptcy Court's judgment and order is affirmed.

V. Conclusion

WHEREFORE, for the foregoing reasons, it is hereby

ORDERED that the September 11, 2020 judgment of the Bankruptcy Court is **AFFIRMED**; and it is further

ORDERED that the Clerk provide a copy of this Memorandum-Decision and Order to the parties.

IT IS SO ORDERED.

7. For example, he maintains that Itria "limited their damages claim at trial" to $22,000. (Dkt. No. 12 at 3-4.)

IN RE: PURDUE PHARMA, L.P.

This Filing Relates to All Matters

21 cv 7532 (CM) [Master Case]
[rel: 21 cv 7585 (CM)
21 cv 7961 (CM), 21 cv 7962 (CM), 21 cv 7966 (CM), 21 cv 7969 (CM), 21 cv 8034 (CM), 21 cv 8042 (CM), 21 cv 8049 (CM), 21 cv 8055 (CM), 21 cv 8139 (CM), 21 cv 8258 (CM), 21 cv 8271 (CM), 21 cv 8548 (CM), 21 cv 8557 (CM), 21 cv 8566 (CM)]

United States District Court,
S.D. New York.

Signed 12/16/2021

Background: Chapter 11 debtors, a privately-held pharmaceutical company and affiliated entities involved in the manufacture and promotion of a proprietary prescription opioid pain reliever, sought confirmation of proposed plan of reorganization which, inter alia, contained broad releases of civil claims against non-debtor family members who owned debtors and against their related entities. United States Trustee (UST), numerous states and municipalities, and others objected. The Bankruptcy Court, Robert D. Drain, J., 633 B.R. 53, entered order confirming plan. Appeal was taken from that order as well as two merged and related orders, one approving debtors' disclosure statement and solicitation materials, and the other authorizing the implementation of certain preliminary aspects of plan.

Holdings: The District Court, Colleen McMahon, J., held that:

(1) the Bankruptcy Court lacked constitutional authority to enter a final order approving the non-consensual releases, even though they were incorporated

into proposed plan, and so standard of review was de novo as to both the Bankruptcy Court's factual findings and its conclusions of law;

(2) the Bankruptcy Court had subject matter jurisdiction to approve the release of claims against non-debtors;

(3) addressing an issue of apparent first impression for the court, the Bankruptcy Code does not authorize a bankruptcy court to order the non-consensual release of non-derivative third-party claims against non-debtors in connection with confirmation of a Chapter 11 plan; and

(4) the plan's classification and treatment of the claims of Canadian unsecured creditors vis-a-vis those of their domestic unsecured creditor "counterparts" did not violate the Code.

Vacated.

1. Bankruptcy ⚿3545

Under the Bankruptcy Code, a Chapter 11 plan must be approved, not by a supermajority of all eligible voters, but by a supermajority of all actual voters. 11 U.S.C.A. § 1126.

2. Bankruptcy ⚿3004.1, 3009

United States Trustee (UST) is a Department of Justice (DOJ) official appointed by the Attorney General to supervise the administration of bankruptcy cases and, under the Bankruptcy Code, has standing to appear in bankruptcy cases and comment on proposed disclosure statements and Chapter 11 plans. 11 U.S.C.A. § 307; 28 U.S.C.A. §§ 581-589.

3. Bankruptcy ⚿2021.1

Bankruptcy Code is "comprehensive scheme" devised by Congress for resolving debtor-creditor relations.

4. Bankruptcy ⚿3033

Bankruptcy courts consider the factors set forth by the Second Circuit in *Iridium*, 478 F.3d 452, in evaluating the fairness of proposed settlements.

5. Bankruptcy ⚿2547

Spendthrift trusts can and often do insulate assets from the bankruptcy process.

6. Bankruptcy ⚿3782, 3786

Generally, in bankruptcy appeals, the district court reviews the bankruptcy court's factual findings for clear error and its conclusions of law de novo. Fed. R. Bankr. P. 8013.

7. Bankruptcy ⚿3782

Bankruptcy court's conclusions of law, reviewed de novo, include rulings as to the bankruptcy court's jurisdiction and interpretations of the Constitution. Fed. R. Bankr. P. 8013.

8. Bankruptcy ⚿3786

Clear error standard used by the district court in reviewing a bankruptcy court's findings of fact is a deferential one. Fed. R. Bankr. P. 8013.

9. Bankruptcy ⚿3786

Bankruptcy court's finding of fact is "clearly erroneous" only if the district court is left with the definite and firm conviction that a mistake has been committed. Fed. R. Bankr. P. 8013.

See publication Words and Phrases for other judicial constructions and definitions.

10. Bankruptcy ⚿2104, 2105

Standard of review applied by the district court in reviewing a bankruptcy court's findings of fact is far less deferential if bankruptcy court is presented with something it cannot adjudicate to final judgment as constitutional matter unless parties consent; in such circumstance,

bankruptcy judge has authority only to hear the proceeding and submit proposed findings of fact and conclusions of law to the district court for de novo review and entry of judgment. Fed. R. Bankr. P. 8013.

11. Bankruptcy ⚿2105

If bankruptcy court issues final order in mistaken belief that it has constitutional authority to do so, district court can treat bankruptcy court's order as report and recommendation, but it must review proceeding de novo and enter final judgment.

12. Bankruptcy ⚿2045, 2053

On Chapter 11 debtors' motion to confirm proposed plan of reorganization, the Bankruptcy Court lacked constitutional authority under *Stern* to enter a final order approving the non-consensual third-party releases incorporated into the plan, and so, on appeal of the Bankruptcy Court's confirmation order, the standard of review was de novo as to both the Bankruptcy Court's factual findings and its conclusions of law; even though the Bankruptcy Court had authority to confirm the plan, which was a core function of a bankruptcy court, the non-consensual releases applied to third-party claims against non-debtors, such third-party claims neither stemmed from debtors' bankruptcy nor would necessarily be resolved in the claims allowance process, and the Bankruptcy Court had only "related to" jurisdiction over them. 28 U.S.C.A. § 157(a); Fed. R. Bankr. P. 8013.

13. Bankruptcy ⚿2043(1)

Under statute governing bankruptcy procedure, Congress divided bankruptcy proceedings into three types: (1) those that "arise under" title 11, (2) those that "arise in" a title 11 case, (3) and those that are "related to" a title 11 case. 28 U.S.C.A. § 157(a).

14. Bankruptcy ⚿2043(2)

Cases that "arise under" or "arise in" a title 11 matter are known as "core" bankruptcy proceedings, while "related to" proceedings are "non-core." 28 U.S.C.A. §§ 157(a), 157(b)(1)-(2)(C).

See publication Words and Phrases for other judicial constructions and definitions.

15. Bankruptcy ⚿2043(2)

Every proceeding pending before a bankruptcy court is either core or non-core. 28 U.S.C.A. § 157(a).

16. Bankruptcy ⚿2043(2)

Core versus non-core distinction is critical when assessing bankruptcy court's constitutional authority to enter final judgment disposing of particular proceeding. 28 U.S.C.A. § 157(a).

17. Bankruptcy ⚿2043(2)

Core/non-core distinction is critically important when assessing the bankruptcy court's subject matter jurisdiction. 28 U.S.C.A. § 157(a).

18. Bankruptcy ⚿2043(3), 2058.1

Bankruptcy court lacks constitutional authority to enter final judgment in proceeding over which it has only "related to" subject matter jurisdiction unless all parties consent. 28 U.S.C.A. § 157(a).

19. Bankruptcy ⚿2058.1

A party otherwise entitled to have a matter adjudicated by an Article III court does not forfeit that constitutional right if the matter is disposed of as part of a plan of reorganization in bankruptcy. U.S. Const. art. 3.

20. Bankruptcy ⚿2041.1

Pursuant to *Stern*, bankruptcy courts have the power to enter a final judgment only in proceedings that stem from the bankruptcy itself or would necessarily be resolved in the claims allowance process.

21. Bankruptcy ⚿3555

Debtors and their affiliated non-debtor parties cannot manufacture constitutional authority for bankruptcy court to resolve non-core claim by artifice of including release of that claim in plan of reorganization.

22. Bankruptcy ⚿3555

In assessing a bankruptcy court's jurisdiction to enjoin a third-party dispute under a plan, the question is not whether the court has jurisdiction over the settlement that incorporates the third-party release, but whether it has jurisdiction over the attempts to enjoin the creditors' unasserted claims against the third party.

23. Bankruptcy ⚿2058.1, 3555

A bankruptcy court's order extinguishing a non-core claim and enjoining its prosecution without an adjudication on the merits finally determines that claim and is equivalent to entering a judgment dismissing the claim and bars the claim under principles of former adjudication; therefore, Congress may not allow a bankruptcy court to enter such an order absent the parties' consent.

24. Bankruptcy ⚿2041.1

Bankruptcy court is creature of statute.

25. Bankruptcy ⚿2046

Bankruptcy court's subject matter jurisdiction is in rem and is limited to res of estate.

26. Bankruptcy ⚿2043(1)

A proceeding "arises under" title 11, for jurisdictional purposes, if the claims invoke substantive rights created by that title. 28 U.S.C.A. § 1334(b).

See publication Words and Phrases for other judicial constructions and definitions.

27. Bankruptcy ⚿2043(1)

A proceeding "arises in" a title 11 case, for jurisdictional purposes, if, for example, parties, by their conduct, submit themselves to the bankruptcy court's jurisdiction by litigating proofs of claim without contesting personal jurisdiction. 28 U.S.C.A. § 1334(b).

See publication Words and Phrases for other judicial constructions and definitions.

28. Bankruptcy ⚿2043(3)

A proceeding is "related to" a title 11 proceeding, for jurisdictional purposes, if its outcome might have any conceivable effect on the bankrupt estate. 28 U.S.C.A. § 1334(b).

See publication Words and Phrases for other judicial constructions and definitions.

29. Bankruptcy ⚿2053

Release of most third-party claims against non-debtor touches outer limit of bankruptcy court's jurisdiction. 28 U.S.C.A. § 1334(b).

30. Bankruptcy ⚿2043(3)

Standard for bankruptcy court's jurisdiction is not that action's outcome will certainly have, or even that it is likely to have, an effect on res of estate; rather, it is whether it might have any conceivable impact on estate. 28 U.S.C.A. § 1334(b).

31. Bankruptcy ⚿2043(3)

The only question a bankruptcy court need ask in determining whether it can exercise "related to" jurisdiction is whether the action's outcome might have any conceivable effect on the bankrupt estate; if the answer to that question is yes, then related to jurisdiction exists, no matter how implausible it is that the action's outcome actually will have an effect on the estate. 28 U.S.C.A. § 1334(b).

32. Bankruptcy ⚿2045

Under governing broad standard, the Bankruptcy Court had "related to" subject matter jurisdiction to approve, as part of proposed plan of reorganization, a release of non-derivative third-party claims against non-debtor family members who owned Chapter 11 debtors; civil proceedings asserted against non-debtor family members might have had conceivable impact on the rest of the estate, as pursuit of such claims threatened to unravel plan's intricate settlements, to alter liabilities of the estate, and to change amount available for distribution to other creditors, all claims in case had high degree of interconnectedness with lawsuits against debtors and against family members, and it was likely that debtors' litigation of their indemnification, contribution, and/or insurance obligations to family members who had served as their directors, officers, or managers would burden estate assets. 28 U.S.C.A. § 1334(b).

33. Insurance ⚿2261, 2270(1), 2921

California law specifically prohibits indemnity or insurance coverage for losses resulting from a violation of its false advertising law or unfair competition law, and under that law an insurer has no duty to defend or advance costs. Cal. Ins. Code § 533.5.

34. Bankruptcy ⚿2125, 2126, 3555

Bankruptcy Code does not authorize a bankruptcy court to order the non-consensual release of non-derivative third-party claims against non-debtors in connection with confirmation of a Chapter 11 plan; sole section of Code expressly authorizing court to enjoin third-party claims against non-debtors without consent of third parties is limited to asbestos cases, neither section of Code authorizing court to enter any "necessary or appropriate" order to carry out provisions of Code nor subsections authorizing a plan to provide adequate means for its implementation or providing that a plan may include "any other appropriate provision" not inconsistent with applicable provisions of Code, whether read individually or together, provide court with such authority, there is no such thing as "equitable authority" or "residual authority" in a bankruptcy court untethered to some specific, substantive grant of authority in Code, and any congressional silence on matter could not be deemed consent. 11 U.S.C.A. §§ 105(a), 524(e), 524(g), 1123(a)(5), 1123(b)(6).

35. Bankruptcy ⚿2553, 2825

"Derivative" claims are those that seek to recover from the bankruptcy estate indirectly on the basis of the debtor's conduct, as opposed to a non-debtor's own conduct.

See publication Words and Phrases for other judicial constructions and definitions.

36. Bankruptcy ⚿2553

Derivative claims in every sense relate to adjustment of debtor-creditor relationship, because they are claims that relate to injury to corporation itself; if creditor's claim is one that bankruptcy trustee could bring on behalf of estate, then it is "derivative."

See publication Words and Phrases for other judicial constructions and definitions.

37. Bankruptcy ⚿2825

In the bankruptcy context, "direct" claims are based upon a "particularized" injury to a third party that can be directly traced to a non-debtor's conduct.

See publication Words and Phrases for other judicial constructions and definitions.

38. Bankruptcy ⚿2553

Claims asserted by states against non-debtor family members who had served as

Chapter 11 debtors' officers, directors, or managers, based on family members' alleged violation of state laws under which individuals who serve in certain capacities in a corporation are individually and personally liable for their personal participation in certain unfair trade practices, were not derivative; claims arose out of out of a separate and independent duty that was imposed by statute on individuals who, by virtue of their positions, were alleged to have personally participated in acts of corporate fraud, misrepresentation, and/or willful misconduct.

39. Statutes ⚿1079

When assessing statutory authority, courts should turn first to the text of the statute.

40. Bankruptcy ⚿2367

Bankruptcy Code expressly authorizes a bankruptcy court to enjoin third-party claims against non-debtors without the consent of those third parties solely and exclusively in cases involving injuries arising from the manufacture and sale of asbestos, and such injunctions cannot be entered in favor of just any non-debtor, but are limited to enjoin actions against a specific set of non-debtors, namely, those who have a particular relationship to the debtor, including owners, managers, officers, directors, employees, insurers, and financiers. 11 U.S.C.A. §§ 524(g), 524(g)(4)(A).

41. Bankruptcy ⚿2761

Bankruptcy Code explicitly exempts certain debtor assets from the bankruptcy estate and provides a finite number of exceptions and limitations to those asset exemptions; courts are not authorized to create additional exceptions. 11 U.S.C.A. § 522.

42. Bankruptcy ⚿3561

In Chapter 11 bankruptcies, a plan that does not follow normal priority rules cannot be confirmed over the objection of an impaired class of creditors. 11 U.S.C.A. § 1129(b).

43. Bankruptcy ⚿3594

In a "structured dismissal," the debtor obtains an order that simultaneously dismisses its Chapter 11 case and provides for the administration and distribution of its remaining assets.

See publication Words and Phrases for other judicial constructions and definitions.

44. Bankruptcy ⚿2126

Equitable power conferred on the bankruptcy court by the section of the Bankruptcy Code authorizing a court to enter any "necessary or appropriate" order to carry out the provisions of title 11 is the power to exercise equity in carrying out the provisions of the Code, rather than to further the purposes of the Code generally, or otherwise to do the right thing. 11 U.S.C.A. § 105(a).

45. Bankruptcy ⚿3549

Subsection of Bankruptcy Code providing that Chapter 11 plan may include "any other appropriate provision" not inconsistent with applicable provisions of Code does not confer substantive authority on the bankruptcy court. 11 U.S.C.A. § 1123(b)(6).

46. Bankruptcy ⚿3372.1

Congress intended that the Bankruptcy Code ensure that all debts arising out of fraud are excepted from discharge no matter what their form. 11 U.S.C.A. § 523(a)(2), (4), (6).

47. Bankruptcy ⚿3377

Civil penalties payable to and for the benefit of governmental units are not dischargeable in bankruptcy. 11 U.S.C.A. § 523(a)(7).

48. Bankruptcy ⚿3412

Under the Bankruptcy Code, releasing a debtor on a debt owed to a creditor does not affect the liability that a nondebtor may have for the same debt. 11 U.S.C.A. § 524(e).

49. Bankruptcy ⚿3553

Section of the Bankruptcy Code providing that a plan of reorganization must provide adequate means for its implementation contains a laundry list of things that a Chapter 11 plan can include in order to make sure that resources are available to implement the plan, any of which can be ordered by a bankruptcy court. 11 U.S.C.A. § 1123(a)(5).

50. Bankruptcy ⚿3553

Under the section of the Bankruptcy Code providing that a plan of reorganization must provide adequate means for its implementation, it is the debtor's resources, not the resources of some third party, that are supposed to be used to implement a plan that will adjust the debtor's relations with its creditors. 11 U.S.C.A. § 1123(a)(5).

51. Bankruptcy ⚿3553

Section of the Bankruptcy Code providing that a plan of reorganization must provide adequate means for its implementation does not confer any special power on the bankruptcy court. 11 U.S.C.A. § 1123(a)(5).

52. Bankruptcy ⚿3553

Section of the Bankruptcy Code providing that a plan of reorganization must provide adequate means for its implementation does not authorize a court to give its imprimatur to something the Code does not otherwise authorize, simply because doing so would ensure funding for a plan. 11 U.S.C.A. § 1123(a)(5).

53. Bankruptcy ⚿3553

Under the section of the Bankruptcy Code providing that a plan of reorganization must provide adequate means for its implementation, the mere fact that money is being used to fund implementation of the plan does not give a bankruptcy court statutory authority to enter an otherwise impermissible order in order to obtain that funding. 11 U.S.C.A. § 1123(a)(5).

54. Bankruptcy ⚿2126, 3570

Section of the Bankruptcy Code providing that a bankruptcy court shall confirm a Chapter 11 plan only if the plan complies with applicable provisions of title 11 confers no substantive right that could be used to undergird an injunction under the section of the Code authorizing the court to enter any "necessary or appropriate" order to carry out the provisions of title 11. 11 U.S.C.A. §§ 105(a), 1129(a)(1).

55. Bankruptcy ⚿2021.1

Bankruptcy Code provides comprehensive federal system to govern orderly conduct of debtors' affairs and creditors' rights.

56. Bankruptcy ⚿2022

Bankruptcy Code was intended to free the debtor of personal obligations while ensuring that no one else reaps a similar benefit.

57. Statutes ⚿1160, 1217

It is a commonplace of statutory construction that the specific governs the general.

58. Bankruptcy ⚿2021.1

The "general/specific canon" of statutory interpretation applies with particular force in bankruptcy, where Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions.

59. Bankruptcy ⚿2124.1

Any "residual authority" of a bankruptcy court, if it even exists, cannot be exercised in contravention of specific provisions of the Bankruptcy Code.

60. Bankruptcy ⚿2053

"Special remedial scheme" contemplated by the Bankruptcy Code addresses the rights of persons who have claims against a debtor in bankruptcy, not claims against other non-debtors.

61. Bankruptcy ⚿2921

Bankruptcy Code lays out a claims allowance process so that creditors can file their claims against someone who has invoked the protection of the Code; it provides a mechanism for those parties to litigate those claims against the debtor and to determine their value.

62. Bankruptcy ⚿2361

In order to take advantage of the "special remedial scheme" set forth in the Bankruptcy Code, debtors have to declare bankruptcy, disclose their assets, and apply them, that is, all of them, with de minimis exceptions, to the resolution of the claims of their creditors.

63. Bankruptcy ⚿2053

Just as a bankruptcy court's ability to provide finality to a third party is defined by its jurisdiction, not its good intentions, so too its power to grant relief to a non-debtor from non-derivative third-party claims can only be exercised within confines of Bankruptcy Code.

64. Bankruptcy ⚿3550

Classification and treatment of the claims of Canadian claimants vis-a-vis those of their domestic unsecured creditor "counterparts" by Chapter 11 plan of debtors, a privately-held pharmaceutical company and affiliated entities, did not violate the Bankruptcy Code; under the plan, Canadian claimants belonged to a different class, general unsecured creditors, than their domestic unsecured creditor "counterparts," which were placed in classes as "non-federal domestic governmental" claimants and "tribe" claimants, respectively, for legitimate reasons, given, inter alia, that Canadian claimants operated under different regulatory regimes with regard to opioids and abatement than their domestic counterparts and that the bulk of their legal claims arose in Canada, and there was no argument that the separate classification was done to disenfranchise a group, to engineer an assenting impaired class, or to manipulate class voting. 11 U.S.C.A. §§ 1129(a)(4), 1129(b)(1).

65. Bankruptcy ⚿3550

Bankruptcy Code does not require that all creditor classes be treated equally, only that there be a reasonable basis for any differentiation. 11 U.S.C.A. §§ 1129, 1129(a)(4).

66. Bankruptcy ⚿3550

Bankruptcy Code expressly permits differentiation between classes of creditors.

67. Bankruptcy ⚿3552

Bankruptcy Code's "equal-treatment mandate" with respect to a Chapter 11 plan's treatment of creditors applies only to claims of all creditors within the same class. 11 U.S.C.A. § 1129(a)(4).

68. Bankruptcy ⚿3550

It does not matter that certain creditors' claims are purportedly "indistinguishable" from those held by other creditors; a Chapter 11 plan may separately classify similar claims so long as the classification scheme has a reasonable basis for doing so. 11 U.S.C.A. § 1129.

69. Bankruptcy ⚿3550

In evaluating a Chapter 11 plan's separate classification of creditors, the court must carefully scrutinize whether such classification was done for the purpose of disenfranchising a particular group in a manner inconsistent with the Bankruptcy Code, to engineer an assenting impaired class, or manipulate class voting. 11 U.S.C.A. § 1129.

70. Bankruptcy ⚿3563.1

Under the Bankruptcy Code, only creditors of a dissenting class can object to the confirmation of a Chapter 11 plan on the grounds that the plan discriminates against their creditor class. 11 U.S.C.A. § 1129(b)(1).

Timothy E. Graulich, Marshall Scott Huebner, Benjamin S. Kaminetzky, Christopher Scott Robertson, Eli James Vonnegut, Davis Polk & Wardwell LLP, New York, NY, for In re: Purdue Pharma, L.P.

DECISION AND ORDER ON APPEAL

McMahon, J.:

This is an appeal from an order of the United States Bankruptcy Court for the Southern District of New York ("Bankruptcy Court") (Drain, B.J.), announced from the bench on September 1, 2021, and filed on September 17, 2021, confirming the Plan of Reorganization proposed by Debtors Purdue Pharma L.P. ("Purdue Pharma") and certain associated companies [1] (the "Confirmation Order"). Appeal is also taken from two merged and related orders of the Bankruptcy Court: the June 3, 2021, order approving Purdue's disclosure statement and solicitation materials (the "Disclosure Order") and the September 15, 2021, order authorizing the implementation of certain preliminary aspects of the Plan (the "Advance Order").

Purdue's bankruptcy was occasioned by a health crisis that was, in significant part, of its own making: an explosion of opioid addiction in the United States over the past two decades, which can be traced largely to the over-prescription of highly addictive medications, including, specifically and principally, Purdue's proprietary, OxyContin.

Despite a 2007 Plea Agreement with the United States – in which Purdue admitted that it had falsely marketed OxyContin as non-addictive and had submitted false claims to the federal government for reimbursement of medically unnecessary opioid prescriptions ("2007 Plea Agreement") – Purdue's profits after 2007 were driven almost exclusively by its aggressive marketing of OxyContin. (*See* JX-2094.0047-88; JX-2481). But by 2019, Purdue was facing thousands of lawsuits brought by persons who had become addicted to OxyContin and by the estates of addicts who had overdosed – either on OxyContin itself or on the street drugs (heroin, fentanyl) for which Purdue's product served as a feeder. It also faced new federal, state and local Medicare reimbursement claims and a number of new false marketing claims brought under various state consumer pro-

1. Purdue Pharma Inc. (''PPI''), Purdue Transdermal Technologies L.P., Purdue Pharma Manufacturing L.P., Purdue Pharmaceuticals L.P., Imbrium Therapeutics L.P., Adlon Therapeutics L.P., Greenfield BioVentures L.P., Seven Seas Hill Corp., Ophir Green Corp., Purdue Pharma of Puerto Rico, Avrio Health L.P., Purdue Pharmaceutical Products L.P., Purdue Neuroscience Company, Nayatt Cove Lifescience Inc., Button Land L.P., Rhodes Associates L.P., Paul Land Inc., Quidnick Land L.P., Rhodes Pharmaceuticals L.P., Rhodes Technologies, UDF LP, SVC Pharma LP, and SVC Pharma Inc. (together, the ''Debtors'' or ''Purdue'').

tection laws. Finally, in November 2020, Purdue pled guilty to a criminal Information filed by the Department of Justice ("DOJ") in the United States District Court for the District of New Jersey; in its plea agreement, the company (though not the people through whom the company acted) admitted to substantial deliberate wrongful conduct ("2020 Plea Agreement"). *See USA v. Purdue Pharma L.P.*, No. 2:20-cr-01028.

Engulfed in a veritable tsunami of litigation, Purdue filed for chapter 11 bankruptcy in September 2019. The intent was for a "*Manville*-style" bankruptcy that would resolve both existing and future claims against the company arising from the prescription of OxyContin. The automatic stay brought a stop to civil litigation against Purdue; and a court-ordered stay halted litigation against certain non-debtors affiliated with the company – principally members of the Sackler family (the "Sacklers" or "Sackler family"),[2] which had long owned the privately-held company – to buy time to craft a resolution. For two years, committees of various classes of creditors – individuals, state and local governments, indigenous North American tribes, even representatives of unborn children who were destined to suffer from opioid addiction – negotiated with Purdue and the Sacklers under the watchful eye of the experienced Bankruptcy Judge, with the assistance of two of this country's finest and most experienced mediators (Layn Phillips and Kenneth Feinberg), as well as a second Bankruptcy Judge (The Hon. Shelley Chapman).

[1] Eventually, the parties crafted a plan of reorganization for Purdue that would, if implemented, afford billions of dollars for the resolution of both private and public claims, while funding opioid relief and education programs that could provide tremendous benefit to the consuming public at large (the "Plan").[3] That Plan was approved by supermajority of the votes cast by the members of each class of creditors.[4] It was confirmed by Judge Drain, who had invested so much of himself in the effort to find a workable solution to a seemingly intractable problem.

[2] But not everyone voted yes. Eight states and the District of Columbia ("D.C."), as well as certain Canadian municipalities and Canadian indigenous tribes, the City of Seattle (alone among all voting municipalities in the United States), as well as some 2,683 individual personal injury claimants, voted against the adoption of the Plan. The same states, municipalities and tribes, together with three of those individual claimants (representing themselves), filed formal objections to the Plan and have appealed from its confirmation.[5] The United States Trustee (the "U.S. Trustee") in Bankruptcy[6] and the U.S.

2. The Sacklers or Sackler family in this opinion means the Mortimer D. Sackler Family (also known as ''Side A'' of the Sackler family) and the Raymond R. Sackler Family (also known as ''Side B'' of the Sackler family).

3. The Plan refers to confirmed chapter 11 bankruptcy plan of reorganization at Bankruptcy Docket Number 3726. (*See* Dkt. No. 91-3, at App.1070-1227).

4. It is true that many members of some creditor classes did not cast a vote, but the law provides that a plan must be approved, not by a supermajority of all eligible voters, but by a supermajority of all actual voters. 11 U.S.C. § 1126. That being so, there is no merit to Appellants' argument that the court should not deem the Plan approved by a supermajority of the affected creditor classes.

5. While the City of Seattle objected to the Plan before the Bankruptcy Court, it did not appeal.

6. The U.S. Trustee ''is a DOJ official appointed by the Attorney General to supervise the administration of bankruptcy cases'' and has standing under 11 U.S.C. § 307 to appear in

Attorney's Office for this District on behalf of the United States of America join in their objections.

All Appellants assign the same reason for their opposition: the Plan provides broad releases, not just of derivative, but of particularized or direct claims – including claims predicated on fraud, misrepresentation, and willful misconduct under various state consumer protection statutes – to the members of the Sackler family (none of whom is a debtor in the bankruptcy case) and to their affiliates and related entities. As the opioid crisis continued and worsened in the wake of Purdue's 2007 Plea Agreement, the Sacklers – or at least those members of the family who were actively involved in the day to day management of Purdue [7] – were well aware that they were exposed to personal liability over OxyContin. Concerned about how their personal financial situation might be affected, the family began what one member described as an "aggressive[ ]" program of withdrawing money from Purdue almost as soon as the ink was dry on the 2007 papers. The Sacklers upstreaming some $10.4 billion out of the company between 2008 and 2017, which, according to their own expert, substantially reduced Purdue's "solvency cushion." Over half of that money was either invested in offshore companies owned by the Sacklers or deposited into spendthrift trusts that could not be reached in bankruptcy and off-shore entities located in places like the Bailiwick of Jersey.

When the family fortune was secure, the Sackler family members withdrew from Purdue's Board and management. Bankruptcy discussions commenced the following year. As part of those pre-filing discussions, the Sacklers offered to contribute toward a settlement, but if – and only if – every member of the family could "achieve global peace" from all civil (not criminal) litigation, including litigation by Purdue to claw back the money that had been taken out of the corporation. The Plan confirmed by the Bankruptcy Court extinguishes all civil claims against the Sacklers that relate in any way to the operations of Purdue – including claims on which certain members of the Sackler family could be held personally liable to entities other than Purdue (principally the various states). These claims could not be released if the Sacklers were themselves debtors in bankruptcy.

Appellants attack the legality of the Plan's non-consensual release of third-party claims against non-debtors on a number of grounds. They argue that the release (referred to in this opinion as the "Section 10.7 Shareholder Release") is both constitutionally defective and not statutorily authorized; that the Bankruptcy Court lacks constitutional authority and subject matter jurisdiction to approve the release or to carry out certain "gatekeeping" aspects of the Plan that relate to it; and that granting a release to the non-debtor Sacklers is unwarranted as a matter of fact and would constitute an abuse of the bankruptcy process.

bankruptcy cases and ''comment on proposed disclosure statements and chapter 11 plans.'' (Dkt. No. 91, at 8 (citing 28 U.S.C. §§ 581-589 and 28 U.S.C. § 586(a)(3)(B)).

7. Ilene Sackler Lefcourt, Kathe Sackler, Mortimer D.A. Sackler, Theresa Sackler, Richard Sackler, Jonathan Sackler, and David Sackler were at some or all relevant times directors of Purdue and its related enterprises. Mortimer D. Sackler and Raymond Sackler had management roles at the company as co-chief executive officers; Richard Sackler also served as president; and Mortimer D.A. Sackler, Ilene Sackler Lefcourt, and Kathe Sackler held officer roles as vice presidents. Mariana Sackler worked at Purdue in research and development.

Debtors and those who voted in favor of the Plan – buttressed by Judge Drain's comprehensive Confirmation Order – argue that the Bankruptcy Court had undoubted jurisdiction to impose these broad third-party releases; insist that they are a necessary feature of the Plan; point out the tremendous public benefit that will be realized by implementing the Plan's many forward-looking provisions; and urge that the alternative – Purdue's liquidation – will inevitably yield far less benefit to all creditors and victims, in light of the cost and extraordinary hurdles that would have to be surmounted in order to claw back the billions of dollars that the Sacklers have taken out of Purdue.

Two of the questions raised by appellants are easily answered. The Bankruptcy Court had undoubted subject matter jurisdiction to enter the challenged releases. And while it may have lacked constitutional authority to give them final approval under the rule of *Stern v. Marshall*, 564 U.S. 462 (2011), that matters little in the great scheme of things; it changes the level of deference this court should give to Judge Drain's findings of fact, but those findings are essentially unchallenged.

The great unsettled question in this case is whether the Bankruptcy Court – or any court – is statutorily authorized to grant such releases. This issue has split the federal Circuits for decades. While the Circuits that say no are united in their reasoning, the Circuits that say yes offer various justifications for their conclusions. And – crucially for this case – although the Second Circuit identified the question as open back in 2005, it has not yet had occasion to analyze the issue. Its only guidance to the lower courts, uttered in that 2005 opinion, is this: because statutory authority is questionable and such releases can be abused, they should be granted sparingly and only in "unique" cases.

This will no longer do. Either statutory authority exists or it does not. There is no principled basis for acting on questionable authority in "rare" or "unique" cases, especially as the United States Supreme Court has recently held that there is no "rare case" rule in bankruptcy that allows a court to trump the Bankruptcy Code. *See Czyzewski v. Jevic Holding Corp.*, —— U.S. ——, 137 S. Ct. 973, 986, 197 L.Ed.2d 398 (2017).

[3] Moreover, the lower courts desperately need a clear answer. As one of my colleagues on the Bankruptcy Court recently noted, plans releasing non-debtors from third party claims are no rarity: "Unfortunately, in actual practice the parties . . . often seek to impose involuntary releases based solely on the contention that anybody who makes a contribution to the case has earned a third-party release. *Almost every proposed Chapter 11 Plan that I receive includes proposed releases.*" *In re Aegean Marine Petroleum Network Inc.*, 599 B.R. 717, 726 (S.D.N.Y. 2019) (Wiles, B.J.) (emphasis added). When every case is unique, none is unique. Given the frequency with which this issue arises, the time has come for a comprehensive analysis of whether authority for such releases can be found in the Bankruptcy Code – that "comprehensive scheme" devised by Congress for resolving debtor-creditor relations. *See RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645, 132 S.Ct. 2065, 182 L.Ed.2d 967 (2012).

Aided by superb briefing and argument on both sides of the question, and by extended ruminations on the subject by several esteemed bankruptcy judges of our own District – Judge Drain not the least – this Court concludes that the Bankruptcy Code does not authorize such non-consensual non-debtor releases: not in its express

text (which is conceded); not in its silence (which is disputed); and not in any section or sections of the Bankruptcy Code that, read singly or together, purport to confer generalized or "residual" powers on a court sitting in bankruptcy. For that reason, the Confirmation Order (and the Advance Order that flows from it) must be vacated.

Because I conclude that the Bankruptcy Court lacked statutory authority to impose the Section 10.7 Shareholder Release, I need not and do not reach the constitutional questions that have been raised by the parties. Nor do I need to decide whether this is a case in which such releases should be imposed if my statutory analysis is incorrect. Those issues may need to be addressed some day, but they do not need to be addressed in order to dispose of this appeal.

This opinion will not be the last word on the subject, nor should it be. This issue has hovered over bankruptcy law for thirty-five years – ever since Congress added §§ 524(g) and (h) to the Bankruptcy Code. It must be put to rest sometime; at least in this Circuit, it should be put to rest now.

PARTIES [8]

The Appellants in this case are the U.S. Trustee William K. Harrington; the States of California, Connecticut, Delaware, Maryland, Oregon, Rhode Island, Vermont, Washington, and D.C. (together, the "State Appellants"); the City of Grande Prairie as Representative for a Class Consisting of All Canadian Municipalities, the Cities of Brantford, Grand Prairie, Lethbridge, and Wetaskiwin; the Peter Ballantyne Cree Nation on behalf of All Canadian First Nations and Metis People; the Peter Ballantyne Cree Nation on behalf itself, and the Lac La Ronge Indian Band (together, the "Canadian Appellants"); and *pro se* Appellants Ronald Bass, Marie Ecke, Andrew Ecke, Richard Ecke, and Ellen Isaacs on Behalf of Patrick Ryan Wroblewski (together, the "Pro Se Appellants").

The Appellees are the Purdue Debtors, as well as the Official Committee of Unsecured Creditors of Purdue Pharma L.P., et al. (the "UCC"),[9] the Ad Hoc Committee of Governmental and Other Contingent Litigation Claimants ("AHC"),[10] the Ad Hoc Group of Individual Victims of Purdue Pharma, L.P. ("PI Ad Hoc Group"), the Multi-State Governmental Entities Group ("MSGE"), the Mortimer-side Initial Covered Sackler Persons ("Side A"), and the Raymond Sackler Family ("Side B").

The Ad Hoc Committee of NAS Children ("NAS Children") appears as *amicus curiae* and has filed an *amicus* brief. (Dkt. No. 158). The U.S. Attorney's Office for this District also appears on behalf of the United States of America as *amicus curiae* and has filed a statement of interest in this case. (Dkt. No. 94).

BACKGROUND

The following facts are derived from the appellate record as designated by the parties to this appeal, unless indicated otherwise. (*See* Dkt. Nos. 78-1, 105, 255). The

8. In this decision, docket numbers abbreviated "Dkt. No." refer to the consolidated docketed appeals at 7:21-cv-7532; docket numbers abbreviated "Bankr. Dkt. No." refer to the underlying bankruptcy docket at 19-23649.

9. The UCC is also referred to in court filings and the appellate record as the "Creditors' Committee." The Court uses the terminology "UCC" consistent with the language provided in the glossary at Docket Number 115-1.

10. The AHC is also referred to in court filings and the appellate record as the "Ad Hoc Committee." The Court uses the terminology "AHC" consistent with the language provided in the glossary at Docket Number 115-1.

Court judicially notices certain public court records and other matters that are subject to judicial notice. *See* Fed. R. Evid. 201(b)-(d).[11]

I. Purdue Pharma, L.P.

Purdue – originally known as "Purdue Frederick Company" – was founded by John Purdue Gray and George Frederick Bingham in 1892. The company was sold to brothers Arthur, Mortimer and Raymond Sackler in 1952. (*See* JX-2148; JX-1985, at 33:12-13).

Purdue Pharma, the Debtors' main operating entity, is a Delaware limited partnership headquartered in Stamford, Connecticut. (Dkt. No. 91-4, at App.1244). Purdue Pharma's general partner is Purdue Pharma Inc. ("PPI"), a New York corporation, also headquartered in Stamford, Connecticut. (*Id.*, JX-1221). The board of directors of PPI manages Purdue Pharma (the "Board"). (Dkt. No. 91-4, at App.1250). Purdue Pharma has 22 wholly owned subsidiaries in the United States and the British Virgin Islands. (*Id.* at App.1244).

Purdue Pharma is wholly owned by Pharmaceutical Research Associates, L.P. ("PRA"), a Delaware limited partnership that is not a debtor in this case. (*Id.* at App.1252). PRA is 99.5% owned, in equal parts, by non-debtors Beacon Company ("Beacon"), a Delaware general partnership, and Rosebay Medical Company L.P. ("Rosebay"), a Delaware limited partnership, which are in turn owned by certain trusts established for the benefit of the Sackler Families. (*Id.*). Beacon is the partnership of Side A of the Sackler family; Rosebay is the partnership of Side B of the Sackler family. (*See* JX-1987, at 42:10-23; JX-3298 at 160:8-10).[12]

Purdue Pharma operates Purdue's branded prescription pharmaceutical business, which includes both opioid and non-opioid products. (Dkt. No. 91-4, at App. 1244). OxyContin is one of Purdue Pharma's three principal branded opioid medications. (*Id.*). The other two are Hysingla and Butrans. (*Id.*). Purdue generated approximately $34 billion in revenue total between 1996-2019, most of which came from OxyContin sales (*See e.g.*, JX-2481); prior to bankruptcy, OxyContin accounted for some 91% of Purdue's U.S. revenue. (*See* JX-1984, at 40:24-41:5; JX-3275, at 338:6-9; JX-0999).

Purdue Pharma manufactures OxyContin for itself and, in limited quantities, for certain foreign independent associated companies ("IAC"), which are ultimately owned by the Sackler family. (Dkt. No. 91-4, at App.1245). Purdue Pharma receives royalties from IACs' sales for OxyContin

11. *See Garber v. Legg Mason Inc.*, 347 F. App'x 665, 669 (2d Cir. 2009) ('' '[a] court may take judicial notice, whether requested or not.' '') (quoting Fed. R. Evid. 201(c)); *Hotel Emps. & Rest. Emps. Union, Local 100 of New York, N.Y. & Vicinity, AFL-CIO v. City of NY Dep't of Parks & Recreation*, 311 F.3d 534, 540 n.1 (2d Cir. 2002) ('' 'Judicial notice may be taken at any stage of the proceeding.' '') (quoting Fed. R. Evid. 201(d)); *Schenk v. Citibank/Citigroup/Citicorp*, No. 10-CV-5056 (SAS), 2010 WL 5094360, at *2 (S.D.N.Y. Dec. 9, 2010) (citing *Anderson v. Rochester–Genesee Reg'l Transp. Auth.*, 337 F.3d 201, 205 n.4 (2d Cir. 2003)) (''Judicial notice may encompass the status of other lawsuits in other courts and the substance of papers filed in those actions''); *Giraldo v. Kessler*, 694 F.3d 161, 163 (2d Cir. 2012) (courts may ''take judicial notice of relevant matters of public record.'').

12. In this opinion, unless otherwise specified, where reference is made to the ''Sackler entities'' this means Rosebay and Beacon, as well as other Sackler family affiliated trusts and entities relevant to this appeal, including those in Exhibit X to the Settlement Agreement, incorporated into the Plan. (*See* Dkt. No. 91-3, at App. 1112, App.1041-1069).

abroad. (*Id.*). The IACs are not debtors in this case.

Until early 2019, members of the Sackler family served as directors of Purdue; the last Sackler's resignation from the Board became effective in the beginning of that year, although many family members stepped down during 2018.

II. The Sackler Family

Since Purdue was sold to brothers Arthur, Mortimer and Raymond Sackler in 1952 (*see* JX-1985, at 33:12-13),[13] the company has been closely held and closely run by members of the Sackler family, many of whom took on an active role in the company comparable to that of senior management prior to 2018. *See In re Purdue Pharma L.P.*, No. 19-23649, 2021 WL 4240974, at *33 (Bankr. S.D.N.Y. Sept. 17, 2021). In large part due to the success of their pharmaceutical business, the Sackler family have long been ranked on Forbes' list of America's Richest Families, becoming one of the top twenty wealthiest families in America in 2015, with a reported net worth of $14 billion dollars. (*See* JX-1985, at 40:24-42:10).

Mortimer Sackler's side of the family is known as "Side A," and Raymond Sackler's side is known as "Side B." (Dkt. No. 91-4, at App.1250). From approximately 1993 until 2018, there were always at least six or seven members of the Sackler family on the Board; independent directors never equaled or outnumbered the number of Sackler family directors on the Board. (*See* Confr. Hr'g Tr., Aug. 19, 2021, at 159:17-25, 22:5-9; Dkt. No. 91-4, at App.1345).

In addition to Purdue, certain members of the Sackler family served as directors of an entity called "MNP," later "MNC" ("MNP/MNC"), which operated as an advisory board for IACs worldwide, including for "specific pharmaceutical manufacturer IACs" and "corporations throughout the world that [the Sackler] family owns and that are in the . . . pharmaceutical business." (*See* Confr. Hr'g Tr., Aug. 18, 2021, at 31:8-18; Confr. Hr'g Tr., Aug. 19, 2021, at 24:12-23). MNP/MNC's recommendations were typically followed by the IACs. (Confr. Hr'g Tr., Aug. 19, 2021, at 23:9-17).

A. Side A

Mortimer D. Sackler, who died in 2010, served as the co-chief executive officer of Purdue with his brother Raymond until the end of his life. (JX-3275.0168-69; Dkt. No. 91-5, at App.2089).

Three of his seven children – Ilene Sackler Lefcourt, Kathe Sackler, and Mortimer David Alfons Sackler ("Mortimer D.A. Sackler") – sat on the Board of Purdue for nearly 30 years, until 2018. (Confr. Hr'g Tr., Aug. 19, 2021, at 19:13-20, 158:6-15; JX-3298.0037; Dkt. No. 91-5, at App.2089). They also served as officers of Purdue, with Mortimer D.A. and Ilene holding the title of vice president and Kathe the title of senior vice president. (Confr. Hr'g Tr., Aug. 19, 2021, at 19:21-25, 22:18-23:4, 158:16-21; JX-3298.0075; JX3275.0169).

Mortimer Sackler's wife Theresa Sackler also served on the Board of Purdue from 1993 until 2018, explaining that her "husband asked me to join . . . it was a family company and he felt that family members should be on the board." (JX-3275.0034, 36; Dkt. No. 91-4, at App.1345).

All four – Ilene, Kathe, Theresa, and Mortimer D.A. Sackler – served as directors on the board of MNP/MNC for many years. (Confr. Hr'g Tr., Aug. 19,

13. The Arthur Sackler family sold its interest in Purdue to the other two branches of the family prior to the invention of OxyContin and has no involvement in the company or in this bankruptcy.

2021, at 19:21-25, 22:18-23:4, 161:2-11; JX-3298.0080; JX-3275.0059).

B. Side B

Raymond Sackler, who died in 2017, served as co-chief executive officer of Purdue with his brother Mortimer D. Sackler. (*See* JX-3275.0168-69).

Raymond Sackler's wife and two sons served as Board members of Purdue. (*See* Dkt. No. 91-4, at App.1345). His sons, Jonathan and Richard Sackler, served from 1990 until 2018, and his wife Beverly Sackler from approximately 1993 until 2017. (*See id.*; Confr. Hr'g Tr., Aug. 18, 2021, at 30:6-8).

In addition to his role as director, Richard Sackler also served as president of Purdue from 2000-2003, co-chair of the Board from 2003-2007, and chair of the Board from approximately 2008 until 2010 or 2011. (Confr. Hr'g Tr., Aug. 18, 2021, at 30:6-22, 44:20-21). He served as a director of MNP/MNC until 2018 and has served as director of at least one IAC. (*Id.* at 31:23-32:19).

Richard Sackler's son David Sacker also served on the Board from 2012 until 2018 and as a director of MNP/MNC. (Confr. Hr'g Tr., Aug. 17, 2021, at 43:12-14, 44:6-13).

Finally, Mariana Sackler, Richard Sackler's daughter, held several roles within the "family business" (JX-1991, at 58:19-25), including working as a consultant in the "research and development department" of Purdue on OxyContin projects and a "PR" role at Mundipharma Italy, an IAC, advancing "information around topics about pain in Italy" and "marketing and selling OxyContin" there. (*Id.* at 30:4-18; 32:12-33:3; 58:19-64:25). Marianna has never been an officer or director of Purdue.

III. OxyContin

OxyContin is a synthetic opioid analgesic – a powerful narcotic substance designed to relieve pain. (*See* JX-2181; JX-2195.0048; JX-2195.0059). Opioid analgesics have been available for several decades to treat moderate to severe pain. (JX-2181; Dkt. No. 91-4, at App.1259). But until the early 1980's they were limited to immediate-release dosage forms. (JX-2181; *see* JX-2199). Immediate-release pain killers are less than ideal because they control pain for only 4-6 hours at a time; by contrast, a controlled-release pain killer can provide relief from serious pain for up to 12 hours at a time. (*See* Dkt. No. 91-4, at App.1259; JX-2181; JX-2199; JX-2185-0010).

In the early 1980's, Purdue developed its first controlled-release morphine drug which it marketed as "MS Contin" (also called "MSContin" and "MS-Contin"). (JX-2181; *see* JX-2199; JX-2180-0030, 0084). MS Contin solved many of the difficulties associated with immediate-release opioids, and it was marketed, largely without abuse, throughout the 1980's and 1990's. (JX-2180-0015, 0078; Dkt. No. 91-4, at App. 1262). However, morphine's stigma as an addictive narcotic caused patients and physicians alike to avoid it. (*See* JX-2180-0030).

So Purdue concentrated on the research, development, and testing of a non-morphine drug: its controlled-release semisynthetic opioid analgesic named "OxyContin." (*See* JX-2181; JX-2199; Dkt. No. 91-4, at App.1261-62). In December 1995, the Food and Drug Administration ("FDA") approved OxyContin for use. (*Id.*). OxyContin's formulations were labeled as "extended release" or "time release" doses because the active ingredients continuously enter into a patient's system over time; a single dose could provide relief from serious pain for up to 12 hours. (*See* JX-2181).

A 2000 *Time* Magazine article explains that OxyContin was quickly "hailed as a miracle" after its introduction in 1995, because "it eases chronic pain because its dissolvable coating allows a measured does of the opiate oxycodone to be released into the bloodstream." (JX-2147).

For years, Purdue contended that OxyContin, due to its "time release" formulation, posed virtually no threat of either abuse or addiction – as opposed to other pain relief drugs, such as Percocet or Vicodin, which are not controlled-release painkillers. *See the Purdue Frederick Company, Inc.*, No. 1:07-cr-00029, Dkt. No. 5-1, at ¶¶20-27 ("Agreed Statement"); (Dkt. No. 91-4, at App.1268-1269). Purdue delivered that message to prescribing physicians and patients alike.

But time-release OxyContin proved to have an efficacy and safety profile similar to that of immediate-release opioid pain relievers. (*See* JX-2195.0027, 48-49, 59). Indeed, in 2001, the FDA required that Purdue remove from its drug label the claim that OxyContin had a very low risk of iatrogenic addiction; Purdue was ordered to add instead the highest level of safety warning that the FDA can place on an approved drug product. (*See* JX-2181; JX-2199; JX-2220).

IV. Purdue's Deceptive Marketing of OxyContin

To promote its new product OxyContin, Purdue launched an aggressive marketing campaign. (*See* JX-2153). That campaign was multi-fold, aiming in part to combat concerns about the abuse potential of opioids and to encourage doctors to prescribe OxyContin for more and different types of pain. (*See* Dkt. No. 91-4, at App. 1268-1269; Agreed Statement, at ¶20; JX-2181.0002).

Before OxyContin, opioid pain relievers were usually prescribed for cancer patients and patients with chronic diseases whose pain was "undertreated." (*See* JX-2181.0002). But Purdue pushed OxyContin as a treatment for many types of pain patients, including those with "noncancer pain" and other "nonmalignant" pain. (*Id.*; *see id.* at 0023, 0044). Purdue repeatedly published advertisements claiming, for example, that OxyContin can be an effective "first-line therapy for the treatment of arthritis" and safely used for "osteoarthritis pain" (JX-2218) and in many cases "mak[ing] unsubstantiated efficacy claims promoting the use of OxyContin for pain relief," "promoting OxyContin for a much broader range of patients with pain than are appropriate for the drug," "overstat[ing] the safety profile of OxyContin," and repeatedly omitting OxyContin's "abuse liability" (JX-2221) – all of which was contemporaneously documented in FDA warning letters to the company throughout the early 2000's. (*See, e.g.*, JX-2218; JX-2221).

By its marketing campaign, Purdue sought to eliminate concerns regarding "OxyContin's addictive potential." (*See* Agreed Statement, at ¶¶19-20; Dkt. No. 91-4, at App.1268-1269). To do this, Purdue needed to encourage doctors and patients to overcome their reservations about the use of opioids. For this purpose, Purdue created a website called "*In The Face of Pain*," which promoted OxyContin pain treatment and urged patients to "overcome" their "concerns about addiction." *See* Petition, *State of Kansas, ex rel. Derek Schmidt, Attorney General v. Purdue Pharma L.P., et al.*, Case No. 2019-cv-000369, at ¶89 (Shawnee Cnty. Dist. Ct. May 16, 2019). Testimonials on the website were allegedly presented as personal stories of OxyContin patients who had overcome life-long struggles with debilitating pain, although they were allegedly written

by Purdue consultants who were paid to promote the drug. *Id.*

Purdue also allegedly distributed pamphlets to doctors. *Id.* at ¶33. In one such pamphlet, *Providing Relief, Preventing Abuse: A Reference Guide To Controlled Substance Prescribing Practices*, Purdue wrote that addiction "is not caused by drugs." *Id.* In another, the "Resource Guide for People with Pain," Purdue explained, "Many people living with pain and even some healthcare providers believe that opioid medications are addictive. The truth is that when properly prescribed by a healthcare professional and taken as directed, these medications give relief – not a 'high.' " *Id.* at ¶35.

Purdue's marketing campaign proved successful. OxyContin was widely prescribed; bonuses to Purdue sales representatives for the sale of OxyContin increased from $1 million in 1996 to $40 million by 2001; and by 2001, annual sales of OxyContin reached $1 billion. (JX-2181.0007; JX-2151). By 2001, OxyContin was "the most prescribed brand-name narcotic medication" in the U.S. (JX-2181.0002, 0007).

V. The Opioid Crisis

But OxyContin's popularity as a pain reliever coincided with the scourge of widespread abuse of the drug around the country. (*See, e.g.*, JX-2147; JX-2148; JX-2149; JX-2180-0078; JX-2181). Many individuals who had been prescribed OxyContin by their doctors for legitimate pain conditions became addicted to the drug. (*See* JX-2181). And hundreds of thousands of seasoned addicts and novice drug abusers, including teenagers, quickly discovered that crushing an OxyContin tablet and then snorting or injecting it resulted in a quick "morphine-like high." (*See* JX-2148; JX-2149; JX-2183; JX-2195.0059).

By the early 2000's, rates of opioid addiction in connection with OxyContin use were skyrocketing throughout the country. (*See* JX-2147; JX-2148; JX-2149). In the early years, "remote, rural areas" were particularly hard hit, due in part to the fact that these areas are

> home to large populations of disabled and chronically ill people who are in need of pain relief; they're marked by high unemployment and a lack of economic opportunity; they're remote, far from the network of Interstates and metropolises through which heroin and cocaine travel; and they're areas where prescription drugs have been abused—though in much smaller numbers—in the past.

Foister v. Purdue Pharma, L.P., 295 F. Supp. 2d 693, 696 (E.D. Ky. 2003) (quotation and internal citation omitted).

However, the crisis was not limited to one type of community or part of the country. (*See* JX-2147). Pill mills opened in urban areas, as unscrupulous physicians began writing prescriptions for OxyContin to stooge purchasers (often drug addicts themselves), who were recruited to obtain and fill prescriptions, turning over the pills to drug dealers, who resold them on the street, making astronomical profits. (*See* JX-2175; JX-2176). This Court presided over the criminal trial of a doctor who ran such a pill mill in Hamilton Heights on the Upper West Side of Manhattan, through which he garnered millions of dollars in ill-gotten gains at the expense of desperate people who were addicted to OxyContin. *See United States v. Mirilashvili*, No. 14-cr-0810 (CM), Dkt. No. 1 (S.D.N.Y. Dec. 9, 2014).

Prosecutions like the one of Dr. Mirilashvili, coupled with enhanced regulatory oversight over both prescribers of opioids and pharmacies that had filled suspiciously high numbers of prescriptions, reduced the number of illicit prescriptions of OxyCon-

tin. But drying up the source. did not end the problem of addiction. Individuals who had been feeding an OxyContin habit turned to alternative sources to get their fix – including street drugs like heroin and its even stronger and more lethal cousin, fentanyl, which is fast acting and 100 times more potent than morphine. (*See* JX-2195.0050-52). The recent increase in overdose deaths in this country is driven in significant part by the increasingly widespread use of fentanyl. (*See* Dkt. No. 91-4, at App.1271).

In 2017, the U.S. Department of Health and Human Services ("DHHS") declared the opioid epidemic to be a national public health emergency.[14] According to the Centers for Disease Control and Prevention, from 1999 to 2019, nearly 247,000 people died in the United States from overdoses involving prescription opioids.[15] DHHS estimates the "economic burden" of prescription opioid misuse in the United States is between $53-72 billion a year, including medical costs, lost work productivity, addiction treatment, and criminal justice costs.[16]

Today, it is estimated that between 21-29% of patients who are prescribed opioids for chronic pain misuse them.[17] Between 8-12% of people who are using an opioid for chronic pain develop an opioid use disorder. *Id.* An estimated 4-6% of those who misuse prescription opioids transition to using heroin. *Id.* About 80% of people who use heroin first misused prescription opioids. *Id.* OxyContin, it seems, is the ultimate "gateway" drug.

VI. Pre-Bankruptcy Litigation Involving Purdue and Members of the Sackler Family

With the swelling opioid crisis, Purdue began to face inquiries about and investigations into OxyContin.

In 2000, the U.S. Attorney of Maine alerted the company to widespread abuse of the drug in rural Maine. (*See* JX-2151; JX-2180-0078; JX-2181). In 2001, the Attorney General of Virginia Mark Earley requested a meeting with company officials regarding widespread abuse of the drug in Virginia. (*See* JX-2151). By 2002, the then-Purdue spokesman Tim Bannon confirmed that there were federal investigations into Purdue's marketing of OxyContin. (*Id.*).

Two decades of litigation, both civil and criminal, ensued.

A. The First Round of Lawsuit: 2001-2007

By 2001, plaintiffs across the country had begun to file individual and class actions against Purdue in state and federal courts, including in the U.S. District Court for the Southern District of New York and in the Supreme Court of the State of New York. (*See e.g.*, JX-2181; Dkt. No. 91-5, at App.2037-2038).[18] Members of the Sackler

14. *HHS Acting Secretary Declares Public Health Emergency to Address National Opioid Crisis,* DHHS (Oct. 26, 2017), https://www.hhs.gov/about/news/2017/10/26/hhs-acting-secretary-declares-public-health-emergency-address-national-opioid-crisis.html.

15. *Drug Overdose: Overview,* Centers for Disease Control and Prevention (Mar. 17, 2021), https://www.cdc.gov/drugoverdose/deaths/prescription/overview.html.

16. DHHS, "Addressing Prescription Drug Abuse in the United States," *available at* https://www.cdc.gov/drugoverdose/pdf/hhs_prescription_drug_abuse_report_09.2013.pdf.

17. *Opioid Overdose Crisis,* National Institute on Drug Abuse (Mar. 11, 2021), https://www.drugabuse.gov/drug-topics/opioids/opioid-overdose-crisis.

18. *See Hurtado, et al. v. The Purdue Pharma Co.,* No. 12648/03 (Richmond Cnty., filed 2003); *Sara v. The Purdue Pharma Co.,* No. 13699/03 (Richmond Cnty., filed 2003); *Serafin v. Purdue Pharma, L.P.,* No. 103031/04

family were not named as defendants in these lawsuits. (*See* Dkt. No. 91-5, at App. 2040).

Plaintiffs in early cases plead a variety of theories of liability pursuant to which Purdue could be held liable as a result of its development, testing, manufacturing, distributing and marketing of OxyContin, including: negligence, strict product liability, failure to warn, breach of express and/or implied warranty, violation of state consumer protection statutes, conspiracy, fraud, and unjust enrichment. *See e.g.*, *Wethington v. Purdue Pharma LP*, 218 F.R.D. 577, 581 n. 1 (S.D. Ohio 2003).

Many of the early cases filed were class actions that sought certification of classes of people who had been prescribed OxyContin and suffered harm as a result. *See e.g.*, *Hurtado v. Purdue Pharma Co.*, No. 12648/03, 6 Misc.3d 1015A, 800 N.Y.S.2d 347, 2005 WL 192351, at **9-14 (Sup. Ct. Richmond Cnty. Jan. 24, 2005) (discussing cases). But given the stringent requirements for class certification, class certification motions in these cases were often denied. For example, in *Foister v. Purdue Pharma L.P.*, plaintiffs in the Eastern District of Kentucky sought unsuccessfully to certify class of "all persons who have been harmed due to the addictive nature of OxyContin." No. Civ.A. 01-268-DCR, 2002 WL 1008608, at *1 (E.D. Ky. Feb. 26, 2002); *see also Gevedon v. Purdue Pharma*, 212 F.R.D. 333, 336 (E.D. Ky. Oct. 17, 2002) (denying class certification); *Campbell v. Purdue Pharma, L.P.*, No. 1:02 CV 00163 TCM, 2004 WL 5840206, at *1 (ED Mo. June 25, 2004) (denying class certification). Class certification was generally deemed inappropriate because courts concluded that individual questions predominated ("addiction to the drug is an individualized question of fact"), thus precluding a finding of commonality. *See Howland et al. v. Purdue Pharma, L.P. et al.*, 104 Ohio St.3d 584, 821 N.E.2d 141, 146-147 (Oh. Sup. Ct. Dec. 15, 2004). When such motions were granted, the decisions were often reversed. *See id.*

Absent class certification, the sheer number of individual cases that were filed meant that cases had to be sent to judicial coordinating panels. In New York, for example, five state cases were transferred to the New York Litigation Coordinating Panel in 2005 – after which 1,117 additional lawsuits were filed and coordinated. *See Hurtado*, 2005 WL 192351, at *15, 6 Misc.3d 1015(A), 800 N.Y.S.2d 347; *Matter of OxyContin*, 15 Misc.3d 388, 390, 833 N.Y.S.2d 357 (Sup. Ct. Richmond Cnty. 2007). Within these coordinated cases, after much discovery, settlements were pursued. *See e.g.*, *Matter of OxyContin II*, 23 Misc.3d 974, 975, 881 N.Y.S.2d 812 (Sup. Ct. Richmond Cnty. 2009) (discussing efforts in 2006-2007 to reach a "universal settlement" of the thousands of New York cases).

Discovery in these lawsuits proved useful to state and federal regulatory agencies

(New York Cnty., filed 2004); *Washington v. Purdue Pharma L.P.,* No. 107841/04 (New York Cnty., filed 2004); *Machey v. The Purdue Pharma Co.,* No. 1:04-cv-02098 (S.D.N.Y., filed 2004); *Pratt v. The Purdue Pharma Co.,* No. 1:04-cv-02100 (S.D.N.Y., filed 2004); *Wilson v. The Purdue Pharma Co.,* No. 1:04-cv-02103 (S.D.N.Y., filed 2004); *Ruth v. The Purdue Pharma Co.,* No. 1:04-cv-02101 (S.D.N.Y., filed 2004); *Terry v. The Purdue Pharma Co.,* No. 1:04-cv-02102 (S.D.N.Y., filed 2004); *Foister v. Purdue Pharma L.P.,* No. 6:01-cv-00268 (E.D. Ky., removed 2001); *Gevedon v. Purdue Pharma,* No. 7:02-cv-00008 (E.D. Ky., removed 2002); *Campbell v. Purdue Pharma, L.P.,* No. 1:02-cv-00163 TCM (ED Mo. removed 2002); *Howland et al. v. Purdue Pharma, L.P. et al.,* No. CV01 07 1651 (Butler Cnty. Ohio, filed 2001); *see also In re OxyContin Products Liability Litigation,* 268 F.Supp.2d 1380, 1380 (J.P.M.L 2003) (stating 20 actions then pending in five federal districts in South Carolina, Mississippi, Alabama, and Louisiana).

that were also investigating Purdue's role in the opioid crisis. Attorney Jayne Conroy, who testified at the Confirmation Hearing on behalf of the AHC, explained that the discovery taken by her firm in hundreds of New York cases against Purdue was later subpoenaed by the Justice Department as part of the federal government's 2006-2007 investigation into Purdue. (Dkt. No. 91-5, at App.2038-2039).

B. The 2007 Settlement and 2007 Plea Agreement

1. Purdue's 2007 Settlements with 26 States and the District of Columbia

In 2007, twenty-six states [19] and D.C. settled investigations into Purdue's promotional and marketing practices regarding OxyContin for $19.5 million ("2007 Settlement").[20] (Dkt. No. 91-4, at App.1269-70; *see* JX-2152). As part of the 2007 Settlement, Purdue entered into a consent judgment with each government party. (Dkt. No. 91-4, at App.1270); *see, e.g.*, Consent Judgement, *Washington v. Purdue Pharma L.P.*, Cause No. 07-2-00917-2 (Sup. Ct. Wash. Thurston Cnty. May 9, 2007), at Section I(M), ¶25 ("Consent Judgment").

Pursuant to the Consent Judgment, Purdue agreed to "establish, implement and follow an OxyContin abuse and diversion detection" ("ADD") program which "consist[ed] of internal procedures designed to identify potential abuse or diversion of OxyContin" for a minimum of ten years. (*See* Dkt. No. 91-4, at App.1270; Consent Judgment, ¶¶13-14). Purdue also agreed to submit "annual compliance certifications to a multistate group of attorneys general for three years." (Dkt. No. 91-4, at App.1270).

In exchange for Purdue's payment and compliance, the settling States agreed to:

> release[ ] and forever discharge[ ], to the fullest extent permitted by law, *Purdue and its past and present officers, directors, shareholders,* employees, co-promoters, affiliates, parents, subsidiaries, predecessors, assigns, and successors (collectively, the "Releasees"), of and from any and all civil causes of action, claims, damages, costs, attorney's fees, or penalties that the Attorney General could have asserted against the Releasees under the State Consumer Protection Law by reason• of any conduct that has occurred at any time up to and including the Effective Date of this Judgment relating to or based upon the Subject Matter of this Judgment ("Released Claims").

(Consent Judgement, Section VI) (emphasis added). According to Judge Drain, these 2007 releases covered about seventy-seven members of the Sackler family. *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *31. The release covered only claims that could have been asserted by the Attorneys General of the settling states; among the claims that were not released were: (1) private rights of action by consumers, (2) claims relating to best price, average wholesale price or wholesale acquisition cost reporting practices or Medicaid fraud or abuse; (3) claims asserting antitrust, environmental or tax liabili-

19. Settling states were Arizona, Arkansas, California, Connecticut, Idaho, Illinois, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Montana, Nebraska, Nevada, New Mexico, North Carolina, Ohio, Oregon, Pennsylvania, South Carolina, Tennessee, Texas, Vermont, Virginia, Washington, and Wisconsin. This includes all State Appellants except Delaware and Rhode Island.

20. Purdue is defined in the Consent Judgment as Purdue Pharma, PPI, The Purdue Frederick Company, and all of their United States affiliates, subsidiaries, predecessors, successors, parents and assigns, who manufacture, sell, distribute and/or promote OxyContin.

ty; (4) claims for property damage; (5) claims to enforce the terms and conditions of the judgment; and (6) any state or federal criminal liability that any person or entity, including Releasees, has or may have to the settling state.

Some of the states did not participate in this 2007 Settlement. Several had already entered into individual settlements with Purdue, while others entered into separate settlements subsequently. (*See* Dkt. No. 91-4, at App.1270). For example, in 2002, Florida settled an investigation into Purdue for $500,000 (*id.*); in 2004, West Virginia settled an action against Purdue for $10 million (*id.*); in 2006, Mississippi settled its investigation into Purdue for $250,000 (*id.*). In 2015, New York signed an assurance of discontinuance of its investigation in exchange for Purdue's payment of a $75,000 penalty and certain promises, including ongoing implementation of the ADD program in New York and submission to annual reviews and monitoring by the Attorney General. *Id.*; *In the Matter of Purdue Pharma L.P.*, Attorney General of the State of New York Assurance No. 15-151, at ¶¶8, 28, 38, 40, 49 (Aug. 19, 2015). In 2016, Kentucky settled an action against Purdue for $24 million. (Dkt. No. 91-4, at App.1270). And in March 2019, Purdue agreed to pay the State of Oklahoma $270 million to settle that state's opioid claims. (*Id.* at App.1278); *see* Consent Judgment, *Oklahoma v. Purdue Pharma et al.*, No. CJ-2017-816, § 4.1 (Dist. Ct. Cleveland Cnty. Mar. 26, 2019).

The releases in these separate cases generally extinguished the claims of the respective state against Purdue for opioid-related misconduct. For example, the West Virginia settlement released "any and all claims and demands" of the Attorney General of West Virginia (on behalf of the state and state agencies) against Purdue and its affiliates, shareholders, officers, directors, and others [21] that were "sustained or incurred as a result of the manufacture, marketing and sale of OxyContin" in West Virginia. (*See* JX-2225). Similarly, the Oklahoma settlement released "any and all claims of any nature" of the Attorney General (the state and its subdivisions) against Purdue, its officers, directors, shareholders, direct and indirect owners, beneficiaries of the owners, and enumerated others, arising out of the conduct alleged in the complaint, including conduct related to the marketing and sale of opioids in Oklahoma. *See* Consent Judgment, *Oklahoma v. Purdue Pharma et al.*, No. CJ-2017-816, §§ 1.1, 5.1, 5.2 (Dist. Ct. Cleveland Cnty. Mar. 26, 2019).

2. Purdue Frederick Company, Inc.'s 2007 Plea Agreement and Related Civil Settlements

Also in 2007, Purdue Frederick Company [22] pled guilty to one felony count of misbranding OxyContin, with the intent to defraud or mislead, in violation of 21 U.S.C. §§ 331(a), 333(a)(2). (Dkt. No. 91-4, at App.1268-69; *see* JX-2153–JX-2168); *see* JX-1899. Purdue Frederick's President and CEO Michael Friedman, its Executive Vice President and Chief Legal Officer Howard R. Udell, and its Chief Scientific Officer Paul D. Goldenheim, in their capacity as corporate officers, each pled guilty to a misdemeanor charge of misbranding.

21. "all . . . present, former, or future masters, insurers, principals, agents, assigns, officers, directors, shareholders, owners, employees, attorneys, representatives. subsidiaries, divisions, affiliates, associated companies, holding companies, partnerships, and joint ventures . . ." (JX-2225).

22. Purdue Frederick Company is an affiliate of Purdue that manufactures and distributes OxyContin. (Dkt. No. 91-4, at App.1268).

(Dkt. No. 91-4, at App.1268); *see The Purdue Frederick Company, Inc.,* No. 1:07-cr-00029, at Dkt. Nos. 7-9.

As part of the Agreed Statement of Facts, the Purdue Frederick Company admitted that:

> [b]eginning on or about December 12, 1995, and continuing until on or about June 30, 2001, certain PURDUE supervisors and employees, with the intent to defraud or mislead, marketed and promoted OxyContin as less addictive, less subject to abuse and diversion, and less likely to cause tolerance and withdrawal than other pain medications . . .

(Agreed Statement, at ¶20; *see* Dkt. No. 91-4, at App.1268-1269).

As part of the 2007 Plea Agreement, Purdue Frederick agreed to pay over $600 million dollars in fines and various other payments.[23] (Dkt. No. 91-4, at App.1269; JX-1899, at § 3). This included $160 million to the United States and the states to settle various civil claims that had been asserted by governments – over $100 million to the United States and over $59 million to "Each state that elects to participate in this settlement . . ." (JX-1899, at § 3(b)). In the federal government's settlement agreement, the United States and its various departments agreed to release "*Purdue and its current and former directors, officers, employees, affiliates, owners*, predecessors, successors and assigns from any civil or administrative monetary claim the United States has or may have" under federal statutes creating causes of action for civil damages or penalties, as well as from administrative actions under various federal departments and programs. (*See id.* at Dkt. No. 5-4, at § IIII). The participating states' settlement agreement and release were limited to Medicaid fraud claims:

> release and forever discharge [the] Company *and its current and former directors, officers, employees, affiliates, owners,* predecessors, successors and assigns from any civil or administrative monetary claim that the State has or may have for any claim submitted or caused to be submitted to the State Medicaid Program for the Covered Conduct . . .

See The Purdue Frederick Company, Inc., et al., No. 1:07-cr-00029, Dkt. No. 5-14, at § III(2)) (emphasis added).

All states except Kentucky opted into the federal settlement. *See id.* at Dkt. No. 141, at 5.

An additional $130 million was set aside to settle private civil liability claims related to OxyContin. (*Id.* at § 3(d)). Ms. Conroy of the AHC testified in the Confirmation Hearing that her approximately 5,000 clients received a total of $75 million out of this settlement fund. (Dkt. No. 91-5, at App.2039).

As part of the resolution of the criminal case, Purdue agreed to a five-year corporate integrity program with the DHHS, pursuant to which DHHS was to monitor Purdue's compliance with federal healthcare law. This monitoring period expired on July 30, 2012. (Dkt. No. 91-4, at App.

23. The fine and payments include: approximately $276.1 million forfeited to the United States; approximately $160 million paid to federal and state government agencies to resolve liability for false claims made to Medicaid and other government healthcare programs; approximately $130 million set aside to resolve private civil claims; approximately $5.3 million paid to the Virginia Attorney General's Medicaid Fraud Control Unit; approximately $20 million paid to fund the Virginia Prescription Monitoring Program; approximately $3 million to Federal and State Medicaid programs for improperly calculated Medicaid rebates; approximately $5 million in monitoring costs; and a $500,000 maximum statutory fine.

1269); *see The Purdue Frederick Company, Inc.*, No. 1:07-cr-00029, at Dkt. No. 5-5. In 2013, Purdue completed the corporate integrity program with no significant adverse findings. (Dkt. No. 91-4, at App. 1269).

The Honorable James P. Jones approved the 2007 Plea Agreement in July of that year. *See The Purdue Frederick Company, Inc.*, No. 1:07-cr-00029, at Dkt. No. 77.

C. The Second Round of Lawsuits: 2014-2019

The 2007 Settlement and Plea Agreement were intended to resolve for all time issues relating to Purdue's misrepresentations about OxyContin. (Dkt. No. 91-5, at App.2039). The corporate integrity agreement with DHHS meant ongoing monitoring (*see The Purdue Frederick Company, Inc.*, No. 1:07-cr-00029, at Dkt. No. 5-5), and the ADD program agreed to with the 26 states and D.C. was meant to create internal procedures that would identify and interrupt abuse or diversion related to OxyContin. (Consent Judgment, ¶14). Purdue, for its part, insisted in its Informational Brief before the Bankruptcy Court that it "accepted responsibility for the misconduct in 2007 and has since then strived never to repeat it." (Dkt. No. 91-4, at App.1268).

However, if Purdue's admissions in its 2020 Plea Agreement are believed, this purported acceptance of responsibility was a charade, and the oversight mechanisms built into the settlements were a conspicuous failure. Judge Drain found that the Sacklers had an "evident desire to continue to drive profits from the products' sale," *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *33, and as they did so, the opioid crisis not only continued, it worsened. (*See* Dkt. No. 91-5, at App.2039-2040; JX-2185). As Mortimer D.A. Sackler testified in the Confirmation Hearing, "overdose deaths . . . continued to rise . . . The overdose deaths kept going up and up." (Confr. Hr'g Tr. Aug. 19, 2021, at 52:7-12).

Starting in about 2014, new lawsuits began to be filed against Purdue concerning its promotion and marketing of OxyContin. (*See e.g.*, JX-2411). But this time, members of the Sackler family were named as defendants. (*See, e.g.*, Confr. Hr'g Tr. Aug. 16, 2021, at 69: 4-15).

1. The Federal Multi-District Litigation in the Northern District of Ohio

At the end of 2017, sixty-four federal cases that had been brought in nine districts across the country by various government entities (state, cities, and counties) against Purdue and other defendants – including pharmacies (like Rite Aid), pharmaceutical companies (like Johnson & Johnson), and pharmaceutical distributors (like McKesson Corporation) – were sent to coordinated multi-district litigation in the Northern District of Ohio ("Opioid MDL"). *See IN RE: National Prescription Opiate Litigation*, MDL-2804, Dkt. No. 1, at Schedule A. The cases in the Opioid MDL asserted a variety of claims against Purdue and others for their role in the opioid crisis, under theories of liability including: (1) public nuisance, (2) false representations, (3) unjust enrichment, (4) common law *parens patriae*, (5) negligence, (6) gross negligence, and (7) consumer protection act claims. (Dkt. No. 91-4, at App.1276); *see e.g.*, Complaint, *County of San Joaquin, et al. v. Purdue Pharma L.P., et al.*, No. 2:17-cv-01485, Dkt. No. 1, Ex. 1 (E.D. Ca. May 24, 2017); Complaint, *Everett v. Purdue Pharma LP et al.*, No. 2:17-00209, Dkt. No. 1-1 (W.D. Wa. Jan. 18, 2017).

The Opioid MDL was assigned to The Honorable Dan A. Polster. At the time of

Purdue's filing for bankruptcy, approximately 2,200 actions against Purdue related to the opioid crisis were pending before Judge Polster. (*See* Dkt. No. 91-4, at App. 1273).

Judge Polster put the cases before him on a settlement track and litigation track and assigned a Special Master to assist in their management. (*See* MDL Dkt. No. 2676, at 3). Given "the immense scope of the opioid crisis" Judge Polster was "very active from the outset of [the] MDL in encouraging all sides to consider settlement." (MDL Dkt. No. 2676, at 11).

Within the litigation track, Judge Polster designated attorneys to coordinate discovery in related state and federal cases (MDL Dkt. No. 616) and issued a case management order meant to "facilitate, to the maximum extent possible, coordination with parallel state court cases." (MDL Dkt. No. 876, at ¶I(b)). Judge Polster ordered the establishment of a joint database of all prescription opiate cases filed in state and federal courts, so that information and documents could be tracked and discovery cross-noticed. (*Id.* at ¶¶III-V). Over 450 depositions were taken under the Opioid MDL umbrella, and over 160 million pages of documents were produced. (MDL Dkt. No. 2676, at 5; *see* Dkt. No. 91-4, at App.1276).

The extensive discovery in the Opioid MDL, and the discovery coordination it facilitated, revealed for the first time the involvement of certain members of the Sackler family in acts that Purdue had agreed not to commit as part of the 2007 Plea Agreement. Schedule A to the 2020 Plea Agreement – to which facts the corporation has stipulated, so they are deemed proved [24] – chronicles Purdue's extensive violation of the 2007 Plea Agreement, which began almost from the time the ink was dry on the papers. (*See* JX-2094.0006, 0015-18). Unable to deny what was apparent from the Opioid MDL discovery, the corporation admitted that Purdue had engaged in aggressive efforts to boost opioid sales, including: offering payments to induce health care providers to write more prescriptions of Purdue opioid products, offering "prescription savings cards" for health care providers to give patients to encourage them to fill prescriptions for opioids, and failing to maintain effective controls against diversion, which included failing to inform the United States Drug Enforcement Administration that health care providers flagged for abuse filled over 1.4 million OxyContin prescriptions. (*Id.*).

Evidence produced in discovery also "subjected the Sacklers to increasing scrutiny and pointed towards culpability of certain members of the family . . ." (Dkt. No. 91-5, at App.2040). This evidence demonstrated that members of the Sackler family were heavily involved in decisions on how to market and sell opioids (*see* JX-2944-45, JX-2952, JX-3013-14, JX-1652). Certain Sacklers, notably Richard, Mortimer D.A., and Theresa, aggressively set and pushed sales targets for OxyContin that were higher than those recommended by Purdue executives (*see* Confr. Hr'g Tr., Aug. 18, 2021, at 84:2-6; Dkt. No. 91-4, at App. 1350-51); accompanied sales representatives on "ride along" visits to health care providers to promote "the sale of Purdue's opioids" (Confr. Hr'g Tr., Aug. 18, 2021, at 70:2-7); approved countless settlements related to Purdue's culpable conduct (*id.* at 126:2-18); and oversaw sales and marketing budgets and corresponding upward trends in OxyContin prescribing. (Confr. Hr'g Tr., Aug. 19, 2021, at 106:15-109:6).

As discovery turned up evidence of the involvement of members of the Sackler

24. The Sacklers do not concede the truth of Purdue's admissions.

family in Purdue's misconduct, those family members were added as defendants in a number of cases pending against Purdue. For example, attorney Jayne Conroy testified that, as a result of information disclosed during the Opioid MDL discovery, she added the Sacklers as defendants in the lawsuits her firm was pursuing against Purdue in New York State Supreme Court. (Confr. Hr'g Tr. Aug. 16, 2021, at 70:16-25; *see also* Dkt. No. 91-5, at App. 2040). Peter Weinberger, another attorney with AHC, similarly acknowledged to the Bankruptcy Court that, "State complaints naming Sackler family members relied on MDL documents extensively." (Bankr. Dkt. No. 3449, at ¶¶ 36-37, 40).

2. State Multi-District Litigations

In addition to the Opioid MDL, over 390 parallel actions against Purdue proliferated in state courts, as well as in local courts in D.C., Puerto Rico, and Guam. (Dkt. No. 91-4, at App.1273). The causes of actions asserted in these various litigations included: (1) violations of state false claims acts; (2) violations of state consumer protection laws; (3) public nuisance; (4) fraud; (5) negligence; (6) unjust enrichment; (7) civil conspiracy; (8) violations of state controlled-substances acts; (9) fraudulent transfer; (10) strict products liability; and (11) wrongful death and loss of consortium. (*Id.*, at App.1276).

In some states, these lawsuits were consolidated in coordinated state proceedings. (*Id.* at App.1273-1274; *see e.g.*, Dkt. No. 91-5, at App.2039-2040). Such coordination occurred in Connecticut, Illinois, New York, Pennsylvania, Texas, and South Carolina. (Dkt. No. 91-4, at App.1273). In New York, cases brought by 58 counties and two dozen cities against Purdue were transferred to and coordinated in Suffolk County. (Dkt. No. 91-5, at App.2040).

While members of the Sackler family were not originally named as defendants in these state court coordinated actions, once their role in the marketing of OxyContin post-2007 was revealed in the Opioid MDL discovery, complaints in many state litigations were amended to name members of the Sackler family as defendants. (*See, e.g.*, Dkt. No. 91-5, at App.2040; *see* Bankr. Dkt. No. 3449, at ¶¶ 36-37, 40). Specifically, Richard Sackler, Jonathan Sackler, Mortimer D.A. Sackler, Kathy Sackler, Ilene Sackler Lefcourt, Beverly Sackler, Theresa Sackler, Mariana Sackler, and David Sackler were named as defendants in various lawsuits. (*See e.g.*, Dkt. No. 91-7, at App.2402-2597). In at least three of these cases, state courts denied the Sackler defendants' motions to dismiss the claims against them. (*See* Dkt. No. 94, at 5; Dkt. No. 91-5, At App.2041); *see e.g.*, Order, *In re Opioid Litigation*, No. 400000/2017, Dkt. No. 1191 (Sup. Ct. Suffolk Cnty. June 21, 2019).

Thus, when Purdue filed for bankruptcy in September 2019, "... the threat of liability for at least some members of the [Sackler] family was real and [ ] without the protections of bankruptcy, individual family members were at risk of substantial judgments against them." (*See* Dkt. No. 91-5, at App.2040). As explained by the UCC in the Confirmation Hearing, it was estimated that "... litigating against the Sacklers could eventually lead to a judgment or multiple judgments greater than $4.275 billion." (Bankr. Dkt. No. 3460, at 33; *see also* Bankr. Dkt. No. 3449, at ¶ 10).

3. The Renewed Lawsuits Against Purdue and Members of the Sackler Family by the Individual States

But private litigation was far from the only game in town. By the middle of 2019, forty-nine states' Attorneys General had filed new or amended lawsuits against Purdue, all of which named specific members of the Sackler family and/or Sackler-related entities. (*See* App.1274); *see e.g.*,

Amended Complaint, *New York v. Purdue Pharma L.P., et al.*, No. 400016/2018 (Sup. Ct. Suffolk Cnty. Mar. 28, 2019). For example, in March 2019, the New York Attorney General amended its earlier complaint against Purdue to add claims against the same eight members of the Sackler family and various Sackler entities.[25] *Id.* at ¶¶814-900. The newly-asserted claims included claims for public nuisance, fraud, gross negligence, willful misconduct, unjust enrichment, fraudulent conveyances, violations of state finance laws and social services laws, and "repeated and persistent" fraud and illegality in violation of Executive Law § 63(12). *Id.* Against the "Sackler entities," the complaint asserted claims for unjust enrichment and fraudulent conveyance. *Id.*

The Attorneys General of all but one of the State Appellants – California, Connecticut, Delaware, Maryland, Oregon, Rhode Island, Vermont, and D.C. – filed or amended complaints that include a range of charges against both Purdue and members of the Sackler family. (*See, e.g.*, Dkt. No. 103-7, at A-1553; Dkt. No. 95-1, at A0008; Dkt. No. 91-7, at App.2598; Dkt. No. 91-8, at App.2661; Dkt. No. 91-9, at App.3153; Dkt. No. 121-2, at MDA-008; JX-1647; JX-0946). The State of Washington did not assert claims against members of the Sackler family specifically but asserted claims against "Does 1 through 99" and "Doe Corporations 1 through 99" who – although not yet named – allegedly acted with Purdue "in committing all acts" in their complaint. (*See* Dkt No. 103-3, at App-630; JX-0944). This left open the possibility of naming members of the Sackler family and Sackler family entities.

The State Appellants' asserted claims included:

- fraudulent transfer (*see e.g.*, Dkt. No. 91-7, at App. 2649; Dkt. No. 91-9, at App.3194);
- fraud and fraudulent misrepresentation (*see e.g.*, Dkt. No. 91-9, at App. 3184);
- unjust enrichment (*see e.g.*, Dkt. No. 91-9, at App.3192; Dkt. No. 103-7, at A-1752; JX-1647.0199);
- negligence (*see e.g.*, Dkt. No. 91-8, at App.2766; Dkt. No. 91-9, at App. 3187; JX-0944.0123);
- public nuisance (*see e.g.*, Dkt. No. 91-8, at App.2768-69; Dkt. No. 91-9, at App.3175; Dkt. No. 103-7, at A-1749; Dkt. No. 95-1, at A0068; JX-1647.0197; JX-0944.0120); and
- violation of state consumer protection statutes by deceptive and unfair acts and practices. (*see e.g.*, Dkt. No. 91-7, at App.2642-2648; Dkt. No. 91-8, at App.2764; Dkt. No. 103-7, at A-1746-47; Dkt. No. 95-1, at A0066-67; Dkt. No. 121-2, at MDA-110; JX-1647.0194; JX-0944.0118).

For example, California asserted two claims for violations of its False Advertising Law (Cal. Bus. & Prof. Code § 17500 *et seq.*), and Unfair Competition Law (Cal. Bus. & Prof. Code § 17200 *et seq.*), as well as a public nuisance claim (Cal. Civ. Code § 3494 *et seq.*), against Purdue and nine individual members of the Sackler family, including Mariana Sackler.[26] (Dkt. No. 95-

25. The entities were described as those "known and unknown entities" that the Sacklers allegedly "used as vehicles to transfer funds from Purdue directly or indirectly to themselves," including Rosebay and Beacon. *Id.* at ¶¶49-54.

26. A California court recently issued a "tentative decision" rejecting the public nuisance theory of liability against Johnson & Johnson and other pharmaceutical companies, including Teva, Allergan, Endo and Janssen. *See* Tentative Decision, *California v. Purdue Pharma, L.P., et al.,* No. 30-2014-00725287-CU-BT-CXC, Dkt. No. 7939 (Cal. Sup. Ct. Nov. 1,

1, at A0066-68; JX-0947). California sought, *inter alia*, the assessment of civil penalties against each defendant and an order directing Purdue and the Sacklers to abate the public nuisance.

Connecticut – the state where Purdue's headquarters are located – asserted four claims for violations of its Unfair Trade Practices Act (Conn. Gen. Stat. § 42-110a *et seq.*) and one claim for fraudulent transfer against Purdue and eight individual members of the Sackler family. (Dkt. No. 91-7, at App.2642-49; JX-0840). Connecticut sought, *inter alia*, civil penalties, restitution, and disgorgement from all defendants, including the Sacklers.

Delaware – where Purdue Pharma's limited partnership was formed – asserted three claims for violations of Delaware's Consumer Fraud Act (6 Del. C. § 2511 *et seq.*) as well as claims for negligence and public nuisance against seven individual members of the Sackler family.[27] (Dkt. No. 91-8, at App.2764-2768; JX-0945; JX-1646). Delaware sought, *inter alia*, civil penalties and abatement.

Maryland asserted a claim for violation of the state's consumer protection laws (Md. Code Ann., Com. Law §§ 13-301 *et seq.*) against the same seven individual members of the Sackler family. (*See* Dkt. No. 121-2, at MDA-008). Maryland, like the other opposing states, sought civil penalties against the Sackler defendants, among other relief.

Oregon asserted three claims against Purdue and eight individual members of the Sackler family – the first seeking a declaratory judgment that Purdue and related entities are the alter egos of the Sacklers and that the state may pierce the corporate veil; the other two asserting claims for fraudulent conveyance. (*See* JX-1647). Oregon sought, *inter alia*, a judgment restraining the Sackler defendants from disposing of property and ordering a return of the conveyed funds.

Rhode Island asserted six claims against Purdue and the eight individual members of the Sackler family for public nuisance, fraud and fraudulent misrepresentation, fraudulent and voidable transfers, violations of Rhode Island's State False Claims Act (R.I. Gen. Laws § 9-1.1-1 *et seq.*), negligence, and unjust enrichment. (Dkt. No. 91-9, at App.3175-94; JX-1648; JX-2214). Rhode Island sought, *inter alia*, civil penalties, treble damages, disgorgement, and restitution.

Vermont asserted four claims against the eight individual members of the Sackler family: two violations of the Vermont Consumer Protection Act (9 V.S.A. § 2451 *et seq.*), unjust enrichment, and public nuisance. (Dkt. No. 103-7, at A-1746-52; JX-1649). Vermont also sought civil penalties, among other relief.

Washington State brought an action against Purdue, "Does 1 through 99," and "Doe Corporations 1 through 99" for violating the Washington's Consumer Protection Act (Wash. Rev. Code § 19.86), for causing a public nuisance, and for breach-

2021). The same theory of liability was thrown out by the Oklahoma Supreme Court in a case against Johnson & Johnson. *See State ex rel. Hunter v. Johnson & Johnson,* 499 P.3d 719 (Okla. Sup. Ct. Nov. 9, 2021). However, also last month, an Ohio jury found three major pharmacy chains liable for damages on the theory that their filling of pill mill prescriptions for opioids created a public nuisance. *See Ohio jury holds CVS, Walgreens and Walmart liable for opioid crisis,* NPR (Nov. 23, 2021), *available at* https://www.npr.org/2021/11/23/1058539458/a-jury-in-ohio-says-americas-big-pharmacy-chains-are-liable-for-the-opioid-epide.

27. Beverly Sackler was not sued in Delaware or Maryland. Mariana Sackler was only sued in California.

ing Washington's common law of negligence. (JX-0944). The Complaint sought abatement, restitution, and statutory penalties, among other relief.

D.C. brought two claims against Purdue and Richard Sackler for violations of its consumer protection statutes (D.C. Code § 28-3904(f)). (*See* JX-0946). D.C. sought, like the others and among other relief, statutory civil penalties against each defendant.

Each State Appellant filed its claims before Purdue filed for bankruptcy in September 2019. None of the cases had been litigated to judgment.[28] (*See* Dkt. 91-4, at App.1278). These cases were not subject to the automatic stay that stopped private litigation in its tracks once Purdue filed, (11 USCA § 362(b)), but the Bankruptcy Court preliminarily enjoined all litigation against Purdue and the Sacklers; that order was affirmed by this court, *In re Purdue Pharms. L.P.*, 619 B.R. 38 (S.D.N.Y. 2020). As a result, no activity has taken place in any of these lawsuits since shortly after Purdue's filing.

4. Lawsuits in Canada

In Canada, a number of class actions were filed against certain of the Debtors with allegations similar to those made in the U.S. (*See* Dkt. No. 91-4, at App.1273, 1477; *see e.g.*, Dkt No. 98-1, at 13–102, 113–202). Prior to Purdue's Chapter 11 filing, the lead plaintiffs in ten of the Canadian class actions settled their claims for $20 million, and Purdue Pharma (Canada) ("Purdue Canada")[29] placed that amount in trust pending approval of the settlement by the Ontario Superior Court of Justice, the Superior Court of Quebec, the Supreme Court of Nova Scotia and the Saskatchewan Court of Queen's Bench (the "Canadian Settlement"). (Dkt. No. 91-4, at App.1477-1478). The Canadian Settlement, once approved and after funds are disbursed, "completely and unconditionally released, forever discharged, and acquitted [the Debtors] from any and all Settled Patient Claims against the Debtors and from any other Proof of Claim or portion thereof in respect of any Settled Patient Claim filed against any Debtor." (*Id.*). Under the Canadian Settlement, no member of the Canadian classes party to that settlement can recover from any source other than the Canadian Settlement trust, and every class member in a settling class bears the burden of proving in the U.S. bankruptcy that its claim was not released and discharged by the Canadian Settlement. (*Id.*).

However, the Canadian Settlement did not cover the claims of the Canadian Appellants, which are Canadian municipalities and indigenous tribes. The Canadian Appellants' lawsuits concerned sales and distribution of OxyContin in Canada, affecting Canadian communities, by Purdue Canada, which the Canadian Appellants assert was controlled by Sackler family members. (Dkt. 98, at 5; Bank. Dkt. No. 3421, at 89-92). The Canadian Appellants' lawsuits against Purdue Canada assert, *inter alia*, claims for conspiracy, public nuisance, negligence, fraud, and unjust enrichment. (Dkt No. 98-1, at 18-19). The Canadian Appellants also stated at oral argument that that they "were barred by

28. Prior to bankruptcy, the lawsuit brought by North Dakota was litigated to judgment, and that judgment was in favor of Purdue. (*See* Dkt. No. 91-4, at App.1278).

29. Purdue Canada is an IAC. It is not a Debtor in this case. Purdue Canada as defined in the Shareholder Settlement Agreement, means Bard Pharmaceuticals Inc., Elvium Life Sciences GP Inc., Elvium Life Sciences Limited Partnership, Elvium ULC, Purdue Frederick Inc. (Canada), Purdue Pharma (Canada), Purdue Pharma Inc. (Canada), and Purdue Pharma ULC. (JX-1625.0027).

the imposition of the stay and the stay-related orders" – the preliminary injunction described above – "from actually naming [certain] Competition Act claim[s] against the Sacklers and the [Shareholder Released Parties]," which they would assert if given the opportunity. (Oral Arg. Tr., Nov. 30, 2021, at 80:11-16).

The Canadian Appellants do not include the Canadian federal government or any Canadian province – all of whom seem to be content with the fact that the Plan excludes claims against Purdue Canada. (*See* Plan, at 10). Indeed, the ten Canadian provinces for their part seem to believe their claims are excluded and have decided to pursue their claims in Canada instead. For example, in press on the topic, Reidar Mogerman, counsel for the British Columbia government, explained that the provinces gave up their claims (worth US$67.4 billion) before the Bankruptcy Court in the U.S. to protect lawsuits they filed against Purdue's Canadian entities.[30] "We didn't want to get swallowed in competition with the U.S. claims and lose our Canadian claims," he explained to the press. *Id.* To date, in Canada, the various Canadian provinces have asked the Ontario Superior Court of Justice to continue to pursue their separate class actions against Purdue Canada. *Id.*

VII. Members of The Sackler Family Insulate Themselves Against Creditors

As Judge Drain found, the evidence indicates members of the Sackler family distributed significant sums of Purdue money to themselves in the years 2008-2016, during which time those Sackler family members were closely involved in the operations of Purdue and aware of the opioid crisis and the litigation risk. *See In re Purdue Pharma L.P.*, 2021 WL 4240974, at *32. As detailed below, this "aggressive[ ]" (to use Richard Sackler's word, *see* JX-1703) pattern of distribution of earnings to shareholders represented a sharp departure from prior practice in two ways.

First, during the period 1996-2007, Purdue up-streamed on average 9% of its revenue per year to the Sacklers; but during the period 2008-2016, Purdue up-streamed on average 53%, and as much as 70%, of its revenue to the Sacklers. (*See* JX-2481).

Second, during the earlier period (1996-2007), the Sacklers kept less than 10% of the money that was distributed by Purdue for themselves, while using over 90% of those distributions to pay taxes on Purdue's earnings; but during the years between 2008-2016, the Sacklers retained, in one form or another, 56% of those distributed earnings, while using just 44% to pay taxes. (Bankr. Dkt. 3410-2).

The 2008-2016 distributions to shareholders also contrasted with the practices of Purdue's peer pharmaceutical companies. (*See* JX 1703).

According to the Sacklers' own expert, this pattern of upstreaming corporate earnings substantially depleted Purdue's treasury during that eight-year period. (JX-0431, p. 77, Fig. 10).

A. The Sacklers Cause the Transfer of Billions of Dollars from Purdue to Themselves

In March 2007, Richard, Jonathan, Kathe, and Mortimer Sackler exchanged emails noting that the "future course [for the business] is uncertain" (JX-2976) and identified the "emergence of numerous new lawsuits" as a "risk[ ] . . . we're not

30. *Provinces plan legal push against Purdue Pharma in wake of U.S. opioid deal,* The Globe and Mail (Sept. 3, 2021), https://www.theglobeandmail.com/canada/article-provinces-plan-legal-push-against-purdue-pharma-in-wake-of-us-opioid.

really braced for." (JX-2957). Just a few months later, in May, shortly after the 2007 guilty plea and settlement, David Sackler emailed Jonathan Sackler, Richard Sackler, and their financial advisor, expressing concern about the family's personal liability for the opioid crisis: "what do you think is going on in all of these courtrooms right now? We're rich? For how long? Until suits get through to the family?" (JX-2237; *see also* JX-2096, at ¶ 161). In his deposition, David Sackler agreed that his May 17, 2007, email reflects "concern[ ] that the family would be sued in connection with Purdue's sale of OxyContin." (JX-1989, at 183:14-184:20, 187:18-188:20). Less than a week after David Sackler sent his email, Richard and Jonathan Sackler met with a bankruptcy attorney, though Purdue was not in debt and not at risk of bankruptcy. (*See* JX-2985; JX-2986).

Thereafter, on July 26, 2007, a family financial advisor sent a confidential memorandum to Jonathan Sackler, in which he advised that Purdue faced "[u]ncapped liabilities" that posed "a huge valuation question" for Purdue at that very moment – the moment when the Plea and settlements were ostensibly ending any illegal behavior and putting further corporate liability – and potential shareholder liability – in the rear view mirror. (JX-1660, at 2-3). He added, "I presume the family has taken most of the appropriate defensive measures." (*Id.* at 3; *see also* JX-2241). One such measure, proposed in a separate memorandum, was "to distribute more free cash flow so [the owners] can purchase diversifying assets." (JX-2254; *see also* JX-2096, at ¶ 162).

By January 2008, the anxiety over impending lawsuits was apparent; Richard Sackler emailed Mortimer Sackler that, "I've been told by Silbert that I will be [sued] and probably soon." (JX-3001). Mortimer Sackler lamented in a later email in February 2008 that he wished to get out of the pharmaceutical business altogether "given the horrible risks, outlooks, difficulties, etc." (Bankr. Dkt. No. 2161, at Ex. 67). In this vein, in April 18, 2008, Richard Sackler warned in a memo that the business posed a "dangerous concentration of risk" and proposed that the family either sell the company or "distribute more free cash flow" to themselves. (JX-2214, ¶ 86; JX-3004; JX-3104). The family chose the latter course.

Beginning in 2008, Purdue began to make significant cash distributions to and for the benefit of the Sacklers. (JX-1988, at 226:13-19 (deposition of Richard Sackler); Confr. Hr'g Tr., Aug. 19, 2021, at 149:6-14 (testimony of Mortimer D.A. Sackler); Confr. Hr'g Tr., Aug. 18, 2021, at 65:8-17 (testimony of Richard Sackler); *see also* Dkt. No. 91-4, at App.1544). As noted above, about 44% of the money distributed went to pay taxes; a small fraction was invested in the IACs, which were owned by the Sacklers; and the rest went to Rosebay and Beacon, the Side A and B Sackler family trusts. (*See* JX-1987, at 156:8-158:4; Confr. Hr'g Tr., Aug. 19, 2021, at 27:7-28:1-12).

In the years leading up to the 2007 Plea Agreement and Settlement, the Sackler family had been content to leave most of Purdue's earnings in the company, except insofar as was necessary to pay taxes. In response to a question from this Court, Debtors acknowledged that, between January 1, 1995 and December 31, 2007, distributions to the Sacklers totaled $1.322 billion, of which $1.192 billion (or 90.2%) was used to pay taxes. (Dkt. No. 177; *see* JX-3050.0042; JX-2481; Bankr. Dkt. 3410-2). In the twelve years prior to 2008, the Sacklers took personal distributions from Purdue that averaged 9% of Purdue's revenue. (*See* JX-2481).

After 2007, Purdue went from distributing less than 15% of its revenue to distributing as much as 70% of revenue.[31] (*Id.*). It also jumped from distributing approximately 38% of its free cash flow in 2006 to distributing 167.4% of free cash flow in 2007 and continued to distribute free cash flow in the 90% range for the next decade. (*Id.*). These distributions totaled approximately $10.4 Billion. (*See* Dkt. No. 91-4, at App.1544; Bankr. Dkt. No. 3410-1, at ¶ 12; Confr. Hr'g Tr., Aug. 18, 2021, at 65:8-17 (testimony of Richard Sackler); Confr. Hr'g Tr., Aug. 19, 2021, at 27:7-28:1-12, 149:6-14 (testimony of Mortimer D.A. Sackler)).

Approximately $4.6 billion of that amount was used to pay pass through taxes (*see* Bankr. Dkt. 3410-2), which attests to the tremendous profitability of Purdue's OxyContin business during that same eleven-year period. In fact, the vast majority of Purdue's earnings between 2008-2017 came from OxyContin sales. (*See* JX-1984, at 40:24-41:5; JX-3275, at 338:6-9; JX-0999).

According to the Sacklers' own expert, the change in distribution pattern drained Purdue's total assets by 75% and Purdue's "solvency cushion" by 82% between 2008 and 2016. (JX-0431, p 77, Fig. 10). Richard Sackler later acknowledged in an email in 2014 that, "in the years when the business was producing massive amounts of cash, the shareholders departed from the practice of our industry peers and took the money out of the business." (JX 1703). In at least one email in 2014, Jonathan Sackler referred to this distributing of cash flow from OxyContin as a "milking" program. (JX-2974).

The obvious implication of this evidence was recognized by Judge Drain in his bankruptcy decision, discussed *infra* in Background Section XII. *See In re Purdue Pharma L.P.*, 2021 WL 4240974, at *27, 31, 32–33. In particular, Judge Drain noted, "I do have an extensive report and trial declarations as to the nature of the assertedly over $11 billion of avoidable transfers, when they occurred, what they comprised, and who they were made to," *id.* at 31; and found, "The record suggest[s] that at least some of the Sacklers were very aware of the risk of opioid-related litigation claims against Purdue and sought to shield themselves from the economic effect of such claims by causing Purdue to make billions of dollars of transfers to them and to shield their own assets, as well, from collection." *Id.* at 32. While he made no finding that these distributions qualified as fraudulent conveyances, or that they could be recouped by Purdue, Judge Drain also acknowledged that the estate had potential claims of "over $11 billon of assertedly avoidable transfers." *Id.* at 27.

As Judge Drain also acknowledged, the distribution of Purdue money to the Sackler family occurred during a time when members of the Sackler family, including those named in many pending cases, were closely involved in the operations of Purdue and well aware of the opioid crisis and the litigation risk. He said, "The testimony that I heard from the Sacklers tended to show, that as a closely held company Purdue was run differently than a public company and that its Board and shareholders took a major role in corporate decision-making, including Purdue's practices regarding its opioid products that was more

31. The absolute amount of these distributions dwarfed distributions for the 1995-2007 period because concerns about the validity of Purdue's OxyContin patent capped its earnings until 2008, when it was definitively held that the patent was valid. (*See* Dkt. No. 241, at 6). After that, Purdue's earnings soared – as did both the amount owed in taxes and the amount that ended up in the Sackler family trusts.

akin to the role of senior management." *Id.* at 33. As Richard Sackler acknowledged in the Confirmation Hearing, he oversaw as director "many settlements," stating, "I was director, and I cannot count up all the settlements that the company entered into while I was a director. But there were many settlements, both private and public." (Confr. Hr'g Tr., Aug. 18, 2021, at 126:2-18). For example, as part of the Board, he approved the settlement of $24 million to the State of Kentucky to resolve unlawful and unfair deceptive trade practice allegations against Purdue in 2015. (*Id.* at 124:16-125:1).

The Sacklers vehemently deny any suggestion that any of these transfers would qualify as fraudulent conveyances. (*See* JX-2096, at ¶G). However, in Addendum A to the 2020 "Settlement Agreement" with the DOJ, the Government asserted its confidence that it could prove that: "From approximately 2008 to 2018, at the Named Sacklers' request, billions of dollars were transferred out of Purdue as cash distributions of profits and transfers of assets into Sackler family holding companies and trusts. Certain of these distributions and transfers were made with the intent to hinder future creditors and/or were otherwise voidable as fraudulent transfers." (*Id.* at Addendum A, ¶6; *see also id.* at ¶¶158-159)

The fact of these extensive transfers of money out of Purdue and into the family coffers is not contested. For example, during the Confirmation Hearing, when Richard Sackler was asked if it were "true that during that time period generally [2008-2018] ... the Purdue Board of Directors transferred out billions of dollars to Sackler family trusts or holding companies," he answered, "Yes ... yes, that we did." (Confr. Hr'g Tr., Aug. 18, 2021, at 65:8-17). Only whether those transfers (or any of them) would qualify as fraudulent conveyances is in dispute. But while that presents an important and interesting question, I agree with Judge Drain that it was not one he needed to resolve in order to rule on the confirmability of the Plan. But at some point – certainly by 2018 – Purdue itself was in a precarious financial position in face of the lawsuits. At the time of the bankruptcy filing, Purdue represented that, while it had "no funded debt and no material past due trade obligations" – or even any "judgment creditors" – "the onslaught of lawsuits has proved unmanageable" and "will result only in the financial and operational destruction of the Debtors and the immense value they could otherwise provide ..." (Dkt. No. 91-4, at App. 1237).

B. A Pre-Petition Settlement Framework Is Proposed That Would Release the Sackler Family From Liability.

In the months before Purdue filed for bankruptcy, Purdue, the Sackler family (now no longer represented on Purdue's Board) and Sackler entities were engaged in discussions about a potential framework for settlement of all claims against Purdue and the Sacklers with "the various parties in the MDL litigation" and certain "subgroups" of creditors and potential creditors. (*See* Confr. Hr'g Tr., Aug. 12, 2021, at 152:23-153:22). John Dubel testified in the Confirmation Hearing [32] that the pre-petition settlement framework discussions involved the concept of third-party releases *and* the concept of using the bankruptcy

32. Mr. Dubel served as the Chairman of the Special Committee of the Board. He was appointed to the Board in July 2019 and chaired the Special Committee investigating the potential claims of Purdue or its estates against the Sacklers. (*See* Bankr. Dkt. No. 3433, at ¶1).

process to release all claims against the Sacklers in exchange for their contribution of funding to the settlement. (*Id.* at 154:1-5). Mr. Dubel explained:

> [I]t was very clear from the . . . Sacklers that if they were going to post up X amount of dollars – and I believe at the time, the settlement framework was somewhere around $3 billion or so – that they were going to seek broad third party releases, and releases from the Debtors, releases of all the estate claims, etc., so that they could be able to put all of that – all of the litigation behind them . . . *it was something that was a prerequisite or a condition to them posting the amount of money that was in the settlement framework* and then ultimately what is in the plan of organization we were seeking approval of.

(*Id.* at 155:25-156:1-12; *see id.* at 209:1-4, 214:8-19) (emphasis added).

So the Sacklers made it clear well before the Debtors filed for chapter 11 bankruptcy that they would contribute toward Purdue's bankruptcy estate only if they received blanket releases that would put "all of the litigation behind them." (*Id.* at 155:25-156:1-12). This was reported heavily in the press at the time of the bankruptcy filing.[33]

This pre-petition settlement framework was then imported into the bankruptcy process. As Mr. Dubel testified, once a pre-petition settlement framework was created, the plan was to "Us[e] the Chapter 11 process to enable us to then organize all of the various claimants into one group under . . . the auspices of the Chapter 11 bankruptcy process." (*Id.* at 154:14-18). He further explained that, "It was the framework that would help us continue to bring all of the various creditor groups towards a decision as to whether it was better to litigate against the Sacklers or attempt to come up with a settlement that would be fair and equitable for all the creditors of the Debtor's estates." (*Id.* at 155:2-9). He testified that some 24 states "were supportive of us moving forward in the process of filing a Chapter 11 and using this [bankruptcy] as a means of coalescing all the parties into one organized spot to address the potential claims that the estates would have against the Sacklers." (*Id.* at 157:4-9).

Purdue's bankruptcy was thus a critical part of a strategy to secure for the Sacklers a release from any liability for past and even future opioid-related litigation without having to pursue personal bankruptcy. David Sackler acknowledged as much in his testimony, "I don't know of another forum that would allow this kind of global solution, this kind of equitable solution for all parties." (Confr. Hr'g Tr., Aug. 17, 2021, at 35:4-6).

VIII. The Underlying Bankruptcy

Facing the mounting lawsuits against both Purdue and members of the Sackler family in the U.S. and abroad, certain U.S. based Purdue entities (Debtors) filed for bankruptcy relief on September 15, 2019. (Bankr. Dkt. No. 1). Members of the Sackler family and the Sackler entities – such as Rosebay and Beacon – did not file for

33. *See e.g., Purdue Pharma's bankruptcy plan includes special protection for the Sackler family fortune,* The Washington Post (Sept. 19, 2019), https://www.washingtonpost.com/business/2019/09/18/purdue-pharmas-bankruptcy-plan-includes-special-protection-sackler-family-fortune; *Where did the Sacklers move cash from their opioid maker?,* ABC News (Sept. 5, 2019), https://abcnews.go.com/US/wireStory/sacklers-move-cash-opioid-maker-65407504.

bankruptcy, despite having been named as defendants in opioid-related lawsuits.

A. Pending Actions Against Purdue and Members of the Sackler Family Are Halted

Purdue quickly moved on September 18, 2019, before the Bankruptcy Court for an injunction halting all actions against Purdue as well as "against their current and former owners (including any trusts and their respective trustees and beneficiaries), officers, directors, employees, and associated entities." (Dkt. No. 91-4, at App.1471, 1562). This meant enjoining over 2,900 actions against Purdue and at least 400 civil suits against the Sacklers. (*Id.*, at App. 1562).

Purdue argued that enjoining all litigation was necessary to facilitate the parties' work towards a global settlement in a single forum – the Bankruptcy Court. After an evidentiary hearing, on October 11, 2019, the Bankruptcy Court temporarily halted all such litigation until November 6, 2019 (*Id.* at App.1472), at which point it granted Purdue's motion enjoining all plaintiffs from continuing or commencing any judicial, administrative, or investigative actions, as well as any other enforcement proceeding, against Purdue or the non-debtor related parties, including against members of the Sackler family. (*Id.*; *see* Bankr. Dkt., No. 2983, at 171). This Court affirmed the Bankruptcy Court's grant of the preliminary injunction. *Dunaway v. Purdue Pharma. L.P. (In re Purdue Pharma. L.P.)*, 619 B.R. 38 (S.D.N.Y. 2020). The expiration date of the preliminary injunction has been extended 18 times, during which period the parties negotiated to come up with the Plan. (*See* Dkt. No. 91-4, at App.1402, 1429, 1472-73; Bankr. Dkt. Nos. 2897, 2488).

B. The Creditor Constituencies in the Bankruptcy

On September 27, 2019, the U.S. Trustee appointed nine creditors to the UCC, an independent fiduciary to represent the interests of all unsecured creditors in the Purdue bankruptcy. (Dkt. No. 91-1, at App.7).[34] The UCC's appointees are Blue Cross and Blue Shield Association; CVS Caremark Part D Services L.L.C. and CaremarkPCS Health, L.L.C.; Cheryl Juaire; LTS Lohmann Therapy Systems, Corp.; Pension Benefit Guaranty Corporation; Walter Lee Salmons; Kara Trainor; and West Boca Medical Center. (Bankr. Dkt. No. 1294; *see* Dkt. No. 115-1, at 5). The UCC also has several ex-officio, non-voting representatives: (i) Cameron County, Texas, on behalf of the MSGE; (ii) the Cheyenne and Arapaho Tribes, on behalf of certain Native American Tribes and Native American-affiliated creditors; and (iii) Thornton Township High School District 205, on behalf of certain public school districts. (*See* Bankr. Dkt. No. 1294).

Between September and November 2019, various other creditor groups were formed to represent creditor constituencies in the bankruptcy, including as follows:

- The AHC was formed in September 2019 and is comprised of ten States, six counties, cites, parishes, or municipalities, one federally recognized American Indian Tribe (the Muscogee (Creek) Nation, as well as the court-appointed Co-Lead Counsel on behalf of the Plaintiffs' Executive Committee in the Opioid MDL (*see* Bankr. Dkt. No. 279);
- NAS Children was formed in September 2019 and is comprised of around 3,500 children, who born with "neonatal abstinence syndrome" due

34. See Official Committee of Unsecured Creditors of Purdue Pharma L.P. and Affiliated Debtors: General Information, KKC, available at http://www.kccllc.net/PurdueCreditors.

to exposure to opioids in utero, and/or their guardians (*see* Bankr. Dkt. No. 1582; Dkt. No. 115-1, at 3);

- The PI Ad Hoc Group was formed in October 2019 and is comprised of 60,761 personal injury claimants, each holding "one or more unsecured, unliquidated, opioid-related personal injury claims against one or more of the Debtors" (*see* Bankr. Dkt. Nos. 3939, 348);
- MSGE was formed in October 2019 and is comprised of 1,317 entities: 1,245 cities, counties and other governmental entities, 9 tribal nations, 13 hospital districts, 16 independent public school districts, 32 medical groups, and 2 funds across 38 states and territories (*see* Bankr. Dkt. No. 1794);
- The Ad Hoc Group of Non-Consenting States ("NCSG") was formed in October 2019 and is comprised of 25 states that did not reach a pre-petition agreement with Purdue or the Sacklers regarding "the general contours of a potential chapter 11 plan" to settle their claims – California, Colorado, Connecticut, Delaware, D.C., Hawaii, Idaho, Illinois, Iowa, Maine, Maryland, Massachusetts, Minnesota, Nevada, New Hampshire, New Jersey, New York, North Carolina, Oregon, Pennsylvania, Rhode Island, Vermont, Virginia, Washington, and Wisconsin (*see* Bankr. Dkt. No. 296);
- The Ratepayer Mediation Participants ("Ratepayers") was formed in October 2019 and is comprised of "proposed representatives of classes of privately insured parties who are plaintiffs and proposed class representatives in their individual and representative capacities in suits brought against [Purdue]" in 25 actions in 25 states (*see* Bankr. Dkt. No. 333; Dkt. No. 91-3, at App.1108); and
- The Ad Hoc Group of Hospitals ("Hospitals") was formed in November 2019 and is comprised of hundreds of hospitals that have treated and treat patients for conditions related to the use of opiates manufactured by Purdue (*see* Bankr. Dkt. 1536).

Other groups that formed during the pendency of the bankruptcy proceedings include:

- The Third-Party Payor Group ("TPP Group"), comprised of certain holders of third-party payor claims (*see* Dkt. No. 91-3, at App.1114);
- The Native American Tribes Group ("Tribes Group"), comprised of the Muscogee (Creek) Nation, the Cheyenne & Arapaho Tribes, an ex officio member of the Creditors' Committee, and other Tribes represented by various counsel from the Tribal Leadership Committee and the Opioid MDL Plaintiffs' Executive Committee (*see id.* at App.1096); and
- The Public School District Claimants ("Public Schools"), comprised of over 60 public school districts in the United States (*see id.* at App.1106; Bankr. Dkt. Nos. 2707, 2304).

Each of these groups was representative of certain creditor constituencies, whose "members" (there was no certified class) held similar types of claims against Purdue.

C. The Court Sets A Bar Date for Filing of Proof of Claims

On January 3, 2020, Purdue filed a "Motion for Entry of an Order (I) Establishing Deadlines for Filing Proofs of Claim and Procedures Relating Thereto, (II) Approv-

ing the Proof of Claim Forms, and (III) Approving the Form and Manner of Notice Thereof" (the "Bar Date Motion")." (*See* Dkt. No. 91-4, at App.1475). On February 3, 2020, the Bankruptcy Court approved the Bar Date Motion, setting June 30, 2020 as the deadline for all persons and entities holding a prepetition claim against Purdue, as defined in section 101(5) of the Bankruptcy Code (a "Claim"), to file a proof of claim. (*Id.*). On June 3, 2020, the Bankruptcy Court entered an order extending the Bar Date to July 30, 2020. (*Id.*; *see id.* at App.1298).

During the five months while the window for filing proofs of claims was open, over 614,000 claimants did so. Just 10% of the claims so filed would give rise to over $140 trillion in aggregate liability – more than the whole world's gross domestic product. (Dkt. No. 91-4, at App.1421; *see* Dkt. No. 91-1, at App.28).[35] The claimants included the federal government, states and political subdivisions, Native American Tribes, hospitals, third-party payors, ratepayers, public schools, NAS monitoring claims,[36] more than 130,000 personal injury victims, and others. (*See* Dkt. No. 91-4, at App.1425-1429; *see* Dkt. No. 91-1, at App.28).

D. The Court Approves Mediation and Appoints Mediators to Facilitate Resolution

On February 20, 2020, Purdue filed an unopposed "Motion for Entry of an Order Appointing Mediators," seeking the appointment of mediators and mandating that the various creditor constituencies participate in mediation. (Dkt. No. 91-4, at App.1486). On March 2, 2020, the Bankruptcy Court approved Purdue's motion and appointed The Honorable Layn Phillips (ret.) and Mr. Kenneth Feinberg as co-mediators (*Id.*; Bankr. Dkt. No. 895). Both are among the most experienced and respected mediators in the country.

IX. The Negotiation of the Bankruptcy Plan

Through mediation, Purdue and stakeholders worked to negotiate a complex settlement framework that would ultimately direct the Debtors' assets and $4.275 billion from the Sackler families toward abating the opioid crisis and restoring victims of the crisis. (*See* Dkt. No.91-4, at App. 1402, 1429; *see* Bankr. Dkt. 2488).

The parties involved in the negotiations included the Debtors and non-debtor related parties (*i.e.*, members of the Sackler family) and the various creditor constituencies. Together, as defined in the court's mediation order, the participating "Mediation Parties" were the Debtors, the UCC, the AHC, the NCSG, the MSGE, the PI Ad Hoc Group, NAS Children, the Hospitals, the TPP group, and the Ratepayers. (Dkt. No. 91-4, at App.1486). The Tribes Group, the Public Schools, the National Association for the Advancement of Colored People, and others also participated in mediation, although not as official Mediation Parties. (*Id.*; *see* Bankr. Dkt. No. 2548).

The mediation progressed in three phases (*id.* at App.1404), as follows:

35. As of October 21, 2021, 628,389 claims have been filed. *See* Bankruptcy Claim Report, *available at* https://restructuring.primeclerk.com/purduepharma/Home-DownloadPDF?id1=MTMwMjM2Mw&id2=0.

36. NAS monitoring claims are those of legal guardians of children born with neonatal abstinence syndrome due to exposure to opioids in utero. (Dkt. No. 91-4, at App.1404; *see* Dkt. No. 115-1 at 3).

A. Phase 1: March 2020-September 2020

Phase one of the mediation addressed "the allocation of value/proceeds available from the Debtors' Estates" as disputed between the "Non-Federal Public Claimants" (the states, federal districts and U.S. territories, political subdivisions, and Native American tribes) and "Private Claimants" (hospitals, private health insurance carriers and third-party payors, and individuals and estates asserting personal injury, including NAS Children). (Dkt. No. 91-4, at App.1487; Bankr. Dkt. No. 855, at 6-7). It proceeded with a "series of rigorous formal mediation sessions during the period from March 6, 2020 to September 11, 2020." (Dkt. No. 91-4, at App.1487).

The mediation resulted in certain resolutions (*see generally* Bankr. Dkt. 1716), the most critical of which included value allocation between and among the various parties, such as:

> First, the Non-Federal Public Claimants agreed that all value received by them through the Chapter 11 Cases would be exclusively dedicated to programs designed to abate the opioid crisis . . . Second, the Non-Federal Public Claimants addressed and resolved . . . value allocation for all Native American Tribes . . . and a default mechanism that, in the absence of a stand-alone agreement between a State or territory and its political subdivisions, provides a structure and process for applying funds to abate the opioid crisis . . .
>
> Third, agreement was reached on written term sheets with certain individual Private Claimant groups that addressed allocation of estate value to each Private Claimant group. These agreements provided, among other things, that each class of Private Claimants will receive fixed cash distributions over time, the values and time periods varying for each class. Moreover, the Ad Hoc Group of Hospitals, the Third-Party Payors, and the NAS Committee (with regard to medical monitoring) each agreed to dedicate substantially all the distributions from their respective Private Creditor Trusts to abate the opioid crisis.

(*See* Dkt. No. 91-4, at App.1487). Ultimately, all participants except "the public school districts and the NAS children physical injury group" were able to achieve "agreement *inter se* as to their respective allocations as a result of the mediation process." (Bankr. Dkt. 2548, at 8).

Each of the term sheets with the private plaintiffs was conditioned on the confirmation of a plan of reorganization that includes participation by the Sackler Families in the plan of reorganization. (Bankr. Dkt. 1716, at 5).

However, not all issues were resolved. On September 23, 2020, while phase one of the mediation had reached "substantial completion" (Bankr. Dkt. 2548), the mediators' report indicated that "there remain terms to be negotiated by the parties with respect to each of the term sheets in order to reach final agreements . . ." (Bankr. Dkt. 1716, at 5-6). With several open terms and the estate claims still to be negotiated, on September 30, the Bankruptcy Court entered a Supplemental Mediation Order, authorizing further mediation to resolve the open issues and to mediate the estate claims (phase 2). (Dkt. No. 91-4, at App. 1551; Bankr. Dkt. Nos. 1756).

B. Phase 2: October 2020-January 31, 2021

The Bankruptcy Court's Supplemental Mediation Order authorized the mediators "to mediate any and all potential claims or causes of action that may be asserted by the estate or any of the Non-Federal Pub-

lic Claimants" against the Sackler families and entities "or that may otherwise become the subject of releases potentially granted to" members of the Sackler families and entities (defined as the "Shareholder Claims"). (*See* Bankr. Dkt. Nos. 1756, at 2; 2584, at 1; 518, at 4). This Order also "narrowed the number of mediating parties on the Shareholder Claims aspect of the mediation" to the Debtors, the UCC, the "Consenting Ad Hoc Committee,"[37] the NCSG, the MSGE, and representatives of the Sacklers. (Bankr. Dkt. Nos. 2584, at 1; 2548, at 2).

In phase two, the mediators received presentations from the parties on their positions regarding the estate claims, including a presentation by the UCC of its "views and findings on its investigation of estate causes of action." (Dkt. No. 91-4, at at App.1551-52; Bankr. Dkt. No. 2584).[38] After the presentations, "numerical negotiation began," with offers and counteroffers proposed. However, no "mutually agreed resolution" was reached among all constituencies before the end of the phase two on January 31, 2021. (Bankr. Dkt. No. 2584).

C. Phase 2 Negotiations Continue with the Sackler families: January 2021 to March 2021

Although court-ordered mediation formally ended on January 31, 2021, settlement negotiations continued among the Sackler families and entities, the Debtors, the NCSG, the UCC, the ACH, and the MSGE regarding the "Sackler contribution" to the Debtors' estate. (*See* Bankr. Dkt. No. 2584, at 9; Dkt. No. 91-4, at App.1552-53). Eight more offers and counteroffers were exchanged between the end of January 2021 and February 18, 2021. (Dkt. No. 91-4, at App.1553).

Ultimately, the Sackler families and entities, the Debtors, the AHC, the "Consenting Ad Hoc Committee," and the MSGE reached an agreement in principle, which settled on a guaranteed amount that the Sackler families would be required to contribute to the Debtors' estate – $4.275 billion over nine years (or ten years if certain amounts were paid ahead of schedule in the first six years). (*Id.* at App.1552-53; *see* Bankr. Dkt. Nos. 2488, 2879). The principal consideration for this payment was the "Shareholder Release" that was to be included in the Debtors' plan of reorganization. (*See* Bankr. Dkt. 2487, at § 10.8). That plan, along with the Debtors' "Disclosure Statement" containing the "Sackler Settlement Agreement Term Sheet" reached in negotiation, were filed with the Bankruptcy Court on March 15, 2021. (*See* Bankr. Dkt. Nos. 2487, 2488).

D. Phase 3: May 7, 2021-June 29, 2021

Phase three of the mediation involved a final push to resolve the dispute of the

37. The Bankruptcy Court did not define what the ''Consenting Ad Hoc Committee'' was, but the mediators' March 23, 2021 report lists ''the Consenting States and the Ad Hoc Committee'' as consisting of the AHC plus the various consenting states listed there – notably Texas, Tennessee, and Florida. (*See* Bankr. Dkt. No. 2548, at 2). The Court assumes this is what is meant by the ''Consenting Ad Hoc Committee.''

38. Occurring contemporaneously with the mediation was a Special Committee's ''comprehensive investigation into potential claims that the Debtors may have against the Sackler Families and Sackler Entities,'' led by attorneys from Davis Polk, who represent the Debtors in the bankruptcy. (Dkt. No. 91-4, at App.1537-1553). Throughout the mediation, the Special Committee was kept apprised of the ''offers and counteroffers that had been communicated through the Mediators by the NCSG, on the one hand, and the Sackler Families, on the other hand.'' (*Id.* at App. 1552).

NCSG [39] over the terms of the agreement reached in phase two of the mediation between and among the Sackler families and entities, the Debtors, the AHC, the "Consenting Ad Hoc Committee," and the MSGE. (Bankr. Dkt. Nos. 2820, 2879). To that end, on May 7, 2021, the Bankruptcy Court asked his colleague, the Honorable Shelley C. Chapman, to preside over a mediation between the NCSG and the Sackler Families with respect to the terms of the settlement. (Bankr. Dkt. No. 2820). Between May 7 and June 29, 2021, Judge Chapman conducted 145 telephone meetings and several in-person sessions between the NCSG and the Sackler families and entities. (*See* Bankr. Dkt. No. 3119).

The result of the mediation was a modified shareholder settlement with the Sackler families and entities, which was agreed to in principle by a fifteen of the twenty-five non-consenting states – specifically, Colorado, Hawaii, Idaho, Illinois, Iowa, Maine, Massachusetts, Minnesota, Nevada, New Jersey, New York, North Carolina, Pennsylvania, Virginia, and Wisconsin. (*Id.* at 2). Those states that reached agreement in principle also agreed to support and/or not object to the Plan.

The remaining non-consenting states – most of which are parties to this appeal – did not agree to the revised settlement. (*Id.*).

The new terms of the settlement included additional payments of $50 million by the Sackler families, and the acceleration of another $50 million in previously agreed settlement payments, resulting in total payments of $4.325 billion. In addition to the money, Judge Chapman induced the parties to agree to several non-monetary terms; specifically, a "material expansion of the scope of the public document repository" to be established under the Plan, and certain prohibitions on Sackler family demands for naming rights in exchange for charitable contributions, together with a few other, minor concessions. (*See* Bankr. Dkt. No. 3119).[40] The Shareholder Release was unchanged. (*See id.*).

On July 7, 2021, Purdue filed the mediator's report in the bankruptcy proceeding, informing Judge Drain of the result of the mediation.

X. Confirmation of the Plan: Summary of the Order on Appeal

Purdue filed the first version of the Plan on March 15, 2021. (Bankr. Dkt. No. 2487). It has subsequently filed twelve amendments to the Plan, the last of which was dictated by Judge Drain as a condition of confirmation. (*See* Bankr. Dkt. No. 3787).

On August 9, 2021, the Confirmation Hearing began before the Bankruptcy Court (Dkt. No. 91-3, at App.651), a six-day event during which 41 witnesses testified (by declaration or otherwise), after which the parties engaged in extensive oral argument. *See In re Purdue Pharma L.P.*, 2021 WL 4240974, at *2.

39. At that time, the non-consenting states included Colorado, Connecticut, Delaware, the District of Columbia, Hawaii, Idaho, Illinois, Iowa, Maine, Maryland, Massachusetts, Minnesota, Nevada, New Hampshire, New Jersey, New York, North Carolina, Oregon, Pennsylvania, Rhode Island, Vermont, Virginia, Washington, and Wisconsin.

40. The value of the "naming rights" concession is dubious, since institution after institution, both here and abroad, is taking the Sacklers' name off various endowed facilities, including the Louvre and the Metropolitan Museum of Art. *See Louvre Removes Sackler Family Name From Its Walls*, The N.Y. Times (Jul. 17, 2019), https://www.nytimes.com/2019/07/17/arts/design/sackler-family-louvre.html; *Met Museum Removes Sackler Name From Wing Over Opioid Ties*, The N.Y. Times (Dec. 9, 2021), https://www.nytimes.com/2021/12/09/arts/design/met-museum-sackler-wing.html

On September 1, 2021, the Bankruptcy Court rendered an oral ruling, stating it would confirm the proposed plan provided certain changes were made to it, the most relevant of which for purposes of this appeal was a modification of the Section 10.7 Shareholder Release:

> I ... require that the shareholder releases in paragraph 10.7(b) [the release of third-party claims against the shareholder released parties], by the releasing parties, be further qualified than they now are. To apply [only] where ... a debtor's conduct or the claims asserted against it [are] a legal cause or a legally relevant factor to the cause of action against the shareholder released party.

(Confr. Hr'g Tr., Sept. 1, 2021, at 134:18-135:2); *see also In re Purdue Pharma L.P.*, 2021 WL 4240974, at *45; *see* Plan, at § 10.7(b) (modifying the Plan in accordance with Judge Drain's instructions). Purdue filed the final version of the Plan the next day (Bankr. Dkt., No. 3726), and on September 17, 2021, Judge Drain issued his edited written decision confirming the Plan.

The salient features of the Plan are as follows:

Trusts to Administer Abatement and Distribution. Under the Plan, the majority of Purdue's current value will be distributed among nine "creditor trusts" that will fund opioid abatement efforts and compensate personal injury claimants, including the National Opioid Abatement Trust ("NOAT"), which will make distributions to qualified governmental entities. (Bankr. Dkt. No. 3456, at ¶¶ 5-6). Most of the creditor trusts are abatement trusts and may only make distributions for the purpose of opioid abatement or to pay attorneys' fees and associated costs. (*Id.* ¶¶ 5-6). Two trusts – the "PI Trust" and "PI Futures Trust" – are the only exceptions: those creditor trusts will make distributions to qualifying personal injury claimants. (*Id.*)

The Public Document Repository. Under the Plan the Debtors are required to create a public document repository of Purdue material available for public review. (Bankr. Dkt. No. 3440, at ¶ 7.) The AHC testified at the Confirmation Hearing that the establishment of this public document repository was among their highest priorities. (Confr. Hr'g Tr., Aug. 13, 2021, at 151:17-152:9 ("[O]f all the aspects of ... the injunctive relief part of [the Plan], [the public document repository] ... is extremely important from the standpoint of, not only what it is that we developed in terms of evidence, [but also] lessons to be learned from the conduct that was uncovered and revealed."); Confr. Hr'g Tr., Aug. 16, 2021, at 83:20-22, 84:12-23 ("[I]it could be that the document repository is actually the most valuable piece of this settlement."). The public document repository will be hosted by an academic institution or library and will include more than 13,000,000 documents (consisting of more than 100,000,000 pages) produced in the chapter 11 case and tens of millions of additional documents, including certain documents currently subject to the attorney client privilege that would not have been produced in litigation. (Bankr. Dkt. No. 3440, at ¶ 7.) The Plan ensures that scholars and the public can have access to all of these materials.

Purdue Pharma Will Cease to Exist. Under the Plan, Purdue Pharma will cease to exist. Its current business operating assets will be transferred to and operated by a new entity, known as "NewCo" in the Plan (Plan, at 28), but to be named KNOA. (Oral Arg. Tr., Nov. 30, 2021, at 158:1-17). NewCo will be governed by a board of five or seven disinterested and independent managers initially selected by the AHC and the MSGE, in consultation with the

Debtors and UCC, subject to a right of observation by the DOJ. (Plan, at § 5.4). NewCo will manufacture products, including Betadine, Denokot, Colace, magnesium products, opioids and opioid-abatement medications, and oncology therapies. (*See* Oral Arg. Tr., Nov. 30, 2021, at 157:19-159:23). Additionally, NewCo will continue the Debtors' development of opioid overdose reversal and addiction treatment medications, and it must deliver millions of doses of those medications at low or no cost when development is complete (these will be distributed to groups or entities to be determined post-emergence). (*Id.* at 159:19-160:7). NewCo will be subject to an "Operating Injunction" that prohibits it from, among other things, promoting opioid products and providing financial incentives to its sales and marketing employees that are "directly" (but not indirectly) based on sales volumes or sales quotas for opioid products. (Bankr. Dkt. No. 3456, at ¶10). It also is subject to "Governance Covenants" that ensure that NewCo provides all its products in a "safe manner," complies with settlement obligations, pursues public health initiatives, and follows pharmaceutical best practices. (*Id.* at ¶11). The Plan provides for the appointment of a monitor to ensure that NewCo complies with the Operating Injunction and Governance Covenants; the monitor will provide the public with regular updates and seek relief from the Bankruptcy Court to the extent necessary to carry out the monitor's obligations. (*Id.* at ¶13). Above all, NewCo is not intended to operate indefinitely: The Plan instruct the managers to use reasonable best efforts to sell the assets of NewCo by December 21, 2024. (*Id.* at ¶15).

Shareholder Settlement Agreement. The Plan incorporates the "Shareholder Settlement Agreement" and the transactions contemplated therein whereby, in exchange for the release of third-party claims against over 1,000 individuals and entities related to the Sackler family ("Shareholder Released Parties"), the Sackler family will give $4.275 billion toward the Purdue estate. (Plan, at 37; Dkt. No. 91-3, at App.1042, 1045-1046, 1050).

Section 10.7(b) of the Plan sets out the terms of the release that the Sacklers, from the inception of the bankruptcy and earlier, insisted on in exchange for contributing funds to Purdue's estate. The Plan "releases and discharges" certain claims that third parties (including states and personal injury claimants) have asserted or might in the future assert against the Shareholder Released Parties. The release of claims against the Shareholder Released Parties permanently enjoins third parties from pursuing their current claims against the Shareholder Released Parties and precludes the commencement of future litigation against any of the Sacklers and their related entities, as long as (i) those claims are "based on or related to the Debtors, their estates, or the chapter 11 cases," and (ii) the "conduct, omission or liability of any Debtor or any Estate is the legal cause or is otherwise a legally relevant factor." (Plan § 10.7(b)). The third-party releases under the Plan are non-consensual; they bind the objecting parties as well as the parties who consented. All present and potential claims connected with OxyContin and other opioids would be covered by the Section 10.7 Shareholder Release.

Channeling Injunction. Under the Plan, all enjoined claims against the Debtors and those against the Shareholder Released Parties are to be channeled to the nine creditor trusts for treatment according to the trust documents of each respective trust ("Channeling Injunction"). (Plan, at p. 10 and § 10.8). However – as the U.S. Trustee points out, and the Debtors do not contest (*see* Dkt. No. 91, at 19-20; Dkt. No. 151, at 23-24) – the claims against the Shareholder Released Parties are effec-

tively being extinguished for nothing, even though they are described as being "channeled." (*See e.g.*, Oral Arg. Tr., Nov. 30, 2021, at 37:9-14; 29:16-17). The U.S. Trustee explains that the Plan documents expressly prohibit value being paid based on causes of action (whether pre-or post-petition) against the Sackler family or other non-debtors for opioid-related claims. (Dkt. No. 91, at 19-20; *see, e.g.*, Dkt. No. 91-2, at App.333 ("Distributions hereunder are determined only with consideration to a Non-NAS PI Claim held against the Debtors, *and not to any associated Non-NAS PI Channeled Claim against a non-Debtor party*.") (emphasis added); *id.* at App.392 ("Distributions hereunder are determined only with consideration to an NAS PI Claim held against the Debtors, *and not to any associated NAS PI Channeled Claim against a non-Debtor party*.") (emphasis added); *id.* at App.433 ("A Future PI Claimant may not pursue litigation against the PI Futures Trust for any Future PI Channeled Claim *formerly held or that would have been held against a non-Debtor party*.") (emphasis added)). And to assert any third-party claim against the trust, the claimant must have filed a proof of claim in the bankruptcy prior to the bar dates, but each of the bar dates passed by the time anyone was notified of the claims' extinguishment. (Dkt. No. 91, at 20). And to get an exception for an untimely filing, a party must proceed through multiple steps, after which the Bankruptcy Court – which serves as a gatekeeper – determines, in its discretion, that the untimely claim qualified under the Plan and granted leave to assert the claim. (*Id.*).

Debtors sidestepped the Plan's effective extinguishment of purportedly channeled third-party claims in its brief by not addressing the U.S. Trustee's points; they made no effort to clarify this in oral argument for the Court. (*See* Dkt. No. 151, at 23-27).

XI. Objections to the Plan

On June 3, 2021, the Bankruptcy Court approved Purdue's disclosure statement. (*See* Bankr. Dkt., No. 2988).

On July 19, 2021, the U.S. Trustee objected to confirmation of the Plan, arguing that the Section 10.7 Shareholder Release was unconstitutional, violates the Bankruptcy Code, and is inconsistent with Second Circuit law. (*See* Bankr. Dkt. No. 3256). Eight states – California, Connecticut, Delaware, Maryland, Oregon, Rhode Island, Washington, Vermont – and D.C. all filed objections, as did the City of Seattle, four Canadian municipalities, two Canadian First Nations and three *pro se* plaintiffs. (Bankr. Dkt. No. 3787, at 28; *see also* Bankr. Dkt. No. 3594). The U.S. Attorney's Office for this District on behalf of the United States of America filed a statement of interest supporting these objections to the Section 10.7 Shareholder Release. (*See* Bankr. Dkt. No. 3268).

The objectors argued, *inter alia* and as applicable to them, that the Section 10.7 Shareholder Release (1) violates the third-party claimants' rights to due process, (2) violates the objecting states' sovereignty and police power, (3) is not permitted under the Bankruptcy Code, and (4) the Bankruptcy Court lacks constitutional, statutory, and equitable authority to approve the Section 10.7 Shareholder Release.

XII. Judge Drain's Decision to Confirm the Plan

Judge Drain's opinion is a judicial *tour de force* – delivered from the bench only days after the end of a lengthy trial, it included extensive findings of fact and addressed every conceivable legal argument in great detail. Sixteen days later, on September 17, the learned bankruptcy judge

filed a written version of that oral decision, running to 54 pages on Westlaw, which is the version summarized here. *See In re Purdue Pharma L.P.*, 633 B.R. 53 (Bankr. S.D.N.Y. Sept. 17, 2021).

Judge Drain began by describing the highly unusual and complex nature of the situation before him – a "massive public health crisis," with a potential creditor body that included "every person in the range of the Debtors' opioid products sold throughout the United States" – individuals, local, state and territorial governments, Indian tribes, hospitals, first responders, and the United States itself. *Id.* at 58. He noted that over 618,000 claims, in an amount exceeding two trillion dollars, had been filed in the bankruptcy. And he commended the parties for working in "unique and trailblazing ways to address the public health crisis that underlies those claims." *Id.*

In his opening remarks, Judge Drain also addressed the elephant in the room:

> These cases are complex also because the Debtors' assets include enormous claims against their controlling shareholders, and in some instances directors and officers, who are members of the Sackler family, whose aggregate net worth, though greater than the Debtors', also may well be insufficient to satisfy the Debtors' claims against them and other very closely related claims that are separately asserted by third parties who are also creditors of the Debtors. *Id.*

Judge Drain then announced the ultimate result:

First, he concluded that there existed no other reasonably conceivable means to achieve the result that would be accomplished by the Plan in addressing the problems presented by this case. Second, he found that well-established precedent – which he described as "Congress in the Bankruptcy Code and the courts interpreting it" – authorized him to confirm the Plan. *Id.* Insofar as is relevant to this appeal,[41] Judge Drain reached the following conclusions.

A. The Section 10.7 Shareholder Release and Settlement with the Sacklers

The meat of this case, both before Judge Drain and on this appeal, is the Bankruptcy Court's approval of the broad releases that the Plan affords to all members of the Sackler family and to their related entities, including businesses and trusts.

The Plan includes two settlements with every member of the Sackler family – whether or not that individual had anything to do with the management of Purdue or personally exercised any control over Purdue – and with a variety of entities related to the Sacklers, including various trusts, businesses, and IACs. Taken together these individuals and entities (not all of whom have been or apparently can

41. Many issues addressed by Judge Drain in his comprehensive opinion are not implicated by any of the appeals to this Court, and so will not be addressed in this decision. These include: objections from insurers that the Plan was not insurance neutral; from the U.S. Trustee to the Plan's treatment of certain attorney fees and expenses; to objections by certain prisoners who filed claims but challenged the sufficiency of notice and what they perceived as a compromising of their rights under the Mandatory Victims Restitution Act, 18 U.S.C. § 3663A; objections by certain states to their classification in the same voting class as their political subdivisions; an objection by the State of West Virginia to the allocation plan for states from the NOAT; and objections by certain Pro Se Appellants to the Plan's release of the Sacklers from criminal liability (it does not).

be identified) are known as the "Shareholder Released Parties." *Id.* at 82–83.

The first settlement disposed of claims that the Debtors could assert against the Shareholder Released Parties for the benefit its creditors. *Id.* These included claims for (1) breach of fiduciary duty against those members of the Sackler family who were involved in – indeed, who drove – the business decisions that were the basis for Purdue's criminal and civil liability, and (2) fraudulent conveyance arising out of the Sackler family's removal of nearly $11 billion from the Debtor corporations over the course of a decade. *See id.* at 90–92.

The second settlement disposed of certain third-party claims that could not be asserted by the Debtors against the Shareholder Released Parties, but were particularized to others. Chief among these claims are claims asserted by the states – both the consenting states and the objecting states – arising under various unfair trade practices and consumer protection laws that make officers, directors and managers who are responsible for corporate misconduct personally liable for their actions. Judge Drain did not review on a state-by-state basis the various state laws applicable to these objector claims, including laws that might forbid insurance coverage or indemnification and contribution claims by those individuals, such that their personal assets are very much at risk. *Id.* at 107–08.

In exchange for these releases, the Shareholder Released Parties agreed to contribute $4.325 billion to a fund that would be used to resolve both public and private civil claims as well as both civil and criminal settlements with the federal government. *Id.* at 84–85. The Sacklers also agreed to the dedication of two charities worth at least $175 million for abatement purposes; to a resolution that barred them from insisting on naming rights in exchange for charitable contributions; to refrain from engaging in any business with NewCo and to dispose of their interest in the non-U.S. Purdue entities within seven years; to certain "snap back" provisions that were designed to ensure the collectability of their settlement payments; and to the creation of an extensive document repository that would archive in a comprehensive manner the history of the Debtors and their involvement in the development, production and sale of opioids. *Id.*

Judge Drain made three fundamental findings relating to these settlements: that the Sackler Settlements were necessary to the Plan; that they were fair and reasonable; and that it was necessary and appropriate for him to approve the non-consensual release of certain third-party claims against the Sacklers, even though they are not debtors.

B. The Sackler Settlements Were Necessary

Judge Drain concluded that these settlements were necessary to the Plan. He noted that a variety of other settlements that were essential components of the Plan – including agreed-upon allocations of the pot of money to be created by the Debtors' estate and the Sackler contribution – would unravel for lack of funding if the Sacklers did not make their $4.325 billion contribution. And he found that they would not make that contribution unless they obtained broad releases from past and future liability. *Id.* at 105–07.

1. The Sackler Settlements Were Fair and Reasonable in Amount

[4] Judge Drain evaluated the fairness of the settlement in light of the factors laid out by the Second Circuit in *Motorola Inc.*

v. Official Committee of Unsecured Creditors & JP Morgan Chase Bank, N.A. (In re Iridium Operating LLC), 478 F. 3d 452, 464-66 (2d Cir. 2007), which is controlling law in this Circuit on the questions. He made the following findings:[42]

(a) The Sackler settlements were the product of arms-length bargaining conducted by able counsel in two separate mediations presided over by three outstanding mediators and preceded by what he described as the "most extensive discovery process not only I have seen after practicing bankruptcy law since 1984 and being on the bench since 2002, but I believe any court in bankruptcy has ever seen." *In re Purdue Pharma L.P.*, 633 B.R. at 85–86. That process led to the production of almost 100 million pages of documents, through which all interested parties could learn "anything suggesting a claim against the shareholder released parties." *Id.*

(b) The settlements were negotiated by exceedingly competent counsel who were, as a result of the discovery process described above, well-informed about both the claims they might bring against the Shareholder Released Parties and the difficulties they would have in pursuing those claims. *Id.* at 86–88.

(c) Purdue's creditors overwhelmingly supported the settlement. *Id.* at 87–88. Some 120,000 votes were cast on the Plan – a number far exceeding the voting in any other bankruptcy case. *Id.* at 60–61. Over 95% of those voting in the aggregate favored the Plan: over 79% of the states and territories supported the Plan; over 96% of other governmental entities and tribes; and over 96% of the personal injury claimants; together with a supermajority of all other claimants. *Id.* at 87–88.

(d) The failure to approve the settlement was likely to result in complex and protracted litigation, with attendant cost and delay, while the settlement offered significant and immediate benefits to the estate and its creditors. *Id.* at 87–89.

[5] (e) Judge Drain focused particularly on the difficulty of collecting any judgments that might be obtained against the Sacklers. *Id.* at 88–89. Ordinarily this factor would rest on things like the paucity of assets available to satisfy judgments. But in this case the problems with collection were the result of what the Sacklers did with the money that they admittedly took out of the corporations between 2008-2016. The assets of family members are held principally in purportedly spendthrift trusts located in the United States and offshore – many of them on the Bailiwick of Jersey – and many of those assets cannot readily be liquidated. As Judge Drain correctly observed, spendthrift trusts can and often do insulate assets from the bankruptcy process. And while generally applicable law governing U.S. trusts allows those trusts to be invaded when they are funded by fraudulent conveyances, there is a substantial question whether the same is true under Jersey law. Additionally, he noted that many Sackler family members live abroad, raising a barrier to an American court's acquiring personal jurisdiction over them. Although the learned bankruptcy judge did not reach any final conclusion about these complicated issues, he readily drew the conclusion that collectability presented a significant concern, one that was obviated by the settlement.

42. Judge Drain considered all of the *Iridium* factors, but not in the order in which they are discussed in *Iridium*. I employ Judge Drain's framework in this decision.

(f) Judge Drain also noted that the cost and delay attendant to the pursuit of the Sacklers – which was in and of itself substantial – would be compounded by the unraveling of the other settlements that were baked into the Plan. Judge Drain concluded that the unraveling of the Plan would inevitably result in the liquidation of Debtors under Chapter 7, which would in turn lead to no recovery for the unsecured creditors (including the personal injury plaintiffs), and no money for any abatement programs. *Id.* at 80–81. This conclusion was reinforced by the fact that, absent confirmation of the Plan, the United States would have a superpriority administrative expense claim in an amount ($2 billion) that would wipe out the value of Purdue's business as a going concern ($1.8 billion). *Id.* at 74–75.

(g) Finally, Judge Drain considered the legal risks of the estates' pursuit of claims against the Sacklers against the benefits of settlement. *Id.* at 90–93.

Judge Drain first chronicled the problems Purdue would have in proving that the admitted conveyances qualified as fraudulent. He noted that over 40% of the purportedly avoidable transfers were used to pay federal and states taxes associated with Purdue, none of which was going to be refunded. *Id.* at 90–91. He identified various technical defenses that the Sacklers could assert to fraudulent conveyance claims, including statutes of limitations and the impact of prior settlements. *Id.* at 91–92. And while admitting that at least some of the Sacklers appeared to have been very much aware of the risk of opioid litigation to Purdue's solvency and their own, he also pointed to evidence that Purdue may not have been "insolvent, unable to pay its debts when due, or left with unreasonably small capital" – which would be necessary to make a conveyance fraudulent – until as late as 2017 or 2018, by which time most or all of the conveyances had been made. *Id.*

As for alter ego, veil-piercing and breach of fiduciary duty claims, Judge Drain noted that most of the Sackler family members had nothing to do with Purdue's operations, and that no one had identified any action taken by any of them in their capacity as passive shareholders that would make them liable on such claims. *Id.* He also identified the extensive government oversight of Purdue after its 2007 Plea Agreement and Settlement with the federal government and certain states, and the fact that neither DHHS nor various state reviews ever identified any improper actions. *Id.* at 92–93.[43]

Judge Drain made no findings about the actual merit of any of the estates' claims against any member of the Sackler family. But weighing these difficulties against the benefits that would be derived from the settlement, he concluded:

> I believe that in a vacuum the ultimate judgments that could be achieved on the estates' claims ... might well be higher than the amount that the Sacklers are contributing. But I do not believe that recoveries on such judgments would be higher after taking into account the catastrophic effects on recoveries that would result from pursuing those claims and unravelling the plan's intricate settlements. And as I said at the beginning of this analysis, there is also the serious issue of problems that would be faced in

43. Given Purdue's admissions in connection with its 2020 Plea Agreement, this Court cannot assign much weight to the "oversight" factor.

collection that the plan settlements materially reduce.

Id.

Judge Drain ended his discussion of the *Iridium* factors with a deeply personal reflection – dare I say, a *cri de coeur* – that is perfectly understandable coming from one who had labored so long and so hard to try to achieve a better result. Admitting that he had "expected a higher settlement," he said:

> This is a bitter result. B-I-T-T-E-R. It is incredibly frustrating that the law recognizes, albeit with some exceptions, although fairly narrow ones, the enforceability of spendthrift trusts. It is incredibly frustrating that people can send their money offshore in a way that might frustrate U.S. law. It is frustrating, although a long-established principle of U.S. law, that it is so difficult to hold board members and controlling shareholders liable for their corporation's conduct.
>
> It is incredibly frustrating that the vast size of the claims against the Debtors and the vast number of claimants creates the need for this plan's intricate settlements. But those things are all facts that anyone who is a fiduciary for the creditor body would have to recognize, and that I recognize.

Id.

Ultimately, however, the learned bankruptcy judge decided that the perfect was the enemy of the good:

> I am not prepared, given the record before me, to risk [the parties'] agreement. I do not have the ability to impose what I would like on the parties.

Id. at 94. And so, albeit with obvious reluctance, he concluded that the settlement was reasonable as that term is understood at law.

2. The Section 10.7 Shareholder Release Was In all Respects Legal

Having concluded that the settlements were fair and reasonable in amount, Judge Drain went on to address a number of challenges to his legal authority to impose the most controversial element of those settlements: The Section 10.7 Shareholder Release. *Id.* at *35. He rejected each such challenge.

Subject matter jurisdiction. First, Judge Drain concluded that he had subject matter jurisdiction to impose the third-party releases and injunctions. Citing *Celotex Corp. v. Edwards*, 514 U.S. 300, 307-08, 115 S.Ct. 1493, 131 L.Ed.2d 403 (1995) and *SPV OSUS, Ltd. v. UBS AG*, 882 F. 3d 333, 339-40 (2d Cir. 2018), he held that he had the undoubted power to enjoin the claims of third parties that had "any conceivable effect" on the Debtors' estates as part of a Bankruptcy Court's "related to" jurisdiction, conferred by Congress in 28 U.S.C. § 1334(b). *In re Purdue Pharma L.P.*, 633 B.R. at 95–98. He concluded that the third-party claims covered by the Section 10.7 Shareholder Release would directly affect the *res* of the Debtors' estates in three different ways: insurance rights, the Shareholder Released Parties' right to indemnification and contribution, and the Debtors' ability to pursue its own overlapping claims against the Sacklers. He concluded by saying, "Depending on the kinds of third-party claims covered by a plan's release and injunction of such claims, *I conclude, therefore, that the Court has jurisdiction to impose such relief, based upon the effect of the claims on the estate rather than on whether the claims are 'derivative . . .*'" *Id.* at 98 (emphasis added).

Due process. Next, Judge Drain concluded that the Section 10.7 Shareholder Release did not violate the third-party

claimants' right to due process. *Id.* at 97–99. He rejected the argument that a release constitutes a *de facto* adjudication of the claim, holding that such a release "is part of the settlement of the claim that channels settlement funds to the estate." *Id.* at 98. And he held that claimants had been provided with constitutionally sufficient notice of the proposed releases. Uncontroverted testimony that Judge Drain found credible established that messages tailored to reach persons who may have been harmed by Debtors' products had reached roughly 98% of the adult population of the United States and 86% of the adult population of Canada, with supplemental notice reaching an estimated 87% of all U.S. adults and 82% of Canadian adults, as well as audiences in 39 countries, with billions of hits on the internet and social media in addition to notice delivered by TV, radio, publications, billboards and outreach to victim advocate and abatement-centered groups. While references contained in the notices sent readers to complex lawyerly descriptions of the release provisions, the notices themselves were written in plain English and specifically mentioned that the Plan contemplated a broad release of civil (not criminal) claims against the members of the Sackler family and related entities.

Constitutional authority. Judge Drain next concluded that he had constitutional power to issue a final order confirming a plan that contains a third-party claims release. *Id.* at 99–100. He determined that a proceeding to determine whether a chapter 11 plan containing such a release was a "core" proceeding, so ordering the non-debtor releases and enjoining the prosecution of third-party claims against non-the Sacklers qualified as "constitutionally core" under *Stern v. Marshall*, 564 U.S. 462 (2011) and its progeny.

Statutory authority. Finally, Judge Drain concluded that he had statutory power to confirm and enter the third-party releases. *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *40-43. He started from the proposition that the Second Circuit, in *Deutsche Bank A.G. v. Metromedia Fiber Network, Inc., (In re Metromedia Fiber Network, Inc.)*, 416 F. 3d 136, 141 (2d Cir. 2005), had indicated that non-consensual third-party releases of claims against non-debtors could be approved, albeit only in "appropriate, narrow circumstances." *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *40. He noted that most of the Circuits were of that view and rejected the reasoning of those courts of appeal that held otherwise. Indeed, he asserted that the view of those Circuits (the Fifth, Ninth, and Tenth Circuits) – which is that Section 524(e) of the Bankruptcy Code precluded the grant of any such release in the context of a settlement – "has been effectively refuted." *Id.* at 101. He analogized the enjoining of third-party claims against non-debtors to his undoubted power to impose a preliminary injunction against the temporary prosecution of third-party claims in order to facilitate the reorganization process. And he asked rhetorically why such a stay could not become permanent if it was crucial to a reorganization process involving massive numbers of overlapping estate and third-party claims. *Id.* at 101–02.

Having concluded that Section 524(e) was not a statutory impediment to a Bankruptcy Court's approval of third-party releases, the Bankruptcy Judge then addressed the question of exactly what provision or provisions in the Bankruptcy Code conferred the necessary authority over claims against non-debtors on him. *Id.* at 101–03. He found such authority in the "necessary or appropriate" power in

Section 105(a) of the Bankruptcy Code coupled with Section 1123(b)(6)'s grant of power to "include any other appropriate provision not inconsistent with the applicable provisions of this title" – what the Seventh Circuit referred to in *In re Airadigm Communications, Inc.*, 519 F. 3d 640, 657 (7th Cir. 2008) as a bankruptcy court's "residual authority." *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *43. He also cited Sections 1123(b)(5) and 1129 of the Bankruptcy Code.

Judge Drain carefully noted that the release in this case extended beyond so-called "derivative" claims – claims that the Debtors could bring against the Sacklers– which claims could assuredly be released by a bankruptcy court exercising *in rem* jurisdiction over the *res* of the estate. But he concluded – largely in reliance on *In re Quigley Co., Inc.*, 676 F.3d 45, 59-60 (2d Cir. 2012) – that he had statutory authority to authorize the release of non-derivative – direct or particularized – claims, because the third party claims to be released in this case were "premised as a legal matter on a meaningful overlap with the debtor's conduct." *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *43-47. Such a claim – one that "essentially dovetail[s] with the facts of the claimants' third-party claims against the Debtors" – was, in Judge Drain's view, "sufficiently close to the claims against the debtor to be subject to settlement under the debtor's plan if enough other considerations support the settlement." *Id.* at 105.

As noted above, Judge Drain did insist that the Section 10.7 Shareholder Release be modified so that it covered only third-party claims in which "a Debtor's conduct, or a claim asserted against the Debtor, must be a legal cause of the released claim, or a legally relevant factor to the third-party cause of action against the shareholder released party." *Id.* at 105. In other words, he insisted that there be substantial factual overlap between the released particularized claims and the derivative claims that no one disputes he had the power to release, such that the released non-derivative claims were "sufficiently close to the claims against the debtor."

***Metromedia* analysis.** Having disposed of all constitutional, jurisdictional, and statutory challenges to his authority to enter the Section 10.7 Shareholder Release (as modified), Judge Drain turned finally to whether this was the "unique" case in which it would be was appropriate to impose them. *Id.* at 105–06. He concluded that it was.

In this regard, he reviewed the law in the various circuits on the subject, viewing with special interest the Third Circuit's conclusion that:

> "To grant non-consensual releases a court must assess 'fairness, necessity to the reorganization' and make specific actual findings to support these conclusions." *In re Cont'l Airlines*, 203 F. 3d 203, 214 (3d Cir. 2001). Relevant consideration might include whether the non-consensual release is necessary to the success of the reorganization; whether the releasees have provided a critical financial contribution to the debtor's plan and whether that financial contribution is necessary to make the plan feasible; and whether the non-consenting creditors received reasonable compensation in exchange for the release, such that the release is fair." *In re Spansion, Inc.*, 426 B.R. 114, 144 (Bankr. D. Del 2010).

In re Purdue Pharma L.P., 2021 WL 4240974, at *46.

Judge Drain also cited with approval the Seventh Circuit's practice of engaging in a

fact-based inquiry into such matters as whether the release is "narrowly tailored, not blanket" (unlike the Section 10.7 Shareholder Release, which releases all types of conduct, including fraud and willful misconduct); whether the release is an essential component of the plan; and whether it was achieved by the exchange of good and valuable consideration that will enable unsecured creditors to realize distributions (which is in fact going to happen in this case). *Id.* at 106.

Judge Drain also noted that the Fourth, Sixth and Eleventh Circuits apply a multifactor test in deciding when it is appropriate to impose a non-consensual release of third-party claims. (*Id.* at 105–06).

Then, while recognizing that "this is not a matter of factors or prongs" (*id.* citing *Metromedia*, 416 F. 3d at 142), Judge Drain made a long list of findings about why this was the "rare" and "unique" case in which a nonconsensual third-party claims release was appropriate. *Id.* at 105–10. These include the following: (i) the Purdue bankruptcy was exceedingly complex; (ii) the Plan has overwhelming creditor support; (iii) without the Sackler payment the settlements would unravel; (iv) while not every Sackler would be making a specific payment toward the settlement,[44] the aggregate settlement payment hinged on each member of the family's being released; (v) the settlement amount was substantial; (vi) the release "is narrowly tailored;"[45] (vii) the settlement was fundamentally fair to the third parties; and (viii) for the reasons discussed at length *supra*, Background Section XII(B)(1), the cost and likelihood of success on the third party claims against the Sacklers – including both the merits and the impediments to collection of any judgment – was outweighed by the immediate and definite benefits of the settlement.

"Best interests" analysis. Section 1129 of the Bankruptcy Code requires that a plan of reorganization may be confirmed only if a litany of requirements is met. One such requirement is found in Subsection (a)(7) of Section 1129, which provides that, for any impaired creditor or class of creditors, if all members of the class do not approve the plan, each member of the class "will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date." *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *50.

Judge Drain applied this so-called "best interests" test to conclude that the holders of claims against non-debtor third parties would receive, on account of the Plan (and taking into account their claims against the Debtors as well as the third parties), materially more than they would receive in a

44. It is actually not clear what members of the Sackler family are contributing to the settlement and in what amounts. The record contains some suggestion that the various trusts that are contributing are for the benefit of all members of the family.

45. Judge Drain did not explain what he meant by that, except to say that the release would be further narrowed so that it was limited in the manner discussed above. I assume that he meant that the release was limited to claims involving the Debtor's conduct, and claims in which the Debtor's conduct is "a legal cause of the released claim, or a legally relevant factor to the third-party cause of action." *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *45.

hypothetical chapter 7 liquidation.[46] *Id.* at 110–12.

State police powers. Judge Drain concluded that his ordering of the non-debtor releases did not violate state sovereignty or any state police power. *Id.* at 111–14. He concluded that actions exempted from the automatic stay by virtue of Section 362(b)(4) were nonetheless subject to court-ordered (*i.e.*, not automatic) injunctive relief, and that Congress' express power under the bankruptcy clause of the Constitution to enact uniform bankruptcy laws overrode any state regulatory or sovereignty argument.

The classification of the Canadians. Finally, Judge Drain addressed whether that the Canadian creditor's classification as Class 11(c) creditors, rather than as Class 4 and 5 creditors, was impermissible. Certain Canadian creditor groups objected to the confirmation of the Plan, arguing that they should be classified with the U.S. unsecured creditor groups in Classes 4 and 5 to participate in the opioid abatement trusts created under the Plan for those classes, rather than receiving their pro rata share of the cash payment to Class 11(c). But Judge Drain concluded that, because there were legitimate reasons for separately classifying the Canadian unsecured creditors from there domestic counterparts, the classification was perfectly permissible. First, the Canadian creditors operate under "different regulatory regimes ... with regard to opioids and abatement" than their domestic counterparts. *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *12. And second, "the allocation mediation conducted by Messrs. Feinberg and Phillips that resulted in the plan's division of the Debtors' assets ... involved only *U.S.-based* public claimants with their own regulatory interests and characteristics." *Id.* (emphasis added).

XIII. The Appeal

The U.S. Trustee, eight states,[47] D.C., certain Canadian municipalities and First Nation groups,[48] and five *pro se* individuals[49] filed notices of appeal of Judge Drain's Confirmation Order in September 2021. (*See* Bankr. Dkt. No. 3724 (amended by Dkt. No. 3812), 3725, 3774 (amended by 3949), 3775 (amended by 3948), 3776 (amended by 3799), 3780 (amended by Dkt. No. 3839), 3784 (amended by Dkt. No. 3818), 3810, 3813, 3832, 3849, 3851, 3853, 3877, 3878). The U.S. Trustee also appealed the Advance Order (Bankr. Dkt. No. 3777) and the Disclosure Order (Dkt. No. 3776).

46. Judge Drain also argued that the best interest test under section 1129(a)(7) requires that the amount that an objecting creditor stands to receive under the plan on account of its claim be at least as much it would receive if the debtor were liquidated under chapter 7. *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *50. Thus, he concluded, the best interest test does not require analysis of the claimant's rights against third parties. *Id.* He acknowledged that his reading of the statute was at odds with at least two of his colleagues' reading of the same statute. I mention this fact but it has nothing to do with the ultimate decision on this appeal.

47. California, Connecticut, Delaware, Maryland, Oregon, Rhode Island, Vermont, and Washington.

48. The City of Grande Prairie as Representative for a Class Consisting of All Canadian Municipalities, the Cities of Brantford, Grand Prairie, Lethbridge, and Wetaskiwin; the Peter Ballantyne Cree Nation on behalf of All Canadian First Nations and Metis People and on behalf itself and the Lac La Ronge Indian Band.

49. Ronald Bass, Marie Ecke, Andrew Ecke, Richard Ecke, and Ellen Isaacs on Behalf of Patrick Ryan Wroblewski.

Among those who did not appeal the Plan were the UCC, the ACH, MSGE, the PI Ad Hoc Group, and other creditors supporting the Plan.

ISSUES ON APPEAL AND CONCLUSIONS OF LAW

This Court's answers to the questions that are being decided on appeal are summarized as follows:

1. Does the Bankruptcy Court have subject matter jurisdiction to impose a release of non-debtor claims?

Yes. Under the law of this Circuit, as most recently set forth in *SPV OSUS Ltd. v. UBS*, 882 F.3d 333 (2d Cir. 2018), the Bankruptcy Court has broad "related to" jurisdiction over any civil proceedings that "might have any conceivable effect" on the estate. *Id.* 339-340. Because the civil proceedings asserted against the non-debtor Sackler family members *might have* a conceivable impact on the estate, the Bankruptcy Court has subject matter jurisdiction to approve the Section 10.7 Shareholder Release and release the claims against the non-debtor Shareholder Released Parties.

2. Does the Bankruptcy Court have statutory authority to approve the non-debtor releases?

No. The Bankruptcy Code does not authorize a bankruptcy court to order the non-consensual release of third-party claims against non-debtors in connection with the confirmation of a chapter 11 bankruptcy plan. The Confirmation Order fails to identify any provision of the Bankruptcy Code that provides such authority. Contrary to the bankruptcy judge's conclusion, Sections 105(a) and 1123(a)(5) & (b)(6), whether read individually or together, do not provide a bankruptcy court with such authority; and there is no such thing as "equitable authority" or "residual authority" in a bankruptcy court untethered to some specific, substantive grant of authority in the Bankruptcy Code. Second Circuit law is not to the contrary; indeed, the Second Circuit has not yet taken a position on this question.

3. Did the Bankruptcy Court fail to provide equal treatment between the Canadian Appellants and their domestic unsecured creditor counterparts?

No. Under the Plan, the Canadian Appellants belong to a different class than their domestic, unsecured creditor "counterparts" – the non-federal governmental claimants and tribe claimants – but legitimate reasons are proffered for that differentiation. The Code does not require that all creditor classes be treated the same – only that there be a reasonable basis for any differentiation between classes. *See Boston Post Rd. Ltd. P'ship v. FDIC (In re Boston Post Rd. Ltd. P'ship)*, 21 F.3d 477, 482-83 (2d Cir. 1994). Here, Judge Drain identified a reasonable basis for differentiating between the Canadian Appellants and the non-federal governmental claimants and tribe claimants. The Plan's classification of the Canadian Appellants thus does not violate the Bankruptcy Code.

It is not necessary to reach any of the other issues that were briefed. The issues identified above are dispositive of all the appeals that have been filed.[50] Nor is it

50. Beyond the above issues, (1) the State Appellants asserts a further issue that the bankruptcy court improperly applied the best interest of creditors test; (2) the Canadian Appellants assert that the Bankruptcy Court does not have personal jurisdiction over their claims, and that the bankruptcy court's approval of the release violated their

necessary to reach either the various constitutional challenges to the Section 10.7 Shareholder Release (lack of due process, infringement on state police powers), or to decide whether, if there were no other legal impediment to approving the Section 10.7 Shareholder Release, it should be approved on the facts of this particular case.

STANDARD OF REVIEW

[6–9] The Court has jurisdiction to hear bankruptcy appeals pursuant to 28 U.S.C. § 158(a). "Generally in bankruptcy appeals, the district court reviews the bankruptcy court's factual findings for clear error and its conclusions of law *de novo*." *In re Charter Commc'ns, Inc.*, 691 F.3d 476, 482-83 (2d Cir. 2012) (citing Fed. R. Bankr. P. 8013). Conclusions of law reviewed *de novo* include "rulings as to the bankruptcy court's jurisdiction" and "interpretations of the Constitution." *In re Motors Liquidation Co.*, 829 F.3d 135, 152, 158 (2d Cir. 2016). As to findings of fact, the "clear error standard is a deferential one." *Id.* at 158. A finding of fact is clearly erroneous only if this Court is "left with the definite and firm conviction that a mistake has been committed." *In re Lehman Bros. 3 Holdings Inc.*, 855 F.3d 459, 469 (2d Cir. 2017).

[10, 11] The standard of review of findings of act is far less deferential if a bankruptcy court is presented with something it cannot adjudicate to final judgment as a constitutional matter unless the parties consent. *Stern v. Marshall*, 564 U.S. 462, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011). In such a circumstance, a bankruptcy judge has authority only to "hear the proceeding and submit proposed findings of fact and conclusions of law to the district court for *de novo* review and entry of judgment." *Exec. Benefits Ins. Agency v. Arkison*, 573 U.S. 25, 34-36, 134 S.Ct. 2165, 189 L.Ed.2d 83 (2014). In that case, the findings of fact are reviewed *de novo* as well. If a bankruptcy court issues a final order in the mistaken belief that it has constitutional authority to do so, the district court can treat a bankruptcy court's order as a report and recommendation, but it "must review the proceeding *de novo* and enter final judgment." *Id.* at 34, 134 S.Ct. 2165.

[12] In this case, the Bankruptcy Court concluded that it had constitutional authority under *Stern* to enter a final order granting the release, because the issue arose in the context of confirming a plan of reorganization – the most "core" of bankruptcy proceedings. *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *40. Appellants urge that Judge Drain misreads *Stern* and argue that he lacked authority to give final approval to those releases, even though they were incorporated into a plan of reorganization.

I agree with Appellants.

[13–15] In 28 U.S.C. § 157(a), Congress divided bankruptcy proceedings into three types: (1) those that "arise under" title 11; (2) those that "arise in" a title 11 case; (3) and those that are "related to" a title 11 case. Cases that "arise under" or "arise in" a title 11 matter are known as core bankruptcy proceedings, while "related to" proceedings are non-core. 28 U.S.C. § 157(b)(1)-(2)(C). Every proceeding pending before a bankruptcy court is either core or non-core.[51]

foreign sovereign immunity and the Foreign Sovereign Immunities Act, 28 U.S.C. § 1602 et seq.; and (3) the U.S. Trustee also asserts that the Bankruptcy Court erred by approving the Debtors' disclosure statement and plan solicitation materials and by authorizing the Debtors to advance funds under Advance Order.

51. "Non-core" proceedings are interchangeably referred to as "related to" proceedings.

[16–18] The core vs. non-core distinction is critical when assessing a bankruptcy court's constitutional authority to enter a final judgment disposing of that proceeding.[52] In particular, a bankruptcy court lacks the constitutional authority to enter a final judgment in a proceeding over which it has only "related to" subject matter jurisdiction unless all parties consent. Any doubt on that score was put to rest by the United States Supreme Court in *Stern v. Marshall*, 564 U.S. 462, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011). In that case, the Supreme Court held that a bankruptcy court lacked constitutional power to adjudicate and enter judgment on a counterclaim asserted by a debtor, Vickie Marshall (aka Anna Nicole Smith) in an adversary proceeding that a creditor (her stepson) had filed against her. The counterclaim (for tortious interference with an *inter vivos* gift from the debtor Marshall's late husband, who was also the creditor's father) did not arise under title 11, nor did it arise in a title 11 case. Even though the claim was asserted in the context of a bankruptcy proceeding, it existed prior to and was independent of debtor Marshall's bankruptcy case.

The Supreme Court ruled that Congress could not "withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at common law, or in equity, or in admiralty." *Murray's Lessee v. Hoboken Land & Improvement Co.*, 59 U.S. 272, 284, 18 How. 272, 15 L.Ed. 372 (1855). Because Marshall's counterclaim for tortious interference was just such a claim, it could only be adjudicated to final judgment by an Article III court; and Congress had no power to alter that simply because the counterclaim might have "some bearing on a bankruptcy case." *Stern,* 564 U.S. at 499, 131 S.Ct. 2594.

In this case, the learned Bankruptcy Judge improperly elided his authority to confirm a plan of reorganization (indubitably a core function of a bankruptcy court) with his authority to finally dispose of claims that were non-consensually extinguished pursuant to that plan over which – as he himself recognized – he has only "related to" jurisdiction over the third-party claims against the non-debtor Sacklers. *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *36-38. *Stern* itself illustrates that not every issue that is litigated under the umbrella of a core proceeding is, to use Judge Drain's phrase, "constitutionally core." The stepson-creditor's claim against Marshall's estate was properly litigated to judgment by the bankruptcy court in a claims allowance adversary proceeding – a core proceeding – but because the debtor's counterclaim was not a "core" claim, it could not be adjudicated to final judgment by the Bankruptcy Court, even though it would impact how much the creditor was ultimately owed.

[19] Judge Drain reasoned that the non-consensual third-party releases that he was approving were "constitutionally core" under *Stern* because plan confirmation is a "fundamentally central aspect of a Chapter 11 case's adjustment of the debtor/creditor relationship." *Id.* at *40. But nothing in *Stern* or any other case suggests that a party otherwise entitled to have a matter adjudicated by an Article III court forfeits that constitutional right if the matter is disposed of as part of a plan of reorganization in bankruptcy. Were it otherwise, then parties could manufacture a bankruptcy court's *Stern* authority simply by inserting the resolution of some otherwise non-core matter into a plan.

52. The core/non-core distinction is also critically important when assessing the bankruptcy court's subject matter jurisdiction, a topic that will be taken in that section.

The learned bankruptcy judge relied on the Third Circuit's recent decision in *In re Millennium Lab Holdings II, LLC.*, 945 F.3d 126, 139 (3d Cir. 2019), *cert. denied sub nom. ISL Loan Tr. v. Millennium Lab Holdings II, LLC*, —— U.S. ——, 140 S. Ct. 2805, 207 L.Ed.2d 142 (2020). In *Millennium*, the court, like Judge Drain in this case, concluded that the "operative proceeding" for purposes of *Stern* analysis was the confirmation proceeding, not the underlying third-party claim against a non-debtor that was being released pursuant to the plan. *In re Millennium Lab Holdings II, LLC*, 591 B.R. 559, 574 (D. Del. 2018), *aff'd sub nom. In re Millennium Lab Holdings II, LLC.*, 945 F.3d 126 (3d Cir. 2019). The Third Circuit read *Stern* to allow a bankruptcy court to confirm a plan containing such releases "because the existence of the releases and injunctions" are " 'integral to the restructuring of the debtor-creditor relationship.' " *Millennium Lab Holdings II, LLC.*, 945 F.3d at 129 (quoting *Stern*, 564 U.S. at 497, 131 S.Ct. 2594).

[20] Perhaps they are, but that is beside the point. In *Stern*, the Supreme Court held that bankruptcy courts have the power to enter a final judgment only in proceedings that "stem[ ] from the bankruptcy itself or would necessarily be resolved in the claims allowance process." *Stern*, 564 U.S. at 499, 131 S.Ct. 2594. It did not say that a bankruptcy court could finally dispose of non-core proceedings as long as they were "integral to the restructuring of the debtor-creditor relationship." The counterclaim in the lawsuit between debtor Marshall and her stepson-creditor was integral to the restructuring of their debtor-creditor relationship, but it was not a core proceeding, so the bankruptcy court could not finally adjudicate it. The correct constitutional question, and the question on which the Bankruptcy Court should have focused in this case, is whether the third-party claims released and enjoined by the Bankruptcy Court either stem from the bankruptcy itself or would necessarily be resolved in the claims allowance process – not whether the release and injunction are "integral to the restructuring of the debtor-creditor relationship."

[21, 22] The third-party claims at issue neither stem from Purdue's bankruptcy nor can they be resolved in the claims allowance process. Yet those claims are being finally disposed of pursuant to the Plan; they are being released and extinguished, without the claimants' consent and without any payment, and the claimants are being enjoined from prosecuting them. Debtors and their affiliated non-debtor parties cannot manufacture constitutional authority to resolve a non-core claim by the artifice of including a release of that claim in a plan of reorganization. As Bankruptcy Judge Bernstein made clear in *In re SunEdison, Inc.*, 576 B.R. 453, 461 (Bankr. S.D.N.Y. 2017), "In assessing a court's jurisdiction to enjoin a third party dispute under a plan, the question is not whether the court has jurisdiction over the settlement that incorporates the third party release, but whether it has jurisdiction over the attempts to enjoin the creditors' unasserted claims against the third party." That proposition applies with equal force to a bankruptcy court's *Stern* authority.

[23] Appellees' argument that *Stern* only limits a bankruptcy court's authority to *adjudicate* claims – not its authority to enter judgments that terminate claims without adjudicating them on the merits – is also flawed. As the U.S. Trustee correctly points out, *Stern*'s holding is to the contrary: "The Bankruptcy Court in this case exercised the judicial power of the United States by *entering a final judgment* on a common law tort claim, even

though the judges of such courts enjoy neither tenure during good behavior nor salary protection." *Stern*, 564 U.S. at 469, 131 S.Ct. 2594 (emphasis added). A bankruptcy court's order extinguishing a non-core claim and enjoining its prosecution without an adjudication on the merits "finally determines" that claim. It is equivalent to entering a judgment dismissing the claim. It bars the claim under principles of former adjudication. Therefore, Congress may not allow a bankruptcy court to enter such an order absent the parties' consent – and consent is lacking here. *See Stern* at 484, 131 S.Ct. 2594.

There really can be no dispute that the release of a claim "finally determines" that claim. It does so by extinguishing the claim, so that it cannot be adjudicated on the merits. A nonconsensual third-party release is essentially a final judgment against the claimant, in favor of the non-debtor, entered "without any hearing on the merits." *In re Aegean Marine Petroleum Network Inc.*, 599 B.R. 717, 725 (Bankr. S.D.N.Y. 2019) (citing *In re Digital Impact*, 223 B.R. 1, 13 n. 6 (Bankr. N.D. Okla. 1998)) (noting that a third-party release has "the effect of a judgment – a judgment against the claimant and in favor of the non-debtor, accomplished without due process."). The fact that the releases are being ordered in the overall context of a plan confirmation that "settles" many disputed matters (against the Debtors, not against non-debtors) does not alter this. The Appellants in this case do not want to settle their claims against the non-debtors – at least, not on the terms set forth in the Plan. This "settlement" is non-consensual – which means that, under *Stern*, a bankruptcy court cannot enter the order that finally disposes of their claims against those non-debtors.

Nor is there any doubt that the entry of an order releasing a claim has former adjudication effects, which is a key attribute of a final judgment. The Supreme Court has twice held that non-consensual third-party releases confirmed by final order are entitled to *res judicata* claim preclusion barring any subsequent action bringing a released claim: First in *Stoll v. Gottlieb*, 305 U.S. 165, 171, 59 S.Ct. 134, 83 L.Ed. 104 (1938), and again in *Travelers Indemnity Co. v. Bailey*, 557 U.S. 137, 155, 129 S.Ct. 2195, 174 L.Ed.2d 99 (2009).[53]

Because the non-consensual releases and injunction are the equivalent of a final judgment for *Stern* purposes, Judge Drain did not have the power to enter an order finally approving them. To the extent of his approval of the Section 10.7 Shareholder Releases, his opinion should have been tendered as proposed findings of fact and conclusions of law, both of which this court could review *de novo*. 11 U.S.C. § 157(c)(1). *Stern*, 564 U.S. at 475, 131 S.Ct. 2594. If approved by this Court, those releases would of course be incorporated into the Plan.

So the standard of review in this case is *de novo* as to both the Bankruptcy Court's factual findings and its conclusions of law.[54]

53. This court's decision in *In re Kirwan Offices S.à.R.L.*, 594 B.R. 489 (S.D.N.Y. 2018) does not stand for the proposition that *Stern* authorizes a bankruptcy court to release non-core claims because a release is not a final judgment on the merits of the third-party claim. In that case, *Stern* was of no moment because, as this court held and the Second Circuit affirmed, all parties had consented to the bankruptcy court's exercise of jurisdiction. *In re Kirwan Offices S.à.R.L.*, 792 F. App'x 99, 103 (2d Cir. 2019).

54. The practical impact of this holding is non-existent, as no one has challenged any of Judge Drain's findings of fact – only the conclusions he drew from them – and the court

DISCUSSION

I. The Bankruptcy Court Has Subject Matter Jurisdiction Over Third-Party Claims Against Non-Debtors That Might Have Any Conceivable Effect on the Debtors' Estate.

[24, 25] A bankruptcy court is a creature of statute. *See Celotex Corp. v. Edwards*, 514 U.S. 300, 307, 115 S.Ct. 1493, 131 L.Ed.2d 403 (1995). Its subject matter jurisdiction is *in rem* and is limited to the *res* of the estate. *Central Virginia Community College v. Katz*, 546 U.S. 356, 362, 126 S.Ct. 990, 163 L.Ed.2d 945 (2006) ("Bankruptcy jurisdiction, at its core, is *in rem*."). Its jurisdiction is limited to "civil proceedings arising under title 11, or arising in or related to cases under title 11." 28 U.S.C. § 1334(b).

[26–28] A proceeding "arises under" title 11 if the claims "invoke substantive rights created by" that title. *See In re Housecraft Industries USA, Inc.*, 310 F.3d 64, 70 (2d Cir. 2002). A proceeding "arises in" a title 11 case if for example "Parties . . ., by their conduct, submit themselves to the bankruptcy court's jurisdiction" by litigating proofs of claim without contesting personal jurisdiction. *In re Millenium Seacarriers, Inc.*, 419 F.3d 83, 98 (2d Cir. 2005); *see In re S.G. Phillips Constructors, Inc.*, 45 F.3d 702, 706 (2d Cir. 1995) ("*a claim filed against the estate . . . could arise only in the context of bankruptcy*") (emphasis in original) (quotation omitted). And a proceeding is "related to" a title 11 proceeding if its "outcome might have any conceivable effect on the bankrupt estate." *In re Cuyahoga Equip. Corp.*, 980 F.2d 110, 114 (2d Cir.1992) *Parmalat Capital Fin. Ltd. v. Bank of Am. Corp.*, 639 F.3d 572, 579 (2d Cir. 2011); *SPV OSUS Ltd. v. UBS*, 882 F.3d 333, 339-340 (2d Cir. 2018).

[29, 30] The release of most third-party claims against a non-debtor touches the outer limit of the Bankruptcy Court's jurisdiction. *See In re Johns-Manville Corp.*, 517 F.3d 52, 55 (2d Cir. 2008) ("*Manville III*"), *rev'd and remanded on other grounds sub nom. Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 129 S.Ct. 2195, 174 L.Ed.2d 99 (2009). But the Second Circuit defines that limit quite broadly. *See SPV OSUS Ltd.*, 882 F.3d at 339-340. The standard is not that an action's outcome will certainly have, or even that it is likely to have, an effect on the *res* of the estate, as is the case in some other Circuits. It is, rather, whether it *might have any conceivable impact* on the estate. *Id.*

Bound to adhere to this broad standard, which has been consistently followed in this Circuit for almost three decades and was applied most recently in *SPV Osus*, I agree with the Debtors that the Bankruptcy Court had subject matter jurisdiction over the direct (non-derivative) third party claims against the Sacklers, under the "related to" prong of bankruptcy jurisdiction.

A. Governing Law

Decades ago, the Second Circuit concluded that the outer limit of a bankruptcy court's *in rem* jurisdiction was defined by whether the outcome of a proceeding asserting a particular claim "might have any conceivable effect" on the *res* of the estate. *See In re Cuyahoga Equipment Corp.*, 980 F.2d at 114. In that case, a liquor distillery and its site of operation containing hazardous wastes was sold to a purchaser that subsequently went bankrupt; the bankruptcy court was asked to resolve not only the proceedings in bankruptcy but approve a settlement that released a creditor bank from claims related to separate environmental cleanup litigation (brought by the

has always had the obligation to review those conclusions *de novo*.

creditor Environmental Protection Agency (the "EPA")). *Id.* at 111-112. The original owner of the liquor distillery site – a non-debtor third party and defendant in the environmental cleanup litigation – objected and appealed arguing, *inter alia*, that the court lacked jurisdiction to approve the settlement. The Second Circuit found that the court had related to jurisdiction because the bank's and the EPA's claims against the estate "bring into question the very distribution of the estate's property." *Id.* at 114. "[Section] 1334(b) undoubtedly vested the district court with the power to approve the agreement between the parties at least to the extent it compromised the bankruptcy claims asserted by the bank and the government." *Id.* at 115.

In *Celotex Corp. v. Edwards*, 514 U.S. 300, 115 S.Ct. 1493, 131 L.Ed.2d 403 (1995), the United States Supreme Court decreed that "related to" jurisdiction was "a grant of some breadth" and that "jurisdiction of bankruptcy courts may extend . . . broadly" in "reorganization under Chapter 11." *Id.* at 308, 115 S.Ct. 1493. And while some courts of appeal have circumscribed the scope of "related to" jurisdiction in their circuits, *see e.g.*, *In re W.R. Grace & Co.*, 900 F.3d 126 (3d Cir. 2018), the Second Circuit has never backed away from its broad reading of "related to" jurisdiction. *See, e.g., In re Ampal-American Israel Corporation*, 677 Fed.Appx. 5, 6 (2d Cir. 2017) (summary order).

The Circuit's most recent discussion of the subject can be found in *SPV OSUS Ltd. v. UBS AG*, 882 F.3d 333 (2d Cir. 2018). SPV Osus Ltd. ("SPV") had sued UBS AG ("UBS") (among others) in the New York State Supreme Court for aiding and abetting Bernie Madoff ("Madoff") and Bernard L. Madoff Investment Securities LLC ("BLMIS") in perpetrating their massive Ponzi scheme. *Id.* at 337-338. If UBS was indeed a joint tortfeasor with Madoff, it had a contingent claim for contribution against the Madoff estate. *Id.* at 340. However, it had not yet asserted such a claim (it was not yet ripe), and the unwaivable bar date for filing claims against the Madoff estate under the Securities Investor Protection Act ("SIPA") had already passed. *Id.* Moreover, there was no realistic possibility that there would be any money available at the end of the day to fund a claim for contribution. *Id.* SPV argued that these facts meant there was no possibility that the outcome of UBS' contribution case "might have any conceivable effect" on the *res* of the Madoff estate. *Id.* It is indeed hard to quarrel with that factual analysis.

But Judge Pooler, writing for a unanimous panel, concluded that UBS's contingent claim for joint tortfeasor contribution against the Madoff estate "might" have an effect on the Madoff estate if there were any "reasonable legal basis" for its assertion. *Id.* at 340-41 (quotation omitted). She explained that the broad jurisdictional standard reflects Congress' intent " 'to grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected with the bankruptcy estate.' " *Id.* at 340 (quoting *Celotex*, 514 U.S. at 308, 115 S.Ct. 1493). While recognizing that " 'related to' jurisdiction is not 'limitless,' " Judge Pooler indicated that "it is fairly capacious." *Id.* And she said, " 'An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate.' " *Id.* (quoting *Celotex*, 514 U.S. at 308, n. 6, 115 S.Ct. 1493).

The fact that UBS and the debtor (Madoff) were alleged to be joint tortfeasors – who, as a matter of state law, have a right

of contribution against one another – provided a "reasonable legal basis" why UBS might someday be able to assert its contingent claim. And while Judge Pooler recognized that "... a payout by the estate to defendants may be improbable, it is not impossible." *Id.* at 342. Since "any claim by defendants potentially alters that distribution of assets among the estates' creditors," *id.*, that was all it took to make the contingent claim "conceivably related" to the Madoff bankruptcy.

Finally – and of particular importance for the case at bar – Judge Pooler found that the "high degree of interconnectedness between this action and the Madoff bankruptcies" supported a finding of "related to" jurisdiction. *Id.* She explained that, "SPV can only proceed on [its claims against UBS] if it establishes that the Madoff fraud occurred" and "it is difficult to imagine a scenario wherein SPV would not also sue Madoff and BLMIS, given that SPV alleges that UBS aided and abetted in their fraud." *Id.*

[31] So in this Circuit, it is well settled that the only question a court need ask is whether "the action's outcome *might have* any conceivable effect on the bankrupt estate." *Id.* (emphasis added). If the answer to that question is yes, then related to jurisdiction exists – no matter how implausible it is that the action's outcome actually will have an effect on the estate.

B. Application of the Law to the Facts

[32] Under the broad standard set forth in *SPV Osus*, I find that the Bankruptcy Court had "related to" subject matter jurisdiction to approve the release of direct, non-derivative third-party claims against the Sacklers. There is absolutely no question that the answer to the question of whether the third-party claims *might have* any conceivable impact on the res of the debtors' estate is yes. Moreover, the intertwining of direct and derivative claims against certain members of the Sackler family, as well as the congruence between the only claim that anyone has identified against the other Sacklers and Purdue's own claim for fraudulent conveyance, justifies the assertion of "related to" jurisdiction under *SPV Osus*'s "interconnectedness" test.

First, the non-derivative third-party claims that are being or might be asserted against the Sacklers are, as in *In re Cuyahoga Equipment Corp.*, the type of claims that "bring into question the very distribution of the estate's property." 980 F.2d at 114. As the Debtors pointed out in oral argument, and as Judge Drain recognized in his opinion, pursuit of the third-party claims threatens to "unravel[ ] the plan's intricate settlements" and "recoveries on ... judgments" against the Sacklers would have a "catastrophic effect" on all parties' possible recovery under the Plan. *See In re Purdue Pharma L.P.*, 2021 WL 4240974, at *33; (Oral Arg. Tr., Nov. 30, 2021, at 124:14-16 ("Continued litigation against the Sacklers destroys all of the interlocking intercreditor settlements enshrined in the plan.")).

Second, as in *SPV Osus*, the claims raised against the Sacklers might have a conceivable impact on the estate, in that they threaten to alter "the liabilities of the estate" and "change" "the amount available for distribution to other creditors." *SPV Osus*, 882 F.3d at 341. This "is sufficient to find that litigation among nondebtors is related to the bankruptcy proceeding." *Id.*

Here, the non-derivative litigation against the Sacklers *might* alter the liabilities and change the amount available for distribution. If, for example, the Appellants were successful in their related claims against the Sacklers, the findings

could alter, or even determine, Purdue's own liability on similar claims, as well as the amount owed to Appellants as creditors. Further, as the Debtors explained at oral argument, there also is the threat that the Appellants' claims could affect "the debtors' ability to pursue the estate's own closely related, indeed, fundamentally overlapping claims against the Sacklers"; this is so because, if the related third-party claims were litigated poorly, the debtor's estate might be less likely to recover on its own claims against the Sacklers, which are worth billions. (*See* Oral Arg. Tr., Nov. 30, 2021, at 123:17-124:13).

Judge Drain pointed out the conceivable effect that the potential alteration of liabilities and ultimate amounts owed creditors and the estate would have on the *res* in his opinion. *See In re Purdue Pharma L.P.*, 2021 WL 4240974, at *37. I agree that these potential effects support a finding of "related to" jurisdiction.

Third, as in *SPV Osus*, all the claims in this case have a high degree of interconnectedness with the lawsuits against the debtors and against the Sacklers – especially those members of the family who can be sued derivatively as well as directly.

As the *SPV Osus* Court explained, " 'The existence of strong interconnections between the third-party action and the bankruptcy has been cited frequently by courts in concluding that the third-party litigation is related to the bankruptcy proceeding.' " *SPV OSUS*, 882 F.3d at 342 (quoting *In re WorldCom, Inc. Sec. Litig.*, 293 B.R. 308, 321 (S.D.N.Y. 2003)). Here, the Section 10.7 Shareholder Release only extends to those claims where the "debtor's conduct or the claims asserted against it [are] a legal cause or a legally relevant factor." (Confr. Hr'g Tr., Sept. 1, 2021, at 134:18-135:2); *see In re Purdue Pharma L.P.*, 2021 WL 4240974, at *45; Plan, at § 10.7(b)). This limitation alone supports a conclusion that any claim that could fall within the scope of the release would necessarily have a high degree of interconnectedness with the debtor's conduct.

Looking at the claims of the Appellants themselves, the interconnectedness of the claims against the Sacklers with those against the Debtors is patent. (*See, e.g.*, Dkt. No. 103-7, at A-1553; Dkt. No. 95-1, at A0008; Dkt. No. 91-7, at App.2598; Dkt. No. 91-8, at App.2661; Dkt. No. 91-9, at App.3153). In fact, the direct and derivative claims against the "insider" or "managerial" Sacklers are essentially congruent. The Appellants have asserted claims in multiple instances against both Purdue and the Sacklers, and in every case they rely on detailed and virtually identical sets of facts to make the claims. Because various state statutes authorize the assertion of direct claims against certain managerial personnel of a corporation who can be held independently liable for the same conduct that subjects the corporation to liability (and them to liability to the corporation for faithless service in their corporate roles), a determination in one of the State Appellants' cases would likely have preclusive impact on a case alleging derivative liability against the same people – a case over which the Bankruptcy Court has undoubted jurisdiction. As the Debtor pointed out at oral argument, there is an obvious inconsistency in bringing "lawsuits against the Sackler[s] alleging that they controlled Purdue, and that Purdue did terrible things, and 500,000 people's lives were maybe snuffed out by Purdue's conduct" yet arguing that those suits "will [not] affect the debtors in any conceivable way." (*See* Oral Arg. Tr., Nov. 30, 2021, at 123:12-17). Some things have not changed since this court decided *Dunaway v. Purdue Pharma. L.P.*, 619 B.R. 38 (S.D.N.Y. 2020); one that has not is this: "Appellants would rely on the same facts to establish

the liability of both parties" and there would be "no way for the Appellants to pursue the allegations against Dr. Sackler without implicating Purdue, and vice versa." *Id.* at 51. The acts of the Sacklers that could form the basis of any released claim "are deeply connected with, if not entirely identical to, Purdue's alleged misconduct." *See id.*

In so holding, I acknowledge that in *In re Johns-Manville Corp.*, 517 F.3d 52 (2d Cir. 2008) ("*Manville III*"), *rev'd and remanded on other grounds sub nom. Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 129 S.Ct. 2195, 174 L.Ed.2d 99 (2009) and *In re Johns-Manville Corporation v. Chubb Insurance*, 600 F. 3d 135 (2d Cir. 2010) ("*Manville IV*"), the Second Circuit said that the existence of shared facts between claims against the debtor and claims against the non-debtor arising out of an independent legal duty that was owed by the non-debtor to a third party was not sufficient to confer "related to" subject matter jurisdiction over the claims against the non-debtors. *Manville III*, 517 F.3d at 64-65. As a result, the Court of Appeals held that the bankruptcy court lacked jurisdiction to enjoin the prosecution of claims asserted by third parties against Travelers, Manville's erstwhile insurer, that arose out of Travelers' alleged failure to alert those third parties to the harmful properties of asbestos, about which Travelers had allegedly learned during its long relationship with Manville. *Id.* at 65. However, while there was a substantial factual overlap between defective product claims against Manville and the failure to disclose claims asserted against its insurer Travelers that were discussed in *Manville III*, there was absolutely no basis for asserting that there could be any impact on the res of Manville's bankruptcy estate if the third party claims were not enjoined. For that reason, *Manville III/IV* is not inconsistent with *SPV OSUS*.

The fact that the release extends to members of the Sackler family who played no role in running the affairs of the company does not alter the analysis. At the present time, the court is not aware of any lawsuits that have been brought against any of those individuals; and despite months of my asking, no one can identify any claim against them that would be released by the Section 10.7 Shareholder Release, other than as the recipients of money taken out of Purdue and upstreamed to the family trusts. But any claims relating to those transfers rightfully belong to the Debtors, whose claims against the world either "arise under" or "arise in" the bankruptcy. And those claims are not implicated by the Section 10.7 Shareholder Release.

Fourth, it is more than conceivable that Purdue's litigation of the question of its indemnification, contribution, or insurance obligations to the director/officer/manager Sacklers could burden the assets of the estate.

Appellants – most particularly the State and Canadian Appellants – insist that their claims lie beyond the "related to" jurisdiction of the Bankruptcy Court in part because their laws bar indemnification, contribution, or insurance coverage for actions like those of the Sacklers (*see* Dkt. Nos. 224, 228-231), and so the claims cannot be extinguished by that court. Without viable claims for indemnification, contribution, or insurance claims, the Appellants argue that their claims against the Sacklers will not have any conceivable effect on the Debtors' estate, thereby depriving the Bankruptcy Court of subject matter jurisdiction.

I begin by noting that this is precisely the type of reasoning that Judge Pooler rejected in *SPV Osus* – a case, I submit, in which the actual possibility that a contin-

gent contribution claim would have any impact on the *res* of the Madoff estate was far less likely than it is in this case. The issue is not whether, at the end of the day, the Sacklers would lose on their contingent claims; it is whether they have a reasonable legal basis for asserting them. (*See* Dkt. Nos. 154, 156).

[33] And the Sacklers do have a reasonable legal basis to assert those claims. The Sacklers named in the State Appellants' suits served as officers, directors or managers of Purdue. As a result, they have claims against Purdue for indemnification and contribution, as well as a call on any D&O insurance proceeds that cover Purdue's officer and directors. As this court noted almost two years ago in *Dunaway*, Purdue's current and former directors and officers of the company are covered by various Limited Partnership Agreements ("LPA"), which provide that Purdue shall indemnify these directors and officers "so long as the Indemnitee shall be subject to any possible Proceeding by reason of the fact that the Indemnitee is or was . . . a director, officer or Agent of [the Purdue entities]." (JX-1773; *see also* JX-1806; JX-1049). The various state unfair trade practices laws that have been cited to this court all subject the Sacklers to the potential for liability because of their status as officers, directors or managers of the corporation – even though that liability is direct, not derivative. Moreover, the LPAs are governed by Delaware law, which allows for indemnification (*see* 6 Del. C. § 17-108; 8 Del. C. § 145), and the states as a general matter look to the state of incorporation for the availability of indemnity. (*See, e.g.*, Dkt. No. 230, at 3, 8–9, 13, 17). Similarly, the Purdue insurance policies that cover the Sackler former directors could be depleted, *inter alia*, if a Sackler former director prevailed in litigation or a plaintiff prevailed in litigation on a non-fraud claim. (*See* Dkt. No. 156, at 15).[55] Under various state laws, the Sacklers parties can also seek an advance against defense costs; even if those costs are ultimately recouped, those defense funds will, for at least some time, leave the estate. *See* CT Gen Stat § 33-776; 8 Del. C. § 145. The law governing insurance coverage is generally the law governing the policy – not the law of the objecting state. Only one state has an exception to that – California, whose law specifically prohibits indemnity or insurance coverage for losses resulting from a violation of its false advertising law or unfair competition law, and under which law an insurer has no duty to defend or advance costs. (Dkt. No. 95, at 3-4); *see* Cal. Ins. Code § 533.5; *Adir International, LLC v. Starr Indemnity and Liability Co.*, 994 F.3d 1032, 1045 (9th Cir. 2021).

And while each objecting state asserts that its laws would bar one or more of indemnification, contribution or insurance in certain instances, no state's law bars all three – not even California's. (*See* Dkt. Nos. 228-231; *see also* Dkt. No. 224).

Recognizing this, the states argue that there can be no indemnification, contribution, or insurance on these facts, including on public policy grounds, because the Sacklers acted in bad faith. (*See e.g.*, Dkt. No. 230, at 2). However, the question of bad faith in this case is hotly disputed. There is no doubt that the Shareholder Released Parties' right to indemnification,

55. The debtors clarified at oral argument that for the relevant periods of time "like 2017 when the claims were made and those policies got triggered" there are applicable claims-made insurance policies, as well as "over a billion dollars of general liability policies" and other policy language that "creates the risk that all Sackler-owned entities could assert claims under those policies." (Oral Arg. Tr., Nov. 30, 2021, at 125:21-12614).

contribution, and/or insurance will be vigorously litigated, as Judge Drain rightly pointed out below. *See In re Purdue Pharma L.P.*, 2021 WL 4240974, at *38. That litigation will cost money. And so it very well *might have* an impact on the estate; in fact, it likely *will have* such an impact.

Given the breadth of the Second Circuit law under *SPV Osus*, I must and I do find that the claims asserted against the Shareholder Released Parties *might have* some conceivable effect on the estate of a debtor, for each of the foregoing reasons, and thus fall within the "related to" jurisdiction of the Bankruptcy Court.

But that only gets us to the next question. And it is the next question that is, in my view, dispositive.

II. The Bankruptcy Court Does Not Have Statutory Power to Release Particularized Third-Party Claims Against Non-Debtors.

[34] Appellants argue that the Bankruptcy Court has no statutory authority to approve a release of third-party claims against non-debtors.

One would think that this had been long ago settled.

It has not been.

There is a long-standing conflict among the Circuits that have ruled on the question, which gives rise to the anomaly that whether a bankruptcy court can bar third parties from asserting non-derivative claim against a non-debtor– a matter that surely ought to be uniform throughout the country – is entirely a function of where the debtor files for bankruptcy.

And while the Second Circuit long ago identified as questionable a court's statutory authority to do this outside of asbestos cases, *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136 (2d Cir. 2005), it has not yet been required to identify any source for such authority.

Lacking definitive guidance from our own Court of Appeals, Judge Drain consulted the law in every Circuit. He concluded that he was statutorily authorized to approve the Section 10.7 Shareholder Release because it is "subject to 11 U.S.C. 1129(a)(1), 1123(a)(5) & (b)(6), 105, and 524(e)." *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *43. "In other words," he stated, "those releases flow from a federal statutory scheme." *Id.*

I appreciate that this Court has, on a prior occasion, said exactly the same thing, using exactly the same language – albeit in the context of affirming a plan that contained an easily distinguishable injunction that barred third parties (one in particular) from bringing one specific type of claim against non-debtors (his former partners) in order to protect the integrity of bankruptcy court orders. *In re Kirwan Offices S.à.R.L.*, 592 B.R. 489, 511 (S.D.N.Y. 2018*), aff'd sub nom. In re Kirwan Offices S.a.R.L.*, 792 F. App'x 99 (2d Cir. 2019). But in *Kirwan*, this Court did not analyze whether there was a statutory (as opposed to a jurisdictional or constitutional) basis for the injunction that was at issue in that case. Indeed, no statutory argument was made.[56]

In this case, however, Appellants – most particularly, the U.S. Trustee, with the United States Attorney for this District appearing as *amicus* – have mounted a

56. In *Kirwan,* the appellant chalked up his failure to raise the issue of statutory authority to his belief that the U.S. Trustee ought to have done so. *In re Kirwan Offices S.à.R.L.,* 592 B.R. at 501. The U.S. Trustee, for perfectly understandable reasons that will be noted when *Kirwan* is discussed below, had no particular interest in using that case as a vehicle to mount such an attack.

full-throated attack on a court's statutory authority to release third-party claims against non-debtors in connection with someone else's bankruptcy.

With the benefit of full briefing and extensive argument from experienced counsel, it is possible to decide whether a court adjudicating a bankruptcy case has the power to release third-party claims against non-debtors. Moreover, it is necessary to reach a conclusion on this subject before delving into constitutional issues that need not be reached if Appellants are correct.

I conclude that the sections of the Code on which the learned Bankruptcy Judge explicitly relied, whether read separately or together, do not confer on any court the power to approve the release of non-derivative third-party claims against non-debtors, including specifically the Section 10.7 Shareholder Release that is under attack on this appeal.

As no party has pointed to any other section of the Bankruptcy Code that confers such authority, I am constrained to conclude that such approval is not authorized by statute.

A Caveat and Some Definitions: I begin this discussion with a caveat. The topic under discussion is a bankruptcy court's power to release, on a non-consensual basis, *direct/particularized* claims asserted *by third parties* against *non-debtors* pursuant to the Section 10.7 Shareholder Release. This speaks to a very narrow range of claims that might be asserted against the Sacklers.

[35, 36] For these purposes, by derivative claims, I mean claims that would render the Sacklers liable because of Purdue's actions (which conduct may or may not have been committed because of the Sacklers). "Derivative" claims are those seek to recover from the estate indirectly "on the basis of [the debtor's] conduct," as opposed to the non-debtor's own conduct. *Manville III*, 517 F.3d at 62 (quoting *MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89 (2d Cir. 1988)). Derivative claims in every sense relate to the adjustment of the debtor-creditor relationship, because they are claims that relate to injury to the corporation itself. If the creditor's claim is one that a bankruptcy trustee could bring on behalf of the estate, then it is derivative. *Madoff*, 40 F.3d at 90.

[37] By direct claims, I mean claims that are not derivative of Purdue's liability, but are based on the Sacklers' own, individual liability, predicated on their own alleged misconduct and the breach of duties owed to claimants other than Purdue. "Direct" claims are based upon a "particularized" injury to a third party that can be directly traced to a non-debtor's conduct. *Id.*

The release of claims against the Sacklers that are derivative of the estate's claims them is effected by Section 10.6(b) of the Plan, which is not attacked as being beyond the power of the Bankruptcy Court.

[38] The Section 10.7 Shareholder Release under attack is different. It releases all members of the Sackler families, as well as a variety of trusts, partnerships and corporations associated with the family and the people who run and advise those entities,[57] from liability for claims that

57. The Section 10.7 Shareholder Release extends to every Sackler presently alive, to their unborn progeny, and to various trusts, partnerships, corporations, and enterprises with which they are affiliated or that have been formed for their benefit. Exhibit X to the Settlement Agreement, expressly incorporated into the Plan (*see* Dkt. No. 91-3, at App. 1112), identifies over 1,000 separate released parties, either by name or by some "identify-

have been brought against them personally by third parties – claims that are not derivative, but as to which Purdue's conduct is a legally relevant factor. Example: nearly all of the State Appellants have a law under which individuals who serve in certain capacities in a corporation are individually and personally liable for their personal participation in certain unfair trade practices. As Judge Drain recognized (*see In re Purdue Pharma L.P.*, 2021 WL 4240974, at *44), the liability imposed by these statutes is not derivative; the claims arise out of a separate and independent duty that is imposed by statute on individuals who, by virtue of their positions, personally participated in acts of corporate fraud, misrepresentation and/or willful misconduct. Liability under those laws is limited to persons who occupied the roles of officer, manager or director of a corporation – which means that there is considerable *factual* overlap, perhaps even complete congruence, between those claims and the derivative claims against the same individuals that Judge Drain had undoubted authority to release and enjoin. But it is undisputed that these laws impose liability, and even penalties, on such persons independent of any corporate liability (or lack of same), and independent of any claim the corporation could assert against them for faithless service as a result of those same acts.[58]

The discussion that follows, then, applies only to direct (non-derivative) claims – sometimes referred to as "particularized" claims – that arise out of the Sacklers' own conduct (*In re Purdue Pharma L.P.*, 2021 WL 4240974, at *45), and that either have been or could be asserted against the non-debtor members of the Sackler family and their affiliates (the Shareholder Released Parties) by parties other than the Debtors' estate.

The Text of the Bankruptcy Code

[39] As one always should when assessing statutory authority, we turn first to the text of the statute.

[40] All parties agree that one and only one section of the Bankruptcy Code expressly authorizes a bankruptcy court to enjoin third party claims against non-debtors without the consent of those third parties. That section is 11 U.S.C. § 524(g), which was passed by Congress in 1994. It provides for such an injunction solely and exclusively in cases involving injuries arising from the manufacture and sale of asbestos. And it sets out a host of conditions that must be satisfied before any such injunction can be entered, including all of the following:

(i) the injunction is to be implemented in connection with a trust the is to be funded in whole or in party by the securities of the debtor and that the debtor will make future payments, including dividends, to that trust 524(g)(2)(B)(i)(I);

(ii) the extent of such alleged liability of a third party arises by reason of one of four enumerated relationships between the debtor and third party (524(g)(4)(A)(ii));

(iii) as part of the proceedings leading to issuance of such injunction, the court appoints a legal representative for the purpose of protecting the rights of persons that might

ing'' feature, such as ''the assets, businesses and entities owned by'' the named released parties. (*See* Dkt. No. 91-3, at App.1041-1069).

58. While Judge Drain expressly found that these claims were not derivative (*In re Purdue Pharma L.P.*, 2021 WL 4240974, at *44), he was quite clear that the congruence between these claims and derivative claims against the same individuals was critically important to his conclusion that they could be released.

subsequently assert demands of such kind (524(g)(4)(B)(i)); and

(iv) the court determines the injunction is fair and equitable to persons that might subsequently assert such demands, and, in light of the benefits provided to such trust on behalf of such third parties. § 524(g)(4)(B)(ii)).

Section 524(g) injunctions barring third party claims against non-debtors cannot be entered in favor of just any non-debtor. They are limited to enjoin actions against a specific set of non-debtors: those who have a particular relationship to the debtor, including owners, managers, officers, directors, employees, insurers, and financiers. 11 U.S.C. § 524(g)(4)(A).

The language of the statute plainly indicates that Congress believed that Section 524(g) created an exception to what would otherwise be the applicable rule of law. Subsection 524(g)(4)(A)(ii) says: "Notwithstanding the provisions of section 524(e), such an injunction may bar any action directed against a third party who is identifiable from the terms of such injunction (by name or as part of an identifiable group) and is alleged to be directly or indirectly liable for the conduct of, claims against, or demands on the debtor." 11 U.S.C. § 524(g)(4)(A)(ii). Section 524(e) provides: "Except as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e). The word "notwithstanding," suggests that the type of injunction Congress was authorizing in § 524(g) would be barred by § 524(e) in the absence of the statute.

A. Legislative History of the Statute

Section 524(g) was passed after the United States Court of Appeals for the Second Circuit had affirmed the entry of an unprecedented injunction barring claims against certain non-debtors in connection with the bankruptcy of the nation's leading manufacturer of asbestos, the Johns Manville Corporation. *MacArthur Co. v. Johns–Manville Corp.* (*In re Johns–Manville Corp.*), 837 F.2d 89, 91 (2d Cir. 1988) ("*Manville I*"). The permanent injunction in that case extended to actions against Manville's insurers, all of whom had dedicated the entire proceeds of their policies – proceeds on which parties other than Manville were additional insureds and had a call – to a settlement fund into which the claims of asbestos victims would be channeled, valued, and resolved. The Second Circuit concluded that the bankruptcy court could permanently enjoin and channel lawsuits against a debtor's insurer relating to those insurance policies because those policies were "property of the debtor's estate." *Id.* at 90. The Court of Appeals did not cite to a single section of the Bankruptcy Code as authorizing entry of the injunction.

Despite the Second Circuit's affirmance of the *Manville I* injunction, questions continued to be raised about its legality. Congress passed Sections 524(g) and (h) of the Bankruptcy Code to remove any doubt that those injunctions were authorized. *See* H.R. Rep. 103-835 at *41 (noting that Subsection (g) was added to Section 524 "in order to strengthen the Manville and UNR trust/injunction mechanisms and to offer similar certitude to other asbestos trust/injunction mechanisms that meet the same kind of high standard with respect to regard for the rights of claimants, present and future, as displayed in the two pioneering cases").

That Section 524(g) applies only to asbestos cases is clear. The statute explicitly states than the trust that "is to assume the liabilities of a debtor" be set up in connec-

tion with "actions seeking recovery for damages allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products" (11 U.S.C. § 524(g)(B)(i)(I)). If that were not clear enough, Congress passed another section to provide that injunctions that had previously been entered *in asbestos cases* – not in any other kind of case – would automatically be deemed statutorily compliant, even if those injunctions did not have all the features required by § 524(g). *See*, 11 U.S.C. § 524(h) ("Application to Existing Injunctions"). The limitation of § 524(h) to asbestos injunctions is important because, prior to the statute's passage, injunctions releasing third party claims against non-debtors had been entered by a few courts in cases involving other industries. *See e.g.*, *In re Drexel Burnham Lambert Grp.*, Inc., 960 F. 2d 285 (2d Cir. 1992) (securities); *In re A.H. Robins Co., Inc.*, 880 F.2d 694 (4th Cir. 1989) (medical devices). The revisions to the Bankruptcy Code neither extend to those injunctions nor deem them to be statutorily compliant.

At the same Congress passed Sections 524(g) and (h), it passed Public Law 111, which provided a rule of construction for Section 524(g). It states that nothing in the 1994 amendments to the Bankruptcy Code, including 524(g), "shall be construed to modify, impair, or supersede any other authority the court has to issue injunctions in connection with an order confirming a plan of reorganization." Pub. L. 103–394 § 111(b) (uncodified). Congress made this statement because the parties in non-asbestos bankruptcy cases took the position that Sections 524(g) and (h) were unnecessary, in that bankruptcy courts already authorized the entry of such injunctions and corresponding approval of non-debtor releases – viz, *Robins* and *Drexel*. But the passage of Public Law 111 did not mean that Congress agreed with that position. As the House Committee on the Judiciary noted in the legislative history of these new provisions:

> Section 111(b) . . . make[s] clear that the special rule being devised for the asbestos claim trust/injunction mechanism is not intended to alter any authority bankruptcy courts *may* already have to issue injunctions in connection with a plan [of] reorganization. Indeed, [asbestos suppliers] Johns–Manville and UNR firmly believe that the court in their cases had full authority to approve the trust/injunction mechanism. And other debtors in other industries are reportedly beginning to experiment with similar mechanisms. *The Committee expresses no opinion as to how much authority a bankruptcy court may generally have under its traditional equitable powers to issue an enforceable injunction of this kind.*

Vol. E., *Collier on Bankruptcy,* at App. Pt. 9–78 (reprinting legislative history pertaining to the 1994 Code amendments) (emphasis added). P.L. 111 was not incorporated into the Bankruptcy Code.

Congress' used of the word "may" indicates that a bankruptcy court's authority to enter such an injunction was at best uncertain. And in light of the last sentence – in which the Committee made it clear that Congress expressed no opinion on that subject – one cannot read this tidbit of legislative history as indicating that Congress had concluded that a bankruptcy court already had such authority under its "traditional equitable powers."

During the course of this appeal, it has been suggested that P.L. 111 expresses Congress' intent to pass a limited law and then allow the courts to work out the contours of whether and how to extend § 524(g)-style authority outside the asbestos context.[59] The very next sentence from

59. I can only assume that this argument derives from Congress' mention of the fact that

that statute's legislative history reveals that nothing could be further from the truth:

> The Committee has decided to provide explicit authority in the asbestos area because of the singular cumulative magnitude of the claims involved. How the new statutory mechanism works *in the asbestos area* may help the Committee judge whether the concept should be extended into other areas.

Id. (Emphasis added)

Plainly, Congress made a decision to limit the scope of the experimenting that was "reportedly" to be happening (and that was in fact happening) in other industries. And it left to itself, not the courts, the task of determining whether and how to extend a rule permitting non-debtor releases "notwithstanding the provisions of section 524(e)" into other areas.

Since 1994, Congress has been deafeningly silent on this subject.

B. Survey of the Relevant Case Law

1. Supreme Court Law

The United States Supreme Court has never specifically considered whether the non-consensual release of non-derivative claims asserted by third parties against non-debtors can be approved in the context of a debtor's bankruptcy. Indeed, on *certiorari* to the Second Circuit from one of its orders in the ongoing *Manville* saga, the High Court announced that its opinion did "not resolve whether a bankruptcy court, in 1986 or today, could properly enjoin claims against nondebtor insurers that are not derivative of the debtor's wrongdoing." *Travelers Indem. Co. v. Bailey*, 557 U.S. at 155, 129 S.Ct. 2195.

The Court has, however, spoken on several occasions about issues that are germane to the consideration of that question.

For one thing, the Court has indicated that the Bankruptcy Code was intended to be "comprehensive." *See RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645, 132 S.Ct. 2065, 182 L.Ed.2d 967 (2012) ("Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions") (quoting *Varity Corp. v. Howe*, 516 U.S. 489, 519, 116 S.Ct. 1065, 134 L.Ed.2d 130 (1996) (Thomas, J., dissenting)).

For another, it has held that the "traditional equitable power" of a bankruptcy court "can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988).

And in two recent cases, the Supreme Court has held, albeit in contexts different from the one at bar, that a bankruptcy court lacks the power to award relief that varies or exceeds the protections contained in the Bankruptcy Code – not even in "rare" cases, and not even when those orders would help facilitate a particular reorganization.

For example, in *Law v. Siegel*, 571 U.S. 415, 134 S.Ct. 1188, 188 L.Ed.2d 146 (2014), the Supreme Court unanimously held the bankruptcy court does not have "a general, equitable power" to order that a debtor's statutorily exempt assets be made available to cover attorney's fees incurred by an estate's trustee in the course of the chapter 7 bankruptcy case. Section 522 of the Bankruptcy Code, by reference to applicable state law, entitled the debtor in

courts dealing with non-asbestos bankruptcies were "reportedly beginning to experiment with similar mechanism."

that case to exempt equity in his home from the bankruptcy estate. *See* 11 U.S.C. § 522(b)(3)(A). A dispute arose between the debtor and the trustee of the estate, causing the trustee to incur substantial legal fees, purportedly as a result of the debtor's "abusive litigation practices." *Law v. Siegel*, 571 U.S. at 415-16, 134 S.Ct. 1188. Seeking to recoup the cost of resolving the dispute with the debtor, the trustee asked the bankruptcy court to order that the otherwise exempt assets be made available to cover his attorney's fees. He argued that such an order was authorized by the "inherent power" of the Bankruptcy Court and by Section 105(a) of the Bankruptcy Code, which provides:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

11 U.S.C. § 105(a).

[41] The High Court disagreed, stating flatly, "A bankruptcy court may not exercise its authority to 'carry out' the provisions of the Code" by taking an action inconsistent with its other provisions. *Law v. Siegel*, 571 U.S. at 425, 134 S.Ct. 1188. It announced that there is "no authority for bankruptcy courts to deny an exemption on a ground not specified in the Code," because the Bankruptcy Code was intended to be a *comprehensive* statement of the rights and procedures applicable in bankruptcy. *Id.* at 416, 134 S.Ct. 1188. The Code explicitly exempts certain debtor assets from the bankruptcy estate and provides a finite number of exceptions and limitations to those asset exemptions. *See* 11 U.S.C. § 522. To the Supreme Court, "comprehensive" means precisely that: "The Code's meticulous – not to say mind-numbingly detailed – enumeration of exemptions and exceptions to those exemptions confirms that courts are not authorized to create additional exceptions." *Law v. Siegel*, 571 U.S. at 424, 134 S.Ct. 1188.

[42, 43] More recently, in *Czyzewski v. Jevic Holding Corp.*, —— U.S. ——, 137 S. Ct. 973, 197 L.Ed.2d 398 (2017), the Court held that the protections explicitly afforded by the Bankruptcy Code could not be overridden in a "rare" case, even if doing so would carry out certain bankruptcy objectives. In chapter 11 bankruptcies, a plan that does not follow normal priority rules cannot be confirmed over the objection of an impaired class of creditors. 11 U.S.C § 1129(b). Notwithstanding that, the bankruptcy court in *Jevic* approved the structured dismissal [60] of a chapter 11 case in which unsecured creditors were prioritized over non-consenting judgment creditors – a violation of ordinary priority rules. The bankruptcy court and the proponents of the structured dismissal argued that the Bankruptcy Code did not specifically state whether normal priority rules had to be followed in chapter 11 (as opposed to chapter 7) cases – that is, the statute was "silent" on the subject – so the court could exercise such authority in "rare" cases in which there were "sufficient reasons" to disregard priority. But the Supreme Court disagreed that any such power existed. It observed that the priority system applicable to those distributions had long been considered fundamental to the Bankruptcy

60. In a structured dismissal, the debtor obtains an order that simultaneously dismisses its chapter 11 case and provides for the administration and distribution of its remaining assets.

Code's purposes and held that the "importance of the priority system leads us to expect more than simply statutory silence if, and when, Congress were to intend a major departure." *Jevic Holding Corp.*, 137 S. Ct. at 984. To the argument that a bankruptcy court could disregard priority if there were "sufficient reasons" to do so, Justice Breyer aptly noted: "It is difficult to give precise content to the concept 'sufficient reasons.' That fact threatens to turn a 'rare case' exception into a more general rule." *Id.* at 986.

It is with these holdings in mind that I examine the law in the various Circuits on the subject of non-consensual release of third-party claims against non-debtors.

I begin, of course, with our own.

2. Second Circuit Law

Manville I: The relevant law in the Second Circuit begins with *Manville I*, which has already been discussed. *Manville's I*'s injunction was subsequently codified in §§ 524(g) and (h)[61] – which, as noted above, are plainly in the Bankruptcy Code, and are limited to the asbestos context, and have never been extended by Congress to other areas of endeavor. It is, moreover, significant that the injunction authorized by the Second Circuit in *Manville I* extended only to claims against parties (insurance companies) holding property that was indisputably part of the *res* of the debtor's estate (policies covering Manville for the manufacture and sale of asbestos). As will be seen when we get to *Manville III/IV*, when the non-debtor was seeking a release in exchange for contributing property to the debtor's estate – as opposed to surrendering property that already was part of the debtor's estate – the result, even in a statutorily authorized asbestos case, was different.

Drexel: The debtor in *In re Drexel Burnham Lambert Grp.*, Inc., 960 F.2d 285 (2d Cir. 1992) was the investment bank Drexel Burnham Lambert Group ("DBL"), which filed for bankruptcy in 1990. DBL's principal creditor was the Securities and Exchange Commission, which was owed $150 million pursuant to a prior settlement. But over 15,000 creditors filed proof of claims against the estate, alleging fraud in connection with four different types of securities transactions.

Judge Milton Pollack of this district withdrew all of these securities claims from the bankruptcy court pursuant to 28 U.S.C. § 157(d) in order to facilitate their settlement. The parties negotiated a settlement that had as its key feature the certification of all the securities claimants into a single, mandatory, non-opt-out class (Rule 23(b)(1)(B)), which was itself divided into two subclasses: A and B. The members of Subclass B – comprised of securities fraud class action plaintiffs – were, as part of the settlement, enjoined from bringing any future actions against the former officers and directors of DBL; while not themselves debtors, those individuals had contributed to DBL's estate.

The district court certified the classes and approved the settlement over the objections of 8 of the 850 proposed class members. Three of the objectors filed appeals, contending in relevant part that the district court had erred by approving the settlement with it the mandatory injunction against the pursuit of third-party claims by non-consenting plaintiffs.

The Second Circuit affirmed the settlement of the securities fraud cases. It noted

61. The Court is advised that the *Manville I* injunction did not conform in every particular to the rules set out in Section 524(g), and that Section 524(h) was included in the Bankruptcy Code to be sure that the *Manville I* injunction was deemed to be Code-compliant notwithstanding that fact.

in passing that, "In bankruptcy cases, a court may enjoin a creditor from suing a third party, provided this injunction plays an important part in the debtor's reorganization plan." *Drexel*, 960 F. 2d at 293 (citing *In re A.H. Robins Co.*, 880 F.2d 694, 701 (4th Cir.)). But it cited no section of the Bankruptcy Code that authorized this proposition. In its brief discussion of the objectors' challenge to the provision in the settlement agreement that barred members of subclass B from bringing or maintaining suits against DBL's officers and directors, the Court of Appeals, reasoning tautologically, said this:

> The Settlement Agreement is unquestionably an essential element of Drexel's reorganization. In turn, the injunction is a key component of the Settlement Agreement. As the district court noted, the injunction limits the number of lawsuits that may be brought against Drexel's former directors and officers. This enables the directors and officers to settle those suits without fear that future suits will be filed. Without the injunction, the directors and officers would be less likely to settle. Thus, we hold that the district court did not abuse its discretion in approving the injunction.

In re Drexel Burnham Lambert Grp., Inc., 960 F. 2d at 293. In other words, the Circuit held that the district court had discretion to approve non-debtor releases as part of the settlement of numerous securities fraud class actions in the context of a bankruptcy, simply and solely because funds were being funneled to the estate that would not otherwise be contributed.

There are numerous reasons why *Drexel* does not answer the question about a court's statutory authority under the Bankruptcy Code to release non-debtors over the objection of third parties who have direct claims against them. Two, however, are dispositive.

First and foremost, the Second Circuit simply did not address this question in *Drexel*. *Drexel* mentioned in passing something about a bankruptcy court's power to enjoin claims but did not identify any source of that power in the Bankruptcy Code. It appears to have assumed *sub silentio* that such authority existed.

Second, *Drexel* was decided two years before Congress passed Sections 524(g) and (h). The opinion's passing mention of a bankruptcy court's power to enjoin a creditor from suing a non-debtor became far less persuasive after Congress (1) amended the Bankruptcy Code to authorize such injunctions, but only in asbestos cases; (2) expressed agnosticism about whether any such authority existed outside of its new legislation; and (3) indicated its intent to consider at some later time whether to extend this authority to industries that were "reportedly experimenting" with such injunctions – which it never has.[62]

There are other reasons to question the continuing viability of *Drexel*. Whether its reasoning can be extended to mass tort cases like this one is highly dubious. Seven years after the Second Circuit's opinion in *Drexel*, the Supreme Court expressed grave doubt about whether the Rule 23(b)(1)(B) "limited fund class action" device that was employed in *Drexel* could ever be employed in the mass tort context like this one, *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 119 S.Ct. 2295, 144 L.Ed.2d 715 (1999). Subsequent to *Ortiz*, courts have consistently rejected attempts to apply the limited fund mandatory class action

62. It bears reiterating that *Drexel* was one of those cases to which the Judiciary Committee referred when it said that debtors in other industries were "reportedly experimenting" with non-debtor injunctions in the years prior to the passage of Section 524(g). *See supra,* note 59.

device to mass torts. *See, e.g., In re Simon II Litig.*, 407 F.3d 125, 137-38 (2d Cir. 2005) (tobacco punitive damages litigation); *Doe v. Karadzic*, 192 F.R.D. 133, 140-44 (S.D.N.Y. 2000) (actions by victims of war crimes committed by Bosnia–Herzegovina brought under the Alien Tort Claims Act).

Moreover, the Supreme Court also said in *Ortiz* that a fund which is "limited" only because the contributing party keeps a large portion of its wealth (*a la* the Sacklers) is "irreconcilable with the justification of necessity in denying any opportunity for withdrawal of class members whose jury trial rights will be compromised, whose damages will be capped, and whose payments will be delayed." *Ortiz v. Fibreboard Corp.*, 527 U.S. at 860, 119 S.Ct. 2295. The exact same thing could be said of the third parties whose claims are being extinguished as part of the Debtors' Plan.

Subsequent Second Circuit law in the *Manville* cases also casts doubt on a bankruptcy court's subject matter jurisdiction to authorize the release of third-party claims against the officers and directors of DBL simply because they would not otherwise have made a contribution to the debtor's estate. *Manville III*, 517 F.3d at 66. In *Manville III/IV*, the Second Circuit concluded that "a bankruptcy court only has jurisdiction to enjoin third-party non-debtor claims that directly affect the *res* of the bankruptcy estate," and held that claims asserted against non-debtors that sought "to recover directly from [the] debtor's insurer for the insurer's own independent wrongdoing" did not have such impact. *Manville III*, 517 F.3d at 65-66. In so ruling the Second Circuit held it of no moment for jurisdictional purposes that the non-debtor was making made a financial contribution to a debtor's estate (*id.*), saying: "It was inappropriate for the bankruptcy court to enjoin claims brought against a third-party non-debtor *solely on the basis of that third-party's financial contribution to a debtor's estate*." *Id.* (Emphasis added) For this proposition, the *Manville III* panel cited with approval the Third Circuit's warning from *In re Combustion Engineering*, where the court had observed that:

> a debtor could create subject matter jurisdiction over any on-debtor third-party [simply] by structuring a plan in such a way that it depended upon third party contribution. As we have made clear, subject matter jurisdiction cannot be conferred by consent of the parties. Where a court lacks subject matter jurisdiction over a dispute, the parties cannot create it by agreement even in a plan of reorganization.

In re Combustion Engineering, 391 F. 3d 190, 228 (3d Cir. 2004).

Finally, changes in class action law since *Drexel* was decided have rendered its facile analysis of the Rule 23(a) factors, especially commonality and typicality, highly suspect. *Amchem Products, Inc., v. Windsor*, 521 U.S. 591, 117 S.Ct. 2231, 138 L.Ed.2d 689 (1997); *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 119 S.Ct. 2295, 144 L.Ed.2d 715 (1999). I strongly suspect that the *Drexel* class certification, and so the *Drexel* settlement, would not and could not be approved today.[63]

But one thing is clear: *Drexel* sheds no light whatsoever on the issue of whether releases like the one at bar are authorized *by the Bankruptcy Code*. That statute was never mentioned.

[44] **New England Dairies/Metromedia**: In *New England Dairies, Inc. v.*

63. It is, of course, for the Second Circuit to make that call – not a district court in the Second Circuit.

Dairy Mart Convenience Stores, Inc., (In re Dairy Mart Conveniences Stores), 351 F. 3d 86, 92 (2d Cir. 2003), the Court of Appeals for this circuit definitively rejected the argument that § 105(a) of the Bankruptcy Code (*see supra*, at p. 94–95) could "create substantive rights that are otherwise unavailable under applicable law." As the author of the opinion (Judge Jacobs) recognized:

> The equitable power conferred on the bankruptcy court by section 105(a) is the power to exercise equity in carrying out the *provisions* of the Bankruptcy Code, rather than to further the purposes of the Bankruptcy Code generally, or otherwise to do the right thing. This language "suggests that an exercise of section 105 power be tied to another Bankruptcy Code section and not merely to a general bankruptcy concept or objective." 2 *Collier on Bankruptcy* ¶ 105.01[1].[64]

In re Dairy Mart Conveniences Stores, 351 F. 3d at 92.

In re Dairy Mart did not involve the confirmation of a plan containing non-debtor releases of third-party claims, so technically it did not speak to the question pending before this Court. But two years later, Judge Jacobs authored *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136 (2d Cir. 2005), which did.

Metromedia Fiber Network, Inc. and its subsidiaries declared bankruptcy. *See Metromedia*, 416 F.3d 136, 138 (2d. Cir. 2005). The company's founder, John W. Kluge, did not. However, as part of the plan of reorganization, Kluge, as grantor, established the "Kluge Trust." *Id.* at 141 n.4. Under the plan of reorganization proposed to the court, the Kluge Trust was to make "a 'material contribution' to the estate" in the bankruptcy, (*id.* at 143), by "[i] forgiv[ing] approximately $150 million in unsecured claims against Metromedia; [ii] convert[ing] $15.7 million in senior secured claims to equity in the Reorganized Debtors; [iii] invest[ing] approximately $12.1 million in the Reorganized Debtors; and [iv] purchas[ing] up to $25 million of unsold common stock in the Reorganized Debtors' planned stock offering." *Id.* at 141. Metromedia itself would continue to exist after its reorganization – albeit under a new name, AboveNET – and to engage in the business of providing high bandwidth telecommunications circuits, which was its historic business model.

In exchange for the Kluge Trust's contributions, the Kluge Trust and certain "Kluge Insiders" were to receive 10.8% of the Reorganized Debtors' common stock and something called the "Kluge Comprehensive Release." *Id.* The Kluge Comprehensive Release provided:

> the Kluge Trust and each of the Kluge Insider shall receive a full and complete release, waiver and discharge from . . . any holder of a claim of any nature . . . of any and all claims, obligations, rights, causes of action and liabilities arising out of or in connection with any matter related to [Metromedia] or one or more subsidiaries . . . based in whole or in part upon any act or omission or transaction taking place on or before the Effective Date.

Id.

The release was broad and did not carve out any exception – even for claims that could not be discharged against a debtor in

64. *In re Dairy Mart* was hardly the first time this settled principle had been recognized by the Second Circuit. *See, e.g., FDIC v. Colonial Realty Co.,* 966 F.2d 57, 59 (2d Cir. 1992) ("105(a) limits the bankruptcy courts equitable powers, which 'must and can only be exercised within the confines of the Bankruptcy Code'") (quoting *Norwest Bank Worthington v. Ahlers,* 485 U.S. 197, 206, 108 S.Ct. 963, 99 L.Ed.2d 169, (1988)).

bankruptcy, such as those predicated on fraud or willful misconduct.

Following confirmation of the plan, appellant creditors Deutsche Bank AG (London Branch) and Bear, Stearns & Co., Inc. challenged the "largely implemented" plan of reorganization and argued that the releases in the plan of reorganization "improperly shield certain nondebtors from suit by the creditors." *Id.* at 138. On appeal, the district court both affirmed the plan of reorganization and ruled that the relief sought by the two banks was not "barred by the doctrine of equitable mootness because effective relief could have been afforded without 'unraveling the plan.' " *Id.* at 139.

The Second Circuit vacated the district court's affirmance of the plan, on the ground that the bankruptcy court had failed to make certain findings necessary to a determination that the non-consensual third-party releases should be approved. *Id.* at 143. But the plan had been substantially consummated by the time the appeal was heard, so the Circuit concluded that the matter was indeed equitably moot. As a result, it declined to remand so that a lower court could make the missing findings and reconsider the propriety of the releases. *Id.* at 145.

Before reaching this result, the panel discussed whether non-debtor releases were available in connection with someone else's bankruptcy. The Circuit identified "two considerations that justify . . . reluctance to approve non-debtor releases." *Id.* at 141. It noted that such releases were not specifically authorized outside of the asbestos context:

> [T]he only explicit authorization in the Bankruptcy Code for nondebtor releases is 11 U.S.C. § 524(g), which authorizes releases in asbestos cases when specified conditions are satisfied, including the creation of a trust to satisfy future claims . . .

Metromedia Fiber Network, Inc., 416 F.3d at 142. And it held, consistent with *In re Dairy Mart*, that Section 105(a) of the Bankruptcy Code did not authorize the approval of such releases:

> True, 11 U.S.C. § 105(a) authorizes the bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]"; but section 105(a) does not allow the bankruptcy court "to create substantive rights that are otherwise unavailable under applicable law." *New England Dairies, Inc. v. Dairy Mart Convenience Stores, Inc. (In re Dairy Mart Convenience Stores, Inc.),* 351 F.3d 86, 92 (2d Cir.2003) (quotations and citation omitted). Any "power that a judge enjoys under § 105 must derive ultimately from some other provision of the Bankruptcy Code." Douglas G. Baird, Elements of Bankruptcy 6 (3d ed.2001); accord *Dairy Mart*, 351 F.3d at 92 ("Because no provision of the Bankruptcy Code may be successfully invoked in this case, section 105(a) affords [appellant] no independent relief.").

Metromedia, 416 F. 3d at 142.

The panel also cautioned that courts should be careful about approving a nonconsensual non-debtor release because the device "lends itself to abuse." *Id.* One particular form of abuse identified by the panel manifests when the release, in effect, "operate[s] as a bankruptcy discharge arrange without a filing and without the safeguards of the Bankruptcy Code." *Id.* Indeed, "The potential for abuse is heightened when releases afford blanket immunity." *Id.*

After observing that, "No case has tolerated nondebtor releases absent a finding of circumstances that may be characterized

as unique,." *Id.*, the panel listed circumstances in which such releases had been authorized in the past, and identified factors that a court should consider when evaluating such releases in the future: (1) the release is important to the plan, (2) the enjoined claims would be channeled to a settlement fund rather than extinguished, (3) the estate receives substantial consideration in return, (4) the released claims would otherwise indirectly impact the debtors' reorganization by way of indemnity or contribution, and (5) the plan otherwise provided for the full payment of the enjoined claims. *Id.* at 141–42. However, the Circuit insisted that the ultimate decision about whether to authorize such releases was "not a matter of factors and prongs." *Id.* 142.

Having said all that, the *Metromedia* court did not rule on whether any or all of the factors it had identified were satisfied in the particular case before it. Nor did it conclude that a non-debtor release should be approved if the factors were satisfied, or consider whether, in the case before it, there might be other reasons why the proposed non-debtor releases should not be approved.

Instead, as noted above, the Circuit vacated approval of the plan and declined to remand for further consideration because the matter had become equitably moot – thereby guaranteeing that those open questions – including the question about whether there was statutory authority for such releases – would not be answered.

So to summarize: No third-party releases were approved in *Metromedia.* The Court of Appeals did not conclude that such releases were consistent with or authorized by the Bankruptcy Code. It did not conclude that the case before it was one of the "unique" instances in which a court's reluctance to approve such releases might (assuming they were authorized) be overcome. And it did not decide whether the Kluge releases measured up to the level that might justify approving them if the case qualified as "unique." *In re Metromedia Fiber Network*, 416 F.3d at 142–143.

In other words, while *Metromedia* said a great deal, the case did not hold much of anything.[65] Its relevance, for present purposes, is that Judge Jacobs cautioned that statutory authority for non-consensual non-debtor releases outside of the asbestos context was at best uncertain – and then disposed of the case on other grounds, without identifying what section or sections of the Bankruptcy Code might actually authorize such relief in non-asbestos bankruptcy.[66]

No subsequent Second Circuit case has filled in the blank.

65. I disagree with Appellants that *Metromedia*'s discussion of non-consensual third-party releases is dictum. (*See id.*). The actual holding in the case is that the bankruptcy court failed to make the findings in order to justify approval of such a release. *Metromedia,* 416 F.3d at 143. A discussion of what type of findings would be necessary to approve a non-consensual third-party release was, at least arguably, a necessary predicate to that holding. The court's equitable mootness ruling only justified the decision not to remand so that the missing findings could be made. The court did not vacate approval of the releases on equitable mootness grounds, so it was not the actual holding in the case.

66. Further to the discussion of *Drexel* – the case was cited by a Second Circuit in *Metromedia,* but only for the proposition that a contribution to a debtor's estate from a released third party was one factor that had in the past been relied on by a court to justify a non-debtor release. That is true as a matter of simple fact. As far as this Court can tell, that is about all that can be said to be left of *Drexel.*

Manville III/IV and In re Quigley[67]: These were asbestos cases, in which a court's statutory authority to impose such non-debtor injunctions is undoubted, as long as all the conditions listed in § 524(g) are met.

As discussed above, in *Manville III/IV*, the Second Circuit concluded that the bankruptcy court lacked subject matter jurisdiction over third party claims against Manville's non-debtor insurer that arose out of an alleged independent duty owed by the insurer to those third parties, rather than out of its contractual relationship as Manville's insurer. The court did not discuss any issue of statutory authority.

And in *Quigley*, the Circuit held that certain claims against the debtor's parent—claims based on the use of the parent's name on the debtors' asbestos products—could not be enjoined pursuant to § 524(g) because the alleged liability was not "by reason of" any of the four "statutory relationships" identified in that section. *Quigley*, 676 F.3d at 49, 60-61. Had the proposed injunction fallen within one of the express statutory relationships, it would have been authorized because the case involved asbestos.

Madoff: *In re Bernard L. Madoff Inv. Securities LLC*, 740 F.3d 81 (2d Cir. 2014) involved a chapter 7 liquidation under the Securities Investor Protection Act (SIPA). The debtor, Bernie L. Madoff Investment Securities ("BLMIS"), was an investment enterprise created to effect the Ponzi scheme of its principal, Bernie Madoff. The bankruptcy estate settled its claims against the estate of Jeffry M. Picower, an alleged Madoff co-conspirator, releasing its claims in exchange for a $5 billion dollar contribution to Madoff bankruptcy estate. In addition to approving that settlement and release, the bankruptcy court permanently enjoined two of the debtor's customers from pursuing putative state tort law class actions against the estate of Jeffry M. Picower in the United States District Court for the Southern District of Florida, to the extent those claims arose from or related to the Madoff Ponzi scheme.

The Second Circuit affirmed the non-debtor injunction because the customer's complaints were predicated on secondary harms flowing from to them from BLMIS, and so were derivative claims that a bankruptcy court had power to discharge pursuant to Section 105(a). The *Madoff* court explained that the Florida plaintiffs had not alleged any direct claim against Picower's estate, because they failed to allege that Picower took any actions aimed at BLMIS customers (such as making misrepresentations to them) that caused particularized injury to those customers. *Id.* at 93.

However, the Second Circuit was careful to note that factual congruence between an estate's claim and an individual creditor's claim against the same non-debtor was not what rendered the asserted claims derivative. It held that, "there is nothing illogical or contradictory" about factual overlap between the allegations asserted in direct claim and a derivative claim; a non-debtor "might have inflected direct injuries on both the [estate's creditors] and [the debtor estate] during the course of dealings that form the backdrop of both sets of claims." *Id.* at 91 (quoting *In re Seven Seas Petroleum, Inc.*, 522 F.3d 575, 587 (5th Cir. 2008)). A creditor could, therefore, bring a direct claim against a non-debtor, even though the debtor might have

67. *Manville III,* 517 F.3d at 66; *Manville IV,* 600 F. 3d at 152; *In re Quigley Co.,* 676 F.3d 45 (2d Cir. 2012).

suffered an identical injury – provided the creditor was not seeking to recover for injuries suffered by the debtor, but for injuries it suffered *directly*. *Id.*

Significantly for our purposes, the Second Circuit did not simply sweep away the Florida class actions; it permitted the creditors to amend their Florida complaints to assert direct claims if they could identify some direct injury that Picower caused them, as there was "conceivably some particularized claim" that the customers could assert against the non-debtor that could not also be asserted or released by the estate. *Id.* at 94.

Tronox: *In re Tronox, Inc.*, 855 F.3d 84 (2d Cir. 2017) was not an asbestos case, but it adds nothing to the above discussion, for two reasons. First and foremost, the Court of Appeals dismissed the appeal for lack of appellate jurisdiction. Second, in that case, the claims asserted against the non-debtors by the third party were again derivative, not direct, claims (*e.g.*, alter ego, piercing the corporate veil, and successor liability) – as in *Madoff*, the plaintiff alleged "no particularized injury" to the claimant. *Id.* Because success on a derivative claim benefits all creditors of the estate, the Circuit held that the bankruptcy "trustee is the proper person to assert the claim, and the creditors are bound by the outcome of the trustee's action." *In re Tronox Inc.*, 855 F.3d at 103 (internal quotation omitted).

But the court went on to say that, "when creditors have a claim for injury that is particularized as to them, they are exclusively entitled to pursue that claim, and the bankruptcy estate is precluded from doing so." *Id.* at 99 (internal citation omitted). There was no discussion of enjoining such particularized claims, let alone any discussion of statutory authority for doing so.

Kirwan (Lynch v. Lapidem): And so we come to *Lynch v. Lapidem* (*In re Kirwan Offs. S.à.R.L.*) 792 Fed. Appx. 99 (2d Cir. 2019) ("*Kirwan*").

In *Kirwan*, the Second Circuit affirmed a bankruptcy court injunction that was included in a plan of reorganization in order to prevent collateral attacks on prior orders of that court. The appellant in *Kirwan* (Lynch) was one of three shareholders in the bankrupt enterprise. He challenged the *bona fides* of the bankruptcy filed by his former partners but lost after trial. The dissident shareholder then absented himself from the hearing on the plan of reorganization, of which he had notice. He did so in the (mistaken) belief that he could avoid any *res judicata* effect of the bankruptcy court's orders as long as he did not participate. *See In re Kirwan Offs. S.à.R.L.*, 592 B.R. 489, 501 (S.D.N.Y. 2018), *aff'd sub nom. In re Kirwan Offs. S.à.R.L.*, 792 F. App'x 99 (2d Cir. 2019).

Anticipating that the dissident shareholder would try to mount a collateral attack on the bankruptcy court's order confirming the plan, the other two shareholders had included therein a provision enjoining any person, including Lynch, from suing anyone in any forum on a claim arising out of the bankruptcy proceeding and the court-approved reorganization. Judge Drain confirmed the plan containing that provision. At the time he entered the order confirming the plan, the Bankruptcy Judge made it clear that Lynch's "opposition to any reasonable restructuring . . . scurried, if not crossed the line, over into bad faith" (*Kirwan*, 592 B.R. at 499), and said it was "in that context . . . that I am prepared to approve the exculpation and injunction provisions of the plan." *Id.* He specifically found that the provision was narrowly tailored and necessary in order to forestall "back-door attacks and collateral litigation for their activities related to

those things," which would impact the reorganized debtor as well the non-debtors who had proceeded in good faith throughout the bankruptcy. *Id.*

In short, the injunction affirmed in *Kirwan* was plainly one designed to preserve and protect the authority of the bankruptcy court and the integrity of its actions *vis a vis* the debtor's estate. Unlike the third-party claims in this case, Lynch's claims against his erstwhile partnership inherently involved the property of the estate – the relief sought would have redistributed *post hoc* the estate following the bankruptcy court's confirmation of the plan.

As noted earlier (*see* footnote 56), Lynch did not argue, either in this Court or in the Second Circuit, that the injunction was not statutorily authorized by the Bankruptcy Code. The grounds asserted and decided were jurisdictional and constitutional, not statutory. Neither this Court nor the Second Circuit analyzed the question of statutory authority, even in the context of the very limited and specially targeted injunction that was included in the debtor's plan.

Summary of Second Circuit Law: The only fair characterization of the law on the subject of statutory authority to release and enjoin the prosecution of third-party claims against non-debtors in a bankruptcy case is: unsettled, except in asbestos cases, where statutory authority is clear. Because the Court of Appeals has decided every other case on non-statutory grounds, its only clear statement is that Section 105(a), standing alone, does not confer such authority on the bankruptcy court outside the asbestos context.

3. The Law in Other Circuits

All but three of the other Circuits have spoken directly to the issue of statutory authority. They have reached conflicting results – a most unfortunate circumstance when dealing with a supposedly uniform and comprehensive nationwide scheme to adjust debtor-creditor relations.

Three of the eleven Circuits – the Fifth, Ninth, and Tenth – reject entirely the notion that a court can authorize non-debtor releases outside the asbestos context. *See In re Pacific Lumber Co.*, 584 F.3d 229, 252 (5th Cir. 2009); *In re Lowenschuss*, 67 F.3d 1394, 1401-02 (9th Cir. 1995); *In re W. Real Estate Fund*, 922 F.2d 592, 600 (10th Cir. 1990). Those courts read § 524(e) as barring the granting of such relief – put otherwise, they under Congress' use of the phrase "Notwithstanding the provisions of § 524(e)" in § 524(g) as creating an exception to an otherwise applicable rule.

The Third Circuit also has not identified any section of the Bankruptcy Code that authorizes such non-debtor releases. Judge Drain points to *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126, 133-40 (3d Cir. 2019) (*In re Purdue Pharma L.P.*, 2021 WL 4240974, at *40), but as in the Second Circuit cases like *Manville III/IV* and *Tronox*, the Third Circuit does not discuss statutory authority in that case. Instead, the *Millennium* court concluded that the bankruptcy court had *constitutional* authority to extinguish certain third-party claims by confirming a chapter 11 plan. *In re Millennium Lab Holdings II, LLC*, 945 F.3d 139-40.

On those occasions when the Third Circuit did address a bankruptcy court's *statutory* authority to impose non-debtor releases, it overturned bankruptcy court orders granting them. For example, in *In re Continental Airlines*, 203 F.3d 203 (3d Cir. 2000), the Court of Appeals *rejected as extra-statutory* the provision in a plan of reorganization that released claims against current and former directors of Continental, and that permanently enjoined shareholder actions against them, finding that the Bankruptcy Code "does

not explicitly authorize the release and permanent injunction of claims against non-debtors, except in one instance not applicable here" – that being asbestos cases. *Id.* at 211; 11 U.S.C. § 524(g). And in *In re Combustion Engineering, Inc.*, 391 F.3d 190 (3d Cir. 2004), the Third Circuit, like the Second Circuit in *Metromedia*, held that Section 105(a) does not give the court the power to create substantive rights that would otherwise be unavailable under the Bankruptcy Code, and vacated the channeling injunction. *Id.* at 238. Neither *Continental Airlines* nor *Combustion Engineering* has ever been overruled by the Third Circuit.

The First, Eighth, and D.C. Circuits have yet to weigh in on the question of whether statutory authority to impose non-debtor releases exists. Judge Drain contends that the First Circuit did decide that issue, in *Monarch Life Ins. Co. v. Ropes & Gray*, 65 F. 3d 973 (1st Cir. 1995), but again, the First Circuit did not identify any statutory authority to impose non-debtor releases in that case. It declined to decide whether Section 105(a) authorized the imposition of a non-debtor release; and it did not cite any other section of the Bankruptcy Code as conferring that authority. *Id.* at 983-94.

Judge Drain cited *In re AOV Indus., Inc.*, 792 F.2d 1140, 1153 (D.C. Cir. 1986) for the proposition that the D.C. Circuit has approved the non-consensual release of third-party claims against non-debtors. But that is wrong. The *AOV Industries* court did not say a word about whether such relief was authorized by statute. The court simply found that the issue before it – whether the bankruptcy court had *constitutional* authority to enter an order releasing non-debtor claims – was equitably moot. *Id.*

The Fourth and Eleventh Circuits have concluded that Section 105(a), without more, authorizes such releases. *See Nat'l Heritage Found., Inc. v. Highbourne Found., Inc.*, 760 F.3d 344, 350 (4th Cir. 2014); *In re Seaside Eng'g & Surveying*, 780 F.3d 1070, 1076-79 (11th Cir. 2015). After *In re Dairy Mart* and *Metromedia*, we know that is not the law in the Second Circuit. So Fourth and Eleventh Circuit law contradict Second Circuit law, and cannot be relied on as authority for the proposition that such releases are statutorily authorized.

That leaves the Sixth and Seventh Circuits, both of which have concluded that Sections 105(a) and 1123(b)(6) of the Bankruptcy Code, read together, codify something that they call a bankruptcy court's "residual authority," and hold that a bankruptcy court can impose non-consensual releases of third-party claims against non-debtors in connection with a chapter 11 plan pursuant to that "residual authority."[68] As discussed in my summary of his opinion, Judge Drain adopted the reasoning of these courts, and added two other sections of the Bankruptcy Code to buttress the analysis.

Summary of Extra-Circuit Law: A majority of the Circuits that have spoken to the statutory authority question either dismiss the idea that such authority exists or, as with the Second Circuit, (i) reject the notion that such authority can be found by looking solely to Section 105(a) and then (ii) fail to answer the question of where such authority can be found. Two Circuits rely solely on Section 105(a), and so have law that conflicts with the Second Circuit's pronouncement. Only two Circuits support the position taken by the learned Bankruptcy Judge.

68. They get the phrase "residual authority" from *United States v. Energy Res. Co.*, 495 U.S. 545, 549, 110 S.Ct. 2139, 109 L.Ed.2d 580 (1990), which I discuss in detail below.

It is against that backdrop of higher court authority that I turn to the order on appeal.

C. The Statutory Provisions Upon Which the Bankruptcy Court Relied

Judge Drain was quite explicit about the statutory provisions that he believed gave him authority to approve these releases as "necessary or appropriate" to carry out the provisions of the Bankruptcy Code: Sections 105(a), 1123(a)(5) and (b)(6), and 1129, together with "residual authority." *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *43.

The question that arises is whether any of the sections other than Section 105(a) confers some substantive right such that a release to enforce that right could be entered pursuant to Section 105(a).

I conclude that they do not.

Rather, each of the cited sections, like Section 105(a), confers on the Bankruptcy Court only the power to enter orders that carry out other, substantive provisions of the Bankruptcy Code. None of them creates any substantive right; neither do they create some sort of "residual authority" that authorizes the action taken by the Bankruptcy Court.

Section 1123(b)(6): Subsections (a) and (b) of 11 U.S.C. § 1123, entitled "Contents of Plan," lay out in considerable detail what a plan of reorganization *must* (subsection (a)) and *may* (subsection (b)) contain in order to be confirmed.

We can quickly dispense with the notion that Section 1123(b)(6) provides the substantive authority for a Section 105(a) injunction or approval of a release.

[45] Section 1123(b)(6) provides that a plan may "include any other appropriate provision not inconsistent with the applicable provisions of this title." 11 U.S.C § 1123(b)(6). In form, Section 1123(b)(6) is substantively analogous to Section 105(a)'s authorization of "any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). If the latter does not confer any substantive authority on the bankruptcy court – and that proposition is well settled, at least in this Circuit – then the former can in no way be read to do so.

That alone would be reason to conclude that Section 1123(b)(6) does not provide the statutory authorization we are seeking. But as Appellants point out, various aspects of the non-consensual Section 10.7 Shareholder Release are indeed inconsistent with certain other provisions of title 11.

[46] First and foremost, the Section 10.7 Shareholder Release is inconsistent with the Bankruptcy Code because it discharges a non-debtor from debts that Congress specifically said could not be discharged by a debtor in bankruptcy. The Section 10.7 Shareholder Release does not carve out or exempt claims for fraud or willful and malicious conduct, liabilities from which Purdue cannot be discharged in its own bankruptcy. *See* 11 U.S.C. §§ 523(a)(2), (4), (6). Reading the Bankruptcy Code as authorizing a bankruptcy court to discharge a non-debtor from fraud liability – something it is strictly forbidden from doing for a debtor – cannot be squared with the fact that Congress intended that the Bankruptcy Code "ensure that all debts arising out of fraud are excepted from discharge no matter what their form." *Archer v. Warner*, 538 U.S. 314, 321, 123 S.Ct. 1462, 155 L.Ed.2d 454 (2003) (internal citation omitted). In other cases in which the releases at issue called for relief from suit that encompassed otherwise non-dischargeable claims, courts either ensured fraud claims were exempt from the releases before approving them,

In re Airadigm Commc'ns, Inc., 519 F.3d 640, 657 (7th Cir. 2008), or simply refused to approve the releases because they included otherwise non-dischargeable claims. *See e.g.*, *In re Fusion Connect, Inc.*, No. 20-05798, 2021 WL 3932346, at *7 (S.D.N.Y. Sept. 2, 2021) (reversing the bankruptcy court's decision to discharge a debtor from an outstanding civil penalty because liability "arising from fraud on consumers" and payable to a governmental entity is "nondischargeable" in a chapter 11 bankruptcy under Section 523(a)(2)). Aside from *Drexel* – which, for all the reasons discussed above, is probably no longer good law – the Second Circuit has never approved a non-consensual release of claims against non-debtors of this sort, nor has it ever explained what provision of the Bankruptcy Code authorizes a bankruptcy court to do so.

[47] Second, as the State Appellants point out, a debtor's discharge cannot relieve him of "any debt ... to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty..." 11 U.S.C. § 523(a)(7). At least some of the claims asserted by the State Appellants seek relief in the nature of non-dischargeable civil penalties payable to and for the benefit of governmental units. Such claims could not be discharged if the Sacklers had filed for personal bankruptcy.

To the extent that Judge Drain held that the Section 10.7 Shareholder Release was not inconsistent with these sections, I respectfully disagree.

Appellants also argue that the Section 10.7 Shareholder Release and corresponding injunctions are inconsistent with Section 524(e) of the Bankruptcy Code, which provides that "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e). On the facts of this case, I cannot agree with that argument – but not because the Code is silent on the subject.

[48] Section 524(e) says, in sum and substance, that releasing a debtor on a debt owed to a creditor does not affect the liability that a non-debtor may have for the same debt. But the claims that would be released by the Section 10.7 Shareholder Release are not claims on which the Sacklers are jointly liable with Purdue. The various state statutes being invoked by Appellants give rise to Sackler liability *independent* of Purdue's liability – albeit for the very same violations of the very same laws – because those laws impose an independent duty on persons who occupy certain managerial positions in a corporation. We would not have this appeal if the Sackler debts being eliminated by the Section 10.7 Shareholder Release were also debts owed by Purdue; we would be back in Section 10.6 land, dealing with derivative claims, where the Bankruptcy Court's power is unchallenged.

It is true that, when passing Section 524(g), Congress stated explicitly that the non-debtor releases therein authorized were being allowed "notwithstanding the provisions of sect. 524(e)." 11 U.S.C. § 524(g). It is hard to read that phrase and not conclude that Congress thought it was creating an exception to Section 524(e) by authorizing the release of third-party claims against non-debtors in certain limited circumstances.

However, back when Congress was considering § 524(g), it had before it a specific situation: the claims being released were against non-debtor insurance companies whose liability was premised on the conduct of their insureds that fell within the terms of the policies they had issued. Ev-

erything that was being released was part and parcel of the bankruptcy estate; the debts owed by Manville and its insurers were the same debts; § 524(e) was obviously implicated. There is no indication, either in the text of the statute or in the legislative history, that Congress ever envisioned that a bankruptcy court could discharge the debts of non-debtors that were not also debts of the debtor. That being so, I cannot read the "notwithstanding" language to create an inconsistency on the facts of this case.

I am, therefore, constrained to conclude that the Section 10.7 Shareholder Release is not inconsistent with § 524(e), because it contains the discharge of debts that are not contemplated by § 524(e).

[49] **Section 1123(a)(5):** Section 1123(a)(5) of the Bankruptcy Code provides that a plan of reorganization must "provide adequate means for [its] implementation." 11 U.S.C. § 1123(a)(5). That section contains a laundry list of things that a plan can include in order to make sure that resources are available to implement the plan – any of which can be ordered by a bankruptcy court.

[50] Injunctions against the prosecution of third-party claims against non-debtors, and the release of such claims, are nowhere to be found on that list. Every single example listed in Subsections 5(A) through (J) authorizes the court to do something with the *debtor's assets* (retaining estate property; transfer of property; sale of property; satisfaction or modification of a lien; cancellation or modification of an indenture or similar instrument; curing or waiving defaults; extension of maturity dates; issuing securities; even amending the debtor's charter). Since the bankruptcy court has *in rem* jurisdiction over the *res* of the debtor's estate, none of that should be surprising. It is equally unsurprising that none of the types of relief listed in Section 1123(a)(5) involves disposing of property belonging to someone other than the debtor or a creditor of the debtor. That is because it is the debtor's resources – not the resources of some third party – that are supposed to be used to implement a plan that will adjust the debtor's relations with its creditors.

Of course, this is not the first case in which the resources of non-debtors are being used to implement a plan; and § 1123(a)(5) does not pretend to contain an exhaustive list of all ways that a plan can provide means for its implementation. The Section begins, after all, with the words "such as." In this case, Debtors argue that the only way to get the resources necessary to implement a viable plan was to agree to the Sacklers' demand for broad releases in exchange for their contribution of money to the bankruptcy estate. They insist that the Section 10.7 Shareholder Release and corresponding injunctions carry out the requirements of Section 1123(a)(5) by ensuring that the Plan has the funding it needs – and if that funding was obtained from some third-party funder on condition of a release and an injunction, then those forms of relief are authorized because the money is needed to fund the Plan.

But the fact that Purdue needs the Sacklers to give the money back does not mean that Section 1123(a)(5) confers on the Debtors or the Sacklers any right to have the non-debtors receive a release from non-derivative third-party claims in exchange for a contribution to Purdue's estate. The Debtors' suggestion that this Section confers some substantive right is exactly the sort of circular reasoning that was rejected by Judge Jacobs where Section 105(a) was concerned. *See In re Dairy Mart*, 351 F.3d at 92 (any such power conferred by Section 105(a) must "be tied

to another Bankruptcy Code section and not merely to a general bankruptcy concept or objective") (quoting 2 *Collier on Bankruptcy* ¶ 105.01[1]). Getting to a confirmable plan is the general bankruptcy objective, nothing more.

[51] Nor does Section 1123(a)(5) confer any special power on the Bankruptcy Court. A court does not propose the plan; the debtor and its creditors put the plan together and present it to the court, which cannot approve the plan unless it contains the required provisions and need not approve it even then. To the extent that any court order is contemplated by Section 1123(a), it is the Confirmation Order – not an injunction and release of claims against non-debtors in order to obtaining funding for a plan, which is essentially what Debtors are proposing.

[52, 53] Finally, and most important, Section 1123(a)(5) does not authorize a court to give its imprimatur to something the Bankruptcy Code does not otherwise authorize, simply because doing so would ensure funding for a plan. Nothing in Section 1123(a)(5) suggests that a debtor has the right to secure sufficient funds for implementation by any means necessary. Section 1123(a)(5) would not, for example, authorize a court to enter an order enjoining a bank from suing a non-debtor employee who embezzled funds and then offered them to her bankrupt brother's estate in exchange for a release of all claims a third party could assert against her. That example is silly, of course, but the point is simple: the mere fact that the money is being used to fund implementation of the plan does give a bankruptcy court statutory authority to enter an otherwise impermissible order in order to obtain that funding. As was the case with Section 1123(b)(6), Judge Drain's reliance on Section 1123(a)(5) begs the ultimate question that must be answered: whether the court has some *independent* statutory authority to issue the non-debtor releases and enjoin third party claims against the Sacklers, such that the Bankruptcy Court can enter a "necessary and appropriate" order to obtain the funding.

[54] **Section 1129(a)(1):** Finally, Section 1129(a)(1) does not provide the substantive authority for a Section 105(a) injunction or approval of a release. Section 1129 is entitled "Confirmation of plan," and Subsection 1129(a)(1) provides that a bankruptcy court "shall confirm a plan only if ... the plan complies with the applicable provisions of this title." 11 U.S.C.A. § 1129. Like the cited sections of § 1123, § 1129(a) confers no substantive right that could be used to undergird a § 105(a) injunction. One highly general provision simply does not confer substantive authority that is required to invoke another highly general provision.

Lack of Any Statutory Prohibition: Having exhausted the statutory provisions on which Judge Drain relied and finding that none of them confers any substantive right as required by *Metromedia*, our exercise should be at an end. But it is not. The Debtors argue that the Bankruptcy Court must be statutorily authorized to approve these releases because no provision of the Bankruptcy Code – including but not limited to § 524(e) – expressly prohibits them.

The notion that statutory authority can be inferred from Congressional silence is counterintuitive when, as with the Bankruptcy Code, Congress put together a "comprehensive scheme" designed to target "specific problems with specific solutions." *RadLAX Gateway Hotel*, 566 U.S. at 645, 132 S.Ct. 2065. In this particular case, a number of red flags suggest that Congressional silence (if indeed Congress

was silent) was not intended to mean consent.

[55] The first is that silence is inconsistent with comprehensiveness, and the Bankruptcy Code "provides a *comprehensive* federal system . . . to govern the orderly conduct of debtors' affairs and creditors' rights." *E. Equip. & Servs. Corp. v. Factory Point Nat. Bank, Bennington*, 236 F.3d 117, 120 (2d Cir. 2001) (emphasis added). "Comprehensive" means "complete, including all elements." Reading elements that do not appear in the text of the Code into the Code is the antithesis of comprehensiveness.

Then-District Judge Sullivan recognized as much in *In re Lehman Bros. Holdings Inc.*, 508 B.R. 283 (S.D.N.Y. 2014). There, the bankruptcy court granted a certain creditor's application for reimbursement of post-petition counsel fees over the U.S. Trustee's objection that the Bankruptcy Code only permitted reimbursement of post-petition administrative expenses. On appeal, Judge Sullivan was not persuaded by appellees' argument that reimbursement for professional fees was authorized by the Bankruptcy Code simply because nothing in the Bankruptcy Code expressly forbade it. He held that, "no such explicit prohibition is necessary" because the requested reimbursement clearly goes against the *purpose* of a reorganization – "Reorganization plans exist to pay claims . . . [the] professional fee expenses were all incurred post-petition, and thus cannot be treated as 'claims.' " *Id.* at 293. He further noted that the federal bankruptcy scheme "cannot remain comprehensive if interested parties and bankruptcy courts in each case are free to tweak the law to fit their preferences." *In re Lehman Bros. Holdings Inc.*, 508 B.R. 283, 294 (S.D.N.Y. 2014) (internal citations omitted).

As I noted above, Justice Breyer recently wrote when discussing the priority scheme set out in the Bankruptcy Code, the importance of certain critical aspects of the bankruptcy scheme "leads us to expect more than simple statutory silence if, and when, Congress were to intend a major departure." *Jevic Holdings Corp.*, 137 S. Ct. at 984. Granting releases to non-debtors for claims that could not be released in favor of the debtors themselves is so far outside the scope of the Bankruptcy Code and the purposes of bankruptcy that the "silence does not necessarily mean consent" principle applies with equal force.

[56] Second, it is hard to infer consent from silence in circumstances when one would not expect Congress to speak. The Code was intended "to free the debtor of his personal obligations *while ensuring that no one else reaps a similar benefit*" *Green v. Welsh*, 956 F.2d 30, 33 (2d Cir. 1992) (emphasis added). It is counterintuitive to imagine that Congress would have thought it necessary to include language specifically forbidding things that that ran counter to that purpose. As one of Judge Drain's colleagues recently reminded us, the ordering of an involuntary release of third-party claims against non-debtors is "an extraordinary thing" that is "different . . . from what courts ordinarily do." *In re Aegean Marine Petroleum Network Inc.*, 599 B.R. 717, 723 (S.D.N.Y. 2019). That is especially true where, as is proposed here, we find ourselves in what Judge Wiles called "the odd situation where we are being asked to use an unwritten authority to release non-debtor officers and directors from claims when the Bankruptcy Code would bar us from giving similar relief to those persons if they were debtors in their own cases." *Id.* at 726 (citing *Metromedia*, 416 F.3d at 142).

Third, Congress has in fact spoken on this subject, and what it has said suggests that it intended Sections 524(g) and (h) to preempt the field where non-debtor releas-

es were concerned. I will not repeat the extensive discussion about the law and its legislative history that appears above, except to say that Congress in its wisdom elected to limit Code-based authority to release third party claims against non-debtors to asbestos litigation – and it declined either to agree with those who argued that bankruptcy courts already had a broader power to authorize such releases. Congress was not unaware that there were non-asbestos bankruptcies with thousands of claimants and nationwide implications in the early 1990s. Other mass tort bankruptcies with thousands upon thousands of potential claimants were pending (*i.e.*, in *A.H. Robins/Dalkon Shield*), as was the highly publicized bankruptcy of a major investment bank (*Drexel*). The Judiciary Committee mentioned the "experimentation" with *Manville*-like relief that was beginning in other industries.

Yet Congress declined to make this extraordinary form of relief – relief that ran counter to the fundamental purpose of the Bankruptcy Code – available in circumstances other than asbestos bankruptcies. And it reserved for itself the right to change that.

So the silence that speaks volumes is not Congress' failure to say, "And you can't give involuntary non-debtor releases to anyone except in an asbestos case." The silence that speaks volumes is the twenty-seven years of unbroken silence that have passed since Congress said, "We are limiting this to asbestos for now, and maybe, when we see how it works in that context, we will extend it later."

[57] Fourth, but by no means least, "it is a commonplace of statutory construction that the specific governs the general." *RadLAX Gateway Hotel*, 504 U.S. at 384. The Supreme Court of the United States has relied on that principle on multiple occasions in refusing to allow generalized provisions of the Bankruptcy Code to override specific directives on a particular subject.

Take, for example, *RadLAX* itself. The plan proposed by the debtors in *RadLAX* provided for the sale of unencumbered assets securing a bank creditor's claim free and clear of all liens. But, in contravention of the provision governing such a "cram down" plan under the Bankruptcy Code, the bid procedures proposed by the debtors precluded the bank holding the mortgage on the property from credit-bidding the amount of its claim, which the Bankruptcy Code specifically authorized the bank to do. 11 U.S.C. § 1129(b)(2)(A)(ii). Nonetheless, the bankruptcy court approved the plan. It agreed with the debtors that the bank did not need to be permitted to bid on the property as long as it was provided with the "indubitable equivalent" of its claim in some other fashion – in this particular case, the cash generated by the auction. 11 U.S.C. § 1129(b)(2)(A)(i)-(iii).

[58] The Supreme Court rejected the debtors' justification, holding that the "indubitable equivalents" subclause (subclause iii) was a general subclause that could not be used to circumvent the specific requirement of subclause (ii) that the bank be permitted to credit-bid at the sale. The Court stated that the debtors' reading of the statute – that clause (iii) permits precisely what clause (ii) proscribes – is "hyperliterally contrary to common sense." *RadLAX Gateway Hotel*, 566 U.S. at 640, 132 S.Ct. 2065. The Court called it "axiomatic" that specific statutory provisions control over general provisions and emphasized that the "general/specific canon" applies with particular force in bankruptcy, because "Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions." *Id.*

Where, as here, Congress has deliberately limited a specific targeted solution (the release of third-party claims against non-debtors) to a specific identified problem (asbestos bankruptcies) – and has even denominated that solution as an exception to the usual rule – *RadLAX* strongly suggests that the general/specific canon should apply with particular force.

Ginsberg & Sons v. Popkin, 285 U.S. 204, 52 S.Ct. 322, 76 L.Ed. 704 (1932) is a pre-Code case, but it illustrates the same principle. There, petitioner argued that Clause 15 of Section 2 of the Bankruptcy Act empowered district judges to issue orders directing the arrest of the former officers and directors of the debtor. Clause 15 provided, "The courts of bankruptcy are hereby invested with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings ... [t]o] make such orders, issue such process, and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this title." Section 2, 11 USCA s 11(15). The reader will immediately appreciate that Clause 15 is the Bankruptcy Act's equivalent of Section 105(a) of the Bankruptcy Code – it was the "necessary and appropriate" clause in the old statutory scheme.

But Section 9(a) of the Bankruptcy Act specifically precluded "a court of bankruptcy" from directing the arrest of former directors and officers, except for contempt or disobedience of its lawful orders. And Section 9(b) prescribed in great detail the conditions to and procedures for invoking the exception under which the court could direct the arrest and detention of such former directors and officers who posed a flight risk.

The Supreme Court refused to read Clause 15 of Section 2 in a way that would render the specific prohibitions and procedures enumerated in Sections 9(a) and (b) superfluous: "In view of the general exemption of bankrupts from arrest under section 9a and the carefully guarded exception made by section 9b as to those about to leave the district to avoid examination, there is no support for petitioner's contention that the general language of section 2(15) is a limitation upon section 9(b) or grants additional authority in respect of arrests of bankrupts." *D. Ginsberg & Sons v. Popkin*, 285 U.S. at 207–08, 52 S.Ct. 322.

The Supreme Court's holdings in these cases old and new are instructive in the present context. Here, Debtors and their allies seek to apply general provisions – Sections 105(a) and 1123(a)(5) and (b)(6) – to justify expanding the express authority conferred by Congress under § 524(g) into a situation that is manifestly not comprehended by that statute. Because the specific controls the general, that reliance is misplaced.

For all these reasons, I cannot conclude that Congressional "silence" should be deemed consent to an expansion of Section 524(g). In fact, I do not believe that Congress has been silent at all. But to the extent it has, its silence supports the Appellants' position, not the Debtors'.

Residual Authority: Finally, I turn to the concept of "residual statutory authority." In these circumstances, I conclude that such authority simply does not exist.

Judge Drain framed the question before him as, "whether the court has statutory *or other power* to confirm a plan with a third-party claim release," and, if so, "what is the statutory *or other source of power* for such a release?" *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *40, *43 (emphasis added). He identified the "other source of power" as the residual power of bankruptcy courts.

[59] But such power, if it even exists, is of no help where, as here, it is being exercised in contravention of specific provisions of the Bankruptcy Code.

Debtors rely heavily on the Supreme Court's decision in *In re Energy Resources Co*, 495 U.S. 545, 110 S.Ct. 2139, 109 L.Ed.2d 580 (1990) for the proposition that a bankruptcy court has "residual authority" to approve reorganization plans that includes all "necessary and appropriate" provisions, as long as those provisions are not inconsistent with title 11. In that case, the Court concluded that two bankruptcy courts – which were forbidden by the Bankruptcy Code from discharging a tax debt [69] and required not to confirm a plan unless satisfied that the IRS would in all likelihood be able to collect taxes owed within six years [70] – had not "transgressed one of the limitations on their equitable power" by directing in a plan of reorganization that certain tax payments be credited in the first instance to so-called "trust fund" tax debt, and only when that debt was satisfied to so-called "non-trust fund" tax debt. *In re Energy Resources Co.*, 495 U.S. 499-50. Trust fund tax debt is guaranteed by third parties; an order directing that the guaranteed debt be paid first meant that if there were any unpaid taxes at the end of the plan period, the IRS could probably not look to third parties for payment. The IRS argued that this provision of the plan was inconsistent with the Bankruptcy Code, because requiring the debtor to pay non-trust fund taxes first would give the IRS a greater chance of recovering 100 cents on the dollar.

But the Supreme Court ruled that the Bankruptcy Code did not require that a plan of reorganization be structured so that the unsecured tax debt was paid first. The bankruptcy court had found (as required by the Bankruptcy Code) that the plan of reorganization proposed by the debtors was likely to succeed. It further found that, if the plan did succeed, all taxes would be fully paid within six years. The express terms of the Bankruptcy Code required nothing more. Therefore, the order directing that tax payments be credited first to back taxes secured by the trust fund, and then to unsecured back taxes, was not inconsistent with any applicable provision of title 11. All the substantive guarantees that the Bankruptcy Code afforded to the IRS were baked into the court's approval of the plan.

No reference in *Energy Resources* to a bankruptcy court's "residual power" authorizes the learned Bankruptcy Judge's approval of the Section 10.7 Shareholder Release under any "residual power" theory. Just two years prior to the *In re Energy Resources* decision, the same Supreme Court – made up of the same nine justices – held that the bankruptcy court's residual equitable authority was bounded by the provisions of the Bankruptcy Code. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988) (holding "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code"). *Energy Resources* is consistent with this principle. Congress legislated a particular right into the Bankruptcy Code; the Supreme Court refused to allow lower courts to expand that right and held that the Bankruptcy Court had the power to authorize anything that was not inconsistent with that right. But the Bankruptcy Code conferred a specific right. In this case, there is nothing in the Bankruptcy Code that specifically authorizes the Section 10.7 Shareholder Re-

69. 11 U.S.C. §§ 507(a)(7), 523(a)(1)(A).

70. 11 U.S.C. § 1129(a)(9)(C).

lease; the Bankruptcy Court (and this Court) is being asked to insert a right that does not appear in the Bankruptcy Code in order to achieve a bankruptcy objective. That is precisely what *In re Dairy Mart* and *Metromedia* prohibit.

Additionally, the *Energy Resources* Court, echoing its own holding of two years earlier, recognized that any residuary power enjoyed by a bankruptcy court must be exercised in a way that "is not inconsistent with the applicable provisions of this title." I have become convinced, for the reasons discussed in great detail above, that the Section 10.7 non-debtor releases are in fact inconsistent with applicable provisions of title 11 – with Sections 524 (g) and (h), with Section 523, and with Section 1141(d), and possibly even with Section 524(e). Therefore, no residual power can authorize such an order.

As a corollary to the "residual authority" argument, several Appellees argue the release of claims against the non-debtor Sacklers and their related entities are proper because the Bankruptcy Code, taken as a whole, creates a "special remedial scheme" in which certain legal proceedings may terminate preexisting rights if the scheme is otherwise consistent with due process. They cite *Martin v. Wilks*, 490 U.S. 755, 109 S.Ct. 2180, 104 L.Ed.2d 835 (1989) for their proposition.

In *Martin v. Wilks*, the Supreme Court announced that, as a general rule, "A judgment or decree among parties to a lawsuit resolves issues as among them, but it does not conclude the rights of strangers to those proceedings." It affirmed the Eleventh Circuit's judgment allowing certain individuals who were *not* parties to an original action to challenge consent decrees entered in that original case. *Id.* at 762, 109 S.Ct. 2180. But, in a footnote, the Court acknowledged an exception to the general rule exists "where a special remedial scheme exists expressly foreclosing successive litigation by nonlitigants, as for example in bankruptcy or probate, legal proceedings may terminate preexisting rights if the scheme is otherwise consistent with due process." *Id.* at 762, 109 S.Ct. 2180, n. 2.

[60–62] Judge Drain did not adopt this reasoning or rest his view about his statutory authority on the Bankruptcy Code's "special remedial scheme" – and rightly so, because it is contrary to Second Circuit law. The "special remedial scheme" contemplated by the Bankruptcy Code addresses the rights of persons who have claims against a debtor in bankruptcy – not claims against other non-debtors. The Code lays out a claims allowance process so that creditors can file their claims against someone who has invoked the protection of the Bankruptcy Code; it provides a mechanism for those parties to litigate those claims against the debtor and to determine their value. In order to take advantage of this "special remedial scheme," debtors have to declare bankruptcy, disclose their assets, and apply them – all of them, with *de minimis* exceptions – to the resolution of the claims of their creditors.

Non-debtors have no such obligations, and so do not have any rights at all under the "special remedial scheme" that is bankruptcy – certainly not the "right" to have claims that are being asserted against them outside the bankruptcy process released. As the Second Circuit held in *Manville III*, the "special remedial scheme" due process exception relating to *in rem* bankruptcy proceedings simply does not give a bankruptcy court subject matter jurisdiction to release *in personam* third-party claims against a non-debtor. *In re Johns-Manville Corp.*, 600 F. 3d 135, 158 (2d Cir. 2010).

Conclusion: No Statutory Authority. In *Metromedia*, the Second Circuit signaled that a Bankruptcy Code could not order the non-consensual release of third-party claims against non-debtors unless some provision of the Bankruptcy Code aside from Section 105(a) authorized it to do so. For the reasons stated above, I conclude that there is no such section, and so no such authority.

It is indeed unfortunate that that this decision comes very late in a process that, from its earliest days in 2019, has proceeded on the assumption that releases of the sort contemplated in Section 10.7 of the Debtors' Plan would be authorized – this despite the language of the Bankruptcy Code and the lack of any clear ruling to that effect. I am sure that the last few years would have proceeded in a very different way if the parties had thought otherwise. But that is why the time to resolve this question for once and for all is now – for this bankruptcy, and for the sake of future bankruptcies. It should not be left to debtors and their creditors to guess whether such releases are statutorily authorized; and it most certainly should not be the case that their availability, or lack of same, should be a function of where a bankruptcy filing is made.

[63] I also acknowledge that the invalidating of these releases will almost certainly lead to the undoing of a carefully crafted plan that would bring about many wonderful things, including especially the funding of desperately needed programs to counter opioid addiction. But just as, "A court's ability to provide finality to a third-party is defined by its jurisdiction, not its good intentions" (*Manville III*, 517 F.3d at 66), so too its power to grant relief to a non-debtor from non-derivative third party claims "can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington*, 485 U.S. at 206, 108 S.Ct. 963.

Because the Bankruptcy Code confers no such authority, the order confirming the Plan must be vacated. Because the Advance Order is an adjunct of and follows from the Confirmation Order, it, too, must be vacated.[71]

III. The Plan's Classification and Treatment of the Canadian Appellants' Claims Does Not Violate the Bankruptcy Code.

Because the court reverses on the ground that there is no statutory authorization in the Bankruptcy Code for the Bankruptcy Court to impose a non-voluntary release of third-party claims against non-debtors, I do not reach the Canadian Appellants' separate attack on the Section 10.7 Shareholder Release. But part of the Canadian Appellants' argument on appeal is that the Plan as confirmed violates the Bankruptcy Code by treating the Canadian Appellants' unsecured claims unfavorably as compared to the claims of their domestic counterpart creditors. The Canadian Appellants explained at Oral Argument that this "inequality" issue must be decided, regardless of how the court ruled on the Section 10.7 Shareholder Release. (*See* Oral Arg. Tr., Nov. 30, 2021, at 71:6-21).

[64] Pursuant to the Plan, the Canadian Appellants are entitled to a share of the

71. The U.S. Trustee has also appealed from the Disclosure Order, asserting that it was inaccurate in certain respects. (Dkt. No. 91, at 10; Dkt. No. 191, at 10). As the Confirmation Order has been vacated without reaching the notice/due process constitutional issues that were raised by the U.S. Trustee, I do not understand that any substantive ruling is needed with respect to the Disclosure Order. Like everything else connected with the Plan, it simply falls by the wayside.

$15 million dollars distributed to a trust that will be divided among all of the general unsecured creditors of the Debtor. (Dkt. No. 59, at 47). At the same time, domestic government and tribe unsecured creditors are not classified as "general" unsecured creditors but are placed in classes 4 and 5 as "Non-Federal Domestic Governmental" claimants and "Tribe" claimants respectively. (*See* Plan, at 2). The Canadian Appellants argue that the Bankruptcy Code contains an "equal-treatment mandate" in Section 1129(a)(4) requiring that "all creditors within the same class enjoy the same 'opportunity' to recover." (Dkt. No. 59, at 47). Because, they argue, the domestic non-federal government claims (Class 4) and tribal claims (Class 5) are "indistinguishable" from theirs (*id.*), the Canadian Appellants posit that they are "similarly situated" to their "domestic counterparts" and thus should be part of the same creditor "class." Since the Plan does not allow the Canadian Appellants to "enjoy shares in trusts seeded with $4.5 billion—300 times as much" as would be available to the general unsecured creditors of Purdue (*Id.*) – the Canadian Appellants argue that there exists "an inequality that is independently fatal to the Plan's treatment of the Canadian Appellants' claims." (*Id.*).

[65] The Court disagrees. Under the Plan, the Canadian Appellants belong to a different class than their domestic, unsecured creditor "counterparts" for perfectly legitimate reasons. The Code does not require that all creditor classes be treated equally, only that there be a reasonable basis for any differentiation. *See Boston Post Rd. Ltd. P'ship v. FDIC (In re Boston Post Rd. Ltd. P'ship)*, 21 F.3d 477, 482-83 (2d Cir. 1994).

[66–68] First, the Bankruptcy Code expressly permits differentiation *between* classes of creditors and the Canadian Appellants rightly recognize that their "equal-treatment mandate" applies only to claims of "all creditors within the same class." (*See* Dkt. No. 59, at 47). The Canadian Appellants' argument that they are of the same "class" as the non-federal government and tribe claimants is unconvincing. It does not matter that the Canadian Appellants' claims are purportedly "indistinguishable" from those held by the domestic unsecured creditors in Classes 4 and 5; a chapter 11 plan may separately classify similar claims so long as the classification scheme has a reasonable basis for doing so. *See In re Boston Post Rd. Ltd. P'ship*, 21 F.3d at 482-83.

In *Boston Post Rd. Ltd. P'ship*, the chapter 11 plan classified unsecured claims against the insolvent Debtor, the Boston Post Road Limited Partnership ("BRP"), differently between the Federal Deposit Insurance Corporation ("FDIC") and BPR's other trade creditors. The classification treated the unsecured trade creditors more favorably than FDIC, while FDIC was BPR's largest unsecured creditor and an anticipated objector to the plan; the differentiation between these classes was done to achieve a "cramdown" of the plan over FDIC's objections. *Id.* at 479. The bankruptcy court denied confirmation of a chapter 11 plan on the basis that the plan impermissibly separately classified similar claims, holding that FDIC's unsecured claims should have been placed in the same class with other unsecured creditors, and the District Court affirmed. *Id.* On appeal, the Second Circuit found that the "Debtor was unable and failed to adduce credible proof of any legitimate reason for segregating the FDIC's unsecured claim from the unsecured claims of BPR's trade creditors." *Id.* at 483. The Debtor's only reasons were that the FDIC's claim purportedly "were created from different circumstances" and "BPR's future viability as a business depends on treating its trade

creditors more favorably than the FDIC." *Id.* These reasons were "availing" to the Circuit. *Id.* In particular, the Circuit took issue with classifying similar claims differently "in order to gerrymander an affirmative vote on a reorganization plan." *Id.* at 482-83 (quotation omitted). The Circuit explained, "approving a plan that aims to disenfranchise the overwhelmingly largest creditor through artificial classification is simply inconsistent with the principles underlying the Bankruptcy Code." *Id.*

[69] In this case, unlike in *Boston Post Rd.* Judge Drain identified a reasonable basis for separately classifying the Canadian Appellants from the domestic unsecured creditors: First, Judge Drain explained that the Canadian creditors operate under "different regulatory regimes . . . with regard to opioids and abatement" than their domestic counterparts. *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *12. Second, Judge Drain explained that "the allocation mediation conducted by Messrs. Feinberg and Phillips that resulted in the plan's division of the Debtors' assets . . . involved only *U.S.-based* public claimants with their own regulatory interests and characteristics." *Id.* (emphasis added). As the Debtors point out, the Canadian Appellants themselves differentiate themselves from the other classes in this manner, explaining (i) "[t]he Canadian Appellants are in Canada, [(ii)] the bulk of their legal claims arise in Canada, [(iii)] those claims concern the operations of Purdue Canada," and (iv) the Canadian Appellants' claims "bear no relation to the Shareholder Released Parties' control, direction, and oversight of the Debtors or their U.S. operations." (Dkt. No. 59, at 17-18; Dkt. No. 151, at 120-121). That very classification on the part of the Canadian Appellants accords with Judge Drain's findings that there is a reasonable basis for the separate classifications. And there is no argument that such separate classification was done for the purpose of disenfranchising a particular group in a manner inconsistent with the Bankruptcy Code, to engineer an assenting impaired class; or manipulate class voting, all of which must be carefully scrutinized by the court. Indeed, it was not.

Under the Plan, the Canadian creditors are classified in Class 11(c), while the domestic municipalities and domestic Indian tribes are classified as Class 4 and 5 creditors. These are perfectly legitimate classifications and the proffered reasons for doing so are reasonable. And the Canadian Appellants do not (and cannot) argue that under the Plan their claims will receive unequal treatment as compared to other claims in their class, Class 11(c), as indeed all claims classified as Class 11(c) are treated equally under the Plan. (Dkt. No. 59, at 44, 47-48).

[70] Finally, Canadian Appellants *cannot* argue that their Class 11(c) claims are treated unfavorably as compared the other creditor classes (like Class 4 and/or Class 5) because their class, Class 11(c), voted to accept the Plan. Under the Bankruptcy Code, only creditors of a *dissenting* class can object to the confirmation of a plan on the grounds that the plan discriminates against its creditor class. Pursuant to section 1129(b)(1) of the Bankruptcy Code, a plan shall be confirmed "if the plan does not discriminate unfairly . . . with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1). Because the Canadian creditors – as part of Class 11(c) – voted to accept the Plan, the Canadian Appellants cannot contend that they are being treated unfavorably.

The classification and treatment of the Canadian Appellants' claims under the

Plan does not violate the Bankruptcy Code.

CONCLUSION

For the foregoing reasons, the Bankruptcy Court's Confirmation Order and related Advance Order must be vacated.

This decision leaves on the table a number of critically important issues that were briefed and argued on appeal – principal among them, whether the Section 10.7 Shareholder Release can or should be approved on the peculiar facts of this case, assuming all the other legal challenges to their validity were resolved in Debtors' favor.

But sufficient unto the day. This and the other issues raised by the parties can be addressed if they need to be addressed – which is to say, if this ruling is reversed.

This constitutes the decision and order of the court. This is a written opinion.

IN RE: IMMUNE PHARMACEUTICALS INC., et al., Debtors.

Case No. 19-13273 (VFP) Jointly Administered

United States Bankruptcy Court,
D. New Jersey.

December 08, 2021

Background: Chapter 7 trustee requested approval of settlement proposing to resolve litigation between debtors, bankruptcy estates, debtors' former directors and their liability insurer, and creditor, in which debtors sought to subordinate creditor's secured claim and trustee alleged that directors breached their fiduciary duties.

Holdings: The Bankruptcy Court, Vincent F. Papalia, J., held that:

(1) creditor's debenture was not a "security" subject to mandatory subordination under Bankruptcy Code;

(2) it was uncertain whether trustee's claims would succeed, thus favoring settlement;

(3) creditor was not a "dealer" subject to registration requirements under the Securities Exchange Act of 1934;

(4) lack of collection difficulties favored settlement;

(5) expense and delay of litigation favored settlement;

(6) paramount interest of creditors favored settlement; and

(7) approval of settlement was warranted.

Settlement approved.

1. Bankruptcy ⚿3033

In determining whether to approve proposed settlement, bankruptcy courts rely on four factors: probability of success in litigation; likely difficulties in collection; complexity of litigation and expense, inconvenience, and delay involved; and paramount interest of creditors. Fed. R. Bankr. P. 9019.

2. Bankruptcy ⚿3033

In applying factors for whether to approve proposed settlement, bankruptcy court need not probe merits of all claims or conduct mini-trial; rather, avoiding litigating issues is one of main advantages of settlement. Fed. R. Bankr. P. 9019.

3. Bankruptcy ⚿3033

In determining whether to approve proposed settlement, bankruptcy court need only canvas issues to determine whether settlement falls above lowest point in range of reasonableness, and under normal circumstances, court should de-

News

Elizabeth A. Sackler Supports Nan Goldin in Her Campaign Against OxyContin

The cultural philanthropist says she stands in solidarity with those calling on another branch of the Sackler family to answer for its role in the opioid epidemic.

by Benjamin Sutton
January 22, 2018

A kit for injecting drugs, including oxycodone pills (photo via Wikimedia Commons)

A kit for injecting drugs, including oxycodone pills (photo via Wikimedia Commons)

Elizabeth A. Sackler, a prominent cultural philanthropist whose name adorns many museum walls, has thrown her support behind artist **Nan Goldin's campaign** against another branch of **the Sackler family** that has profited enormously from the **opioid epidemic** through its company, Purdue Pharma.

"The opioid epidemic is a national crisis and Purdue Pharma's role in it is morally abhorrent to me," Sackler said in a statement sent to Hyperallergic. "I admire Nan's commitment to take action and her courage to tell her story. I stand in solidarity with

artists and thinkers whose work and voices must be heard."

Mortimer and **Raymond Sackler**, Elizabeth Sackler's uncles, were the principal owners of **Purdue Pharma** in 1995, when the company released the prescription painkiller OxyContin onto the market. The company **pleaded guilty** in 2007 to a federal charge that it had mislabeled the drug and mislead the public about its addictive properties, agreeing to pay an unprecedented $600 million fine. Nevertheless, sales of the drug showed no signs of slowing, and as of 2016 Purdue Pharma had made **more than $31 billion** from sales of OxyContin. Foundations run by Mortimer and Raymond Sackler's side of the family have given millions of dollars to **cultural institutions** in the US, UK, and Europe, including the the Solomon Guggenheim Foundation, the Metropolitan Museum, the Dia Arts Foundation, the Louvre, and the Victoria & Albert Museum.

"My father, Arthur M. Sackler, died in 1987, before OxyContin existed and his one-third option in Purdue Frederick was sold by his estate to his brothers a few months later," Elizabeth Sackler added. "None of his descendants have ever owned a share of Purdue stock nor benefitted in any way from it or the sale of OxyContin. I stand with all angry voices against abuse of power that harms or compromises any and all lives."

In **an article earlier this month**, Goldin revealed her years-long struggle with OxyContin addiction, which she detailed at greater length in **an interview with the *New York Times*** published today. Originally prescribed three pills per day for pain relief related to a surgery, she wrote that she "got addicted overnight" and her daily consumption eventually ballooned to 18 pills per day. When she was no longer able to afford OxyContin, she says she snorted another pain relief drug, fentanyl, and overdosed. While Goldin has been clean

since January 2017 according to her article, many do not survive: between 1999 and 2016 there were some 200,000 opioid-related deaths; in 2015 alone, **more than 20,000** people died of prescription pain relief drug overdoses in the US. In October 2017, President Trump **declared** opioid addiction a national public health emergency.

"We are deeply troubled by the prescription and illicit opioid abuse crisis, and we would welcome an opportunity to sit down with Ms. Goldin to discuss her ideas," Robert Josephson, a spokesperson for Purdue Pharma, told Hyperallergic. "For more than 15 years, this company has supported many of the initiatives she is advocating, which includes collaborating with law enforcement, funding state prescription drug monitoring programs and enhancing their interoperability, and distributing the CDC Guideline for Prescribing Opioids for Chronic Pain." Josephson added that the company recently launched programs to educate teenagers about the dangers of opioids and funds grants that help provide law enforcement agencies with naloxone, an emergency medication that can rapidly reverse the effects of an opioid overdose. On its website, Purdue Pharma has further outlined **some of the initiatives** it has launched in response to the opioid crisis.

As of this writing, more than 5,500 people have signed **Goldin's petition** calling on Purdue Pharma to respond to the opioid crisis, including funding rehab centers and treatment programs, educating the public and doctors about the risks of OxyContin, and advertising the risks associated with the drug more prominently.

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United States District Court, N.D. California,
San Jose Division.

UNITED STATES of America, Plaintiff,
v.
Elizabeth A. HOLMES, Defendant.

Case No. 5:18-cr-00258-EJD-1
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Signed 05/21/2021
|
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ORDER RE: MOTIONS IN LIMINE

EDWARD J. DAVILA, United States District Judge

***1** On July 28, 2020, a federal grand jury returned a Third Superseding Indictment, charging Defendants Elizabeth Holmes and Ramesh "Sunny" Balwani with ten counts of wire fraud ("Counts 3 through 12"), in violation of 18 U.S.C. § 1343, and two counts of conspiracy to commit wire fraud ("Counts 1 through 2"), in violation of 18 U.S.C. § 1349. Third Superseding Indictment ("TSI"), Dkt. No. 469. Defendants were charged with making deceptive representations about their company, Theranos, and its technology.

In anticipation of trial, Holmes and the Government each filed motions in limine ("MIL"). Mots. in Limine, Dkt. Nos. 560-578, 588. Both parties timely opposed and replied in support of their respective motions. Dkt. Nos. 659-670, 672-678, 682, 704-721, 726, 740. The Court conducted hearings on May 4-6, 2021. Trs. of Proceedings, Dkt. Nos. 792-794. Having considered the parties' arguments, the relevant law, and the record in this case, the Court **GRANTS** in part and **DENIES** in part the following motions in limine, as set forth below.

I. BACKGROUND

Holmes founded Theranos, a health care and life sciences company, in 2003. TSI ¶ 1. Holmes served as the company's Chief Executive Officer. *Id*. Balwani was a board member, President, and Chief Operating Officer of Theranos. *Id*. ¶ 2.

Theranos' stated mission was to revolutionize medical laboratory testing through its allegedly innovative methods of drawing and testing blood and diagnosing patients. *Id*. ¶ 4. During the company's first ten years, its scientists worked toward developing proprietary technology that could run clinical tests using only tiny drops of blood. *Id*. ¶ 5. Theranos also worked toward developing a method for drawing a few drops of capillary blood from a patient's finger using a small lancet. *Id*. The blood was then stored in a "nanotainer." *Id*. Theranos sought to develop a second device called the Theranos Sample Processing Unit ("the TSPU," "Edison," or "miniLab") that could quickly and accurately analyze blood samples stored in the nanotainer. *Id*. The Government contends that the promises of these devices were never realized; the devices "consistently" produced inaccurate and unreliable results. *Id*. ¶ 16. Despite this, Defendants began a publicity campaign to promote the company and its devices. *Id*. ¶¶ 6-9. In September 2013, Theranos offered blood testing at Walgreens' "Wellness Centers" in California and Arizona. *Id*. ¶ 10.

The Government argues that Defendants conspired to commit and committed fraud through two fraudulent schemes: one to defraud investors and another to defraud doctors and patients. The Court outlines these schemes below.

Scheme to Defraud Investors. Defendants allegedly made materially false and misleading statements and failed to disclose material facts to investors. Based on the false statements, investors invested money in Theranos. Specifically, from 2013 to 2015, Defendants allegedly made misstatements regarding:

1. Theranos' proprietary analyzer: Defendants allegedly made misstatements about Theranos' proprietary analyzer—the TSPU, Edison, or miniLab—when they claimed the analyzer was presently capable of accomplishing certain tasks, with more precision than other blood tests, and at a faster rate, when they knew these statements were false. *Id*. ¶ 12(A).

***2** 2. Theranos' financial health: Defendants allegedly misrepresented Theranos' financial well-being when they

told investors the company was financially strong and stable and would make huge profits in 2014 and 2015 when, in fact, they knew Theranos would only generate modest revenue. *Id*. ¶ 12(B).

3. Technology demonstrations: Defendants allegedly deceived investors through misleading technology demonstrations intended to cause potential investors to believe blood tests were being conducted on Theranos' proprietary analyzer when Defendants knew the analyzer was operating in "null protocol." *Id*. ¶ 12(C).

4. Walgreens partnership: Defendants allegedly misled investors when they told them Theranos had an expanding partnership with Walgreens when the Walgreens rollout had stalled due to concerns with Theranos' performance. *Id*. ¶ 12(D).

5. United States Department of Defense ("DOD") relationship: Defendants allegedly told investors the company had a profitable and revenue-generating business relationship with the DOD and that Theranos technology was deployed on the battlefield. Defendants allegedly knew that Theranos had limited revenue from military contracts and that its technology was not used in the battlefield. *Id*. ¶ 12(E).

6. Food and Drug Administration ("FDA") approval: Defendants allegedly misled investors when they told them that Theranos did not need the FDA to approve its proprietary analyzer and tests when Defendants knew this to be false. *Id*. ¶ 12(F).

7. Patient testing: Defendants allegedly told investors that patient tests were conducted using Theranos manufactured analyzers. Defendants allegedly knew that Theranos used third-party, commercially available analyzers. *Id*. ¶ 12(G).

8. Peer review: Defendants allegedly falsely told investors that several national or multinational pharmaceutical companies and research institutions had examined, used, and validated Theranos technology. *Id*. ¶ 12(H).

9. Media representations: Defendants allegedly made the false and misleading statements described above to reporters and then shared the resulting articles directly with potential investors and via Theranos' website. *Id*. ¶ 12(I).

Scheme to Defraud Doctors and Patients. The Government argues that, from 2013 to 2016, Defendants advertised and marketed Theranos technology to doctors and patients, and falsely claimed that the tests were accurate and reliable. *Id*. ¶¶ 14-15. Their claims about Theranos technology were implicit and explicit. *Id*. ¶ 15. Despite knowing that Theranos' technology suffered from recurring accuracy and reliability problems, Defendants allegedly advertised the tests as accurate and reliable. *Id*. ¶¶ 16-17. Specifically, Defendants used materially false and misleading marketing materials and advertisements, and transmitted Theranos blood results that Defendants knew contained, or likely contained, inaccurate information. *Id*. ¶¶ 16-18. For instance, Theranos' public website touted its lab's ability to perform tests "quickly and accurately on samples as small as a single drop." *Id*. ¶ 9. Defendants also allegedly provided patients with reports that contained or were likely to contain: (1) inaccurate and unreliable results; (2) improperly adjusted reference ranges defining a normal or healthy result for a given test; (3) improperly removed "critical" results, i.e., results suggesting a patient needed medical attention; and (4) results generated from improperly validated assays, further decreasing the reliability of those tests. *Id*. ¶ 17(C).

II. LEGAL STANDARD

***3** Motions in limine are a "procedural mechanism to limit in advance testimony or evidence in a particular area." *United States v. Heller*, 551 F.3d 1108, 1111 (9th Cir. 2009). Like other pretrial motions, motions in limine are "useful tools to resolve issues which would otherwise clutter up the trial." *City of Pomona v. SQM N. Am. Corp.*, 866 F.3d 1060, 1070 (9th Cir. 2017). Accordingly, "a ruling on a motion in limine is essentially a preliminary opinion that falls entirely within the discretion of the district court." *Id*.; *see Luce v. United States*, 469 U.S. 38, 41 n.4, 105 S.Ct. 460, 83 L.Ed.2d 443 (1984) (explaining that a court may rule in limine "pursuant to the district court's inherent authority to manage the course of trials").

In many instances, however, rulings "should be deferred until trial, so that questions of foundation, relevancy, and potential prejudice may be resolved in proper context." *United States v. Pac. Gas & Elec. Co.* ("*PG&E*"), 178 F. Supp. 3d 927, 941 (N.D. Cal. 2016). For example, in order to exclude evidence on a motion in limine, "the evidence must be inadmissible on all potential grounds." *McConnell v. Wal-Mart Stores, Inc.*, 995 F. Supp. 2d 1164, 1167 (D. Nev. 2014). Thus, denial of a motion in limine to exclude certain evidence does not mean that all evidence contemplated by the motion will be admitted, only that the court is unable to make a comprehensive ruling in advance of trial. *Id*. at 1168. Moreover, even if a district

court does rule in limine, the court may "change its ruling at trial because testimony may bring facts to the district court's attention that it did not anticipate at the time of its initial ruling." *City of Pomona*, 866 F.3d at 1070; *see also Ohler v. United States*, 529 U.S. 753, 758 n.3, 120 S.Ct. 1851, 146 L.Ed.2d 826 (2000) ("[I]n limine rulings are not binding on the trial judge, and the judge may always change his mind during the course of a trial.").

A. Federal Rule of Evidence 401

Under Rule 401 of the Federal Rules of Evidence, evidence is relevant if "it has any tendency to make a fact more or less probable than it would be without the evidence...and the fact is of consequence in determining the action." Fed. R. Evid. 401(a)-(b). "Relevancy simply requires that the evidence logically advance a material aspect of the party's case." *United States v. Ruvalcaba-Garcia*, 923 F.3d 1183, 1188 (9th Cir. 2019) (internal quotations omitted).

B. Federal Rule of Evidence 403

Even if evidence is relevant, it must be excluded if its "probative value is substantially outweighed by a danger of...unfair prejudice, confusing the issues, [or] misleading the jury." Fed. R. Evid. 403. Evidence is unfairly prejudicial when it has "an undue tendency to suggest decision on an improper basis, commonly, though not necessarily, an emotional one." *Old Chief v. United States*, 519 U.S. 172, 180, 117 S.Ct. 644, 136 L.Ed.2d 574 (1997). "Unfair prejudice can result from evidence that makes it more likely for a juror 'to defer to findings and determinations relevant to credibility made by an authoritative, professional factfinder rather than determine those issues for themselves.' " *United States v. Sine*, 493 F.3d 1021 (9th Cir. 1992).

C. Federal Rule of Evidence 802

Hearsay evidence is inadmissible unless otherwise provided for under a federal statute, the Federal Rules of Evidence, or "other rules prescribed by the Supreme Court." Fed. R. Evid. 802. Hearsay is a statement "the declarant does not make while testifying at the current trial or hearing" and which "a party offers in evidence to prove the truth of the matter asserted in the statement." Fed. R. Evid. 801. "Hearsay within hearsay" is only admissible "if each part of the combined statements conforms with an exception to the rule." Fed. R. Evid. 805.

III. HOLMES'S MOTIONS IN LIMINE AND RELATED GOVERNMENT MOTIONS

A. Holmes's MIL to Exclude Evidence Concerning Wealth, Spending, And Lifestyle (Dkt. No. 567)

***4** The Government argues that during her tenure as founder and Chief Executive Officer ("CEO") of Theranos, Holmes engaged in a widespread fraudulent scheme to defraud investors and obtain money and property under false pretenses. In addition to amassing millions of dollars for the company, Holmes obtained significant personal benefits arising from her position. She received a generous salary, which allowed her to live a luxurious lifestyle replete with an expensive rental home, a luxury SUV, and assorted high-end merchandise. Decl. of Amy Mason Saharia in Supp. of Holmes's Mot. to Strike Rule 404(b) Notice or, in the Alternative, Compel Adequate Rule 404(b) Disclosure, Dkt. No. 421-1, Ex. A at 9. Holmes also utilized company funds to pay for luxury travel and accommodations. *Id*. Additionally, she routinely assigned her personal assistant to non-company tasks, such as personal shopping and product returns. *Id*.

The Government argues these benefits extend to non-tangible experiences that enhanced Holmes's status in society. *Id*. In particular, she was hailed as a visionary businesswoman in numerous publications. *Id*. This increased publicity allowed her to associate with "celebrities, dignitaries, and other wealthy and powerful individuals." *Id*.

The Government seeks to introduce evidence of these tangible and non-tangible benefits to show Holmes's motive, opportunity, intent, preparation, plan, knowledge, identity, consciousness of guilt, or absence of mistake or accident under Federal Rule of Evidence 404(b). Holmes moves to preclude the government from introducing this evidence on two grounds. *See* Holmes's Mot. in Limine to Exclude Evidence Concerning Wealth, Spending and Lifestyle Under Rules 401-403 ("Holmes 567 Mot."), Dkt. No. 567. First, Holmes argues this evidence is irrelevant to any fact of consequence in this proceeding. Fed. R. Evid. 401, 402. Second, even if deemed relevant, Holmes argues the probative value of this evidence is substantially outweighed by the prejudicial danger of misleading the jury to base their decision on improper basis, as well as confusing the issue and needlessly wasting the Court's time. Fed. R. Evid. 403.

The issue of evidence of wealth, particularly lack thereof, "is something of an old chestnut in the law of evidence." *United States v. Mitchell*, 172 F.3d 1104, 1108 (9th Cir. 1999). In

Mitchell, the trial court admitted evidence of the defendant's poverty to prove motive to commit a bank robbery. *Id*. The Ninth Circuit reversed because evidence of wealth or poverty without a nexus to an "inclination, desperation, or other evidence that the person was likely to commit the crime" is not relevant. *Id*. at 1109. Ultimately, the evidence must show "more that the mere fact that the defendant is poor." *Id*. (quoting *United States v. Jackson*, 882 F.2d 1444, 1449 (9th Cir. 1989) (upholding trial court's admission of evidence of financial difficulty given the "unexplained and abrupt change in that status")).

However, the force of *Mitchell*'s holding is diminished because "wealth evidence, unlike poverty evidence, does not entail the same risk of unfair prejudice." *United States v. Flores*, 510 F. App'x 594, 595 (9th Cir. 2013). As with evidence of poverty, evidence of wealth or lavish lifestyle is not admissible standing alone but may be admissible to prove motive, knowledge, or intent. *See United States v. Weygandt*, 681 F. App'x 630, 633 (9th Cir. 2017) (evidence of wealth admissible to show defendant could have purchased necessary equipment but chose not to in order to enhance wealth); *United States v. Reyes*, 660 F.3d 454, 464 (9th Cir. 2011) (evidence of gains from stock option backdating is admissible to permit "jury to draw a reasonable inference that [defendant] knew what he was doing"). Nonetheless, evidence of an individual's lavish spending habits, without a connection to an individual's participation in criminal activity, is irrelevant. *See United States v. Hatfield*, 685 F. Supp. 2d 320, 326 (E.D.N.Y. 2010) ("[I]t is irrelevant if [defendant] spent his fortune on lavish parties, instead of donating it to starving Malawian orphans.").

***5** Holmes argues that evidence regarding her wealth and lifestyle is irrelevant because it has no bearing on any fact of consequence. She notes the factual issues for the jury are whether she participated in (1) a scheme to defraud investors or paying patients, through (2) the use of wire, radio or television and with (3) a specific intent to defraud those investors and paying patients. Holmes 567 Mot. at 2. Holmes argues that the evidence of wealth and lavish lifestyle lack a "particularized connection to the alleged conduct." Holmes Reply Br. In Supp. of Holmes's 567 Mot. ("Holmes 567 Reply"), Dkt. No. 710, at 2. The Government contends that the evidence is relevant because it represents the fruit of Holmes's fraudulent scheme. Gov't Opp'n to Holmes's 567 Mot. ("Gov't 567 Opp'n"), Dkt. No. 663, at 2. Further, the accumulation of these items indicates that "she intended to defraud in order to obtain those benefits" and further motivated her "to continue and conceal her fraud." *Id.*

The Government's arguments come close to the impermissible use of evidence to show Holmes was wealthy and wished to become wealthier. On its face, this does not appear to have the requisite connection to the alleged conduct required under case law. Despite this shortcoming, the Government's theory of relevance has some merit. As in *Reyes*, each time Holmes made an extravagant purchase, it is reasonable to infer that she knew her fraudulent activity allowed her to pay for those items. *See Reyes*, 660 F.3d at 464. While the benefits of these purchases are not as directly tied to the fraud as backdating stocks was in *Reyes*, it may still be probative of Holmes's scienter. Therefore, this evidence passes the minimal threshold for relevance.

Nevertheless, the Court in its discretion "may exclude relevant evidence if its probative value is substantially outweighed by a danger of...unfair prejudice." Fed. R. Evid. 403. Unfair prejudice "speaks to the capacity of some concededly relevant evidence to lure the factfinder into declaring guilt on a ground different from proof specific to the offense charged." *Old Chief*, 519 U.S. at 180, 117 S.Ct. 644. In this particular context, evidence of Holmes's wealth can be construed as "appeals to class prejudice" which are considered "highly improper" because they "may so poison the minds of jurors even in a strong case that an accused may be deprived of a fair trial." *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 239–40, 60 S.Ct. 811, 84 L.Ed. 1129 (1940). Appeals to class prejudice that are "obvious" and "persistent" are unfairly prejudicial. *United States v. Stahl*, 616 F.2d 30, 32–33 (2d Cir. 1980) (discussing an overzealous prosecutor's entire trial strategy centered on inflaming prejudice against the defendant's wealth, readily apparent from the prosecutor's opening argument, witness interrogation, and closing argument).

At the hearing, the Government indicated that Holmes's desire to maintain her lifestyle as Theranos CEO and founder and all the accompanying celebrity and benefits (financial or otherwise) were motivating factors for her to continue to engage in the fraudulent conduct alleged in the indictment. The Government argues that its case does not center on a persistent appeal to class prejudice, as in *Stahl*, but rather that the desire for wealth is a piece in a complex puzzle comprising Holmes's intent to perpetuate this broad-ranging fraud. However, this balance is complicated by the fact that the evidence of her wealth and fame is not highly

(or even moderately) probative of intent to defraud. When one combines the fact that this case implicates potentially dangerous technology with an argument concerning an individual's greed, jurors could easily "judge the merits of this matter by their attitudes about such things." Holmes 567 Reply at 5.

The evidence of Holmes's position as CEO and founder will undoubtedly be introduced at trial. As discussed at the hearing, it is common knowledge that CEOs and heads of Silicon Valley technology companies enjoy lifestyles commensurate with those positions that are significantly different than those of the general public. The Government may introduce evidence that Holmes enjoyed a lifestyle as Theranos CEO that is comparable to those of other tech company CEOs. This includes salary, travel, celebrity, and other perks and benefits commensurate with the position. However, references to specific purchases or details reflecting branding of clothing, hotels, or other personal items is not relevant, and the prejudicial effect of that evidence outweighs any probative value.

***6** Based on the foregoing, the Court **GRANTS IN PART** Holmes's MIL to exclude evidence referencing her wealth, spending, and lifestyle that is outside the general nature of her position as Theranos CEO. As noted at the hearing, the Court may revisit this ruling should circumstances warrant.

B. Holmes's MIL to Exclude FDA Inspection Evidence (Dkt. No. 573)

In August of 2013, "Theranos contacted [the] FDA (the Food and Drug Administration) with a proposal to submit for FDA clearance the [laboratory developed tests] that would be run on Theranos' proprietary devices in its...laboratory." Holmes's Mot. in Limine to Exclude FDA Inspection Evidence Under Rules 401-404 and 801-803 ("Holmes 573 Mot."), Dkt. No. 573, at 2. By the winter of 2013, "Theranos and [the] FDA agreed to a submission plan to accomplish that goal." *Id*. One aspect of this plan concerned Theranos' nanotainer. *See id*. On August 25, 2015, "FDA conducted unannounced inspections at Theranos' laboratories in California and Arizona." *Id*. These inspections partly focused on making sure the nanotainers were properly classified and identifying whether certain regulations applied to them. *Id*. at 3. The FDA ceased its inspection of Theranos' Arizona lab "without making any observations, but continued its inspection of the California laboratory until September 16, 2015." *Id*. at 2–3.

Holmes now moves to exclude "evidence of or reference to, [the FDA's] 2015 inspections of Theranos." *Id.* at 1. Holmes's motion refers specifically to 27 exhibits that "relate to FDA's inspections," and that were "identified by the Government...as proposed exhibits." *Id*. at 3. These exhibits ("the FDA inspection evidence") encompass the documented observations of the FDA (Forms 483),[1] internal emails among FDA agents, and records of communications between Holmes and Ramesh "Sunny" Balwani made during and about the FDA inspection. *Id*. at 1–4. Holmes argues that "[t]hese documents should be excluded along with any corresponding testimony offered by the government."[2] *Id*. at 3–4.

1 In her motion, Holmes explains Forms 483 by referencing a website, "FDA Form 483 Frequently Asked Questions," https://www.fda.gov/inspections-compliance-enforcement-and-criminal-investigations/inspection-references/fda-form-483-frequently-asked-questions. *See* Holmes 573 Mot. at 3, n.6. This website states, among other things, the following: "An FDA Form 483 is issued to firm management at the conclusion of an inspection when an investigator(s) has observed any conditions that in their judgment may constitute violations of the Food Drug and Cosmetic (FD&C) Act and related Acts.

2 Holmes specifically mentions that "the [G]overnment has indicated that it intends to elicit testimony from FDA's Director of Chemistry and Toxicology Devices, Dr. Courtney Lias, during the case in chief." Holmes 573 Mot. at 4.

Holmes argues that the FDA inspection evidence should be excluded for four reasons: it is not relevant; it is unfairly prejudicial under Rule 403; it is inadmissible character and propensity evidence, under Rule 404; and it is inadmissible hearsay.

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Relevance

The Court finds that evidence arising out of the FDA inspection of the Theranos lab in California is relevant as to Holmes's state of mind, intent, and knowledge regarding the alleged misrepresentations about the accuracy and reliability

of Theranos' blood tests. The FDA inspection evidence would have a tendency to show knowledge of issues with the nanotainer and failings in Theranos' technology. This, in turn, could support the Government's theory of the case: that Holmes made representations that Theranos could provide accurate, fast, reliable, and cheap blood tests and test results despite knowing that their technology was not capable of doing so.

***7** Holmes asserts several reasons why the FDA inspection evidence is irrelevant. Holmes 573 Mot. at 5–6. For example, Holmes asserts that the last equity round closed before the inspection took place, and therefore, the FDA inspection evidence could not have informed her knowledge, state of mind, or motive at the time of the alleged misstatements to investors. Holmes further argues that the FDA inspection evidence does not prove FDA approvals or clearances for any Theranos product were, in fact, required. Holmes also suggests that the FDA inspection pertained primarily to nanotainers, whereas the FDA-related allegation in the indictment refers to Theranos' proprietary analyzer and tests. More generally, Holmes states that the FDA inspection is too limited in scope because, for example, "[t]he FDA inspectors made no findings regarding the performance of Theranos' laboratory or the accuracy and reliability of Theranos' blood tests." Holmes's Reply Br. in Supp. of Holmes 573 Mot. ("Holmes 573 Reply"), Dkt. No. 716, at 3. In the end, however, the Federal Rules of Evidence set a low bar for relevance. *See* Fed. R. Evid. 401 (defining "relevant evidence" as "evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence"). "[T]he requirements of Federal Rule of Evidence 401 are not especially stringent." *Rios v. Tilton*, No. 2:07-cv-0790 KJN P, 2016 WL 29567, at *6 (E.D. Cal. Jan. 4, 2016) (citing *Slaughter-Payne v. Shinseki*, 522 F. A'ppx 409, 410 (9th Cir. 2013) (noting the "low bar for relevancy under Federal Rule of Evidence 401.")); *see also United States v. Miranda-Uriarte*, 649 F.2d 1345, 1353 (9th Cir. 1981) (same); *Sandoval v. Cty. of San Diego*, 985 F.3d 657, 666 (9th Cir. 2021) (same).

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Unfair prejudice

Holmes argues that admitting the FDA inspection evidence would be unfairly prejudicial. According to Holmes, admitting such evidence presents a risk that the jury would perceive the FDA's unannounced inspections of Theranos and the technical and purportedly authoritative forms and communications arising out of those inspections as indicative of guilt. Holmes cites as analogs *Curtis v. M&S Petroleum, Inc.*, 174 F.3d 661, 673 (5th Cir. 1999) (holding that Mississippi Department of Environmental Quality evidence was properly excluded, in part, because "[that agency's] evidence of likely violations of environmental regulations would have been unduly prejudicial due to its apparent official nature"), and *Smith v. I-Flow Corp.*, No. 09 C 3908, 2011 WL 12627557, at *2 (N.D. Ill. June 15, 2011) (holding that an FDA warning letter was to be excluded as unfairly prejudicial). Holmes 573 Mot. at 7. These cases are unhelpful. In *Curtis*, the primary basis for evidence exclusion was that the evidence was cumulative, and *Smith* lacks a meaningful analysis.

Having weighed the risk of unfair prejudice against the probative value of the evidence, the Court finds that the evidence is more probative than prejudicial. The nature and scope of inspections can be explored through witness testimony to provide information and context of the process.

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Inadmissible character and propensity evidence

Holmes next argues that the FDA inspection evidence should be excluded per Rule 404. Holmes is concerned that the Government will proffer evidence of purported pushback by Theranos personnel on FDA's tactics and theories during the inspection as improper propensity evidence against Holmes.

The Court finds that the FDA inspection evidence is not propensity evidence, but rather evidence that is probative of Holmes's state of mind, intent, and knowledge. Specifically, the evidence has a tendency to show Holmes' state of mind regarding Theranos' interactions with the regulatory agencies, the extent to which Holmes knew or should have known that Theranos was failing to meet certain federal regulations, and whether Holmes intended to mislead investors regarding the accuracy and reliability of Theranos' technology. The Court declines to exclude the evidence on Rule 404 grounds at this time.

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Inadmissible hearsay

Holmes also argues that the FDA inspection evidence is inadmissible hearsay. Specifically, Holmes relies on Rule 803(8)(A)(iii), which provides that public records that contain factual findings from legally authorized investigations are admissible only "in a civil case or against the government in a criminal case." Fed. R. Evid. 808(8)(A)(iii)). Citing *United States v. Orellana-Blanco*, 294 F.3d 1143, 1149 (9th Cir. 2002), Holmes argues that because the FDA inspection evidence constitutes public records prepared by a government agency and because the evidence is not being used in a civil case or against the government in a criminal case, the evidence is inadmissible. Holmes 573 Mot. at 8.

***8** In opposition, the Government looks to Rule 803(8)(A)(ii), which states that the rule against hearsay does not exclude "[a] record or statement of a public official...[setting out] a matter observed while under a legal duty to report, but not including, in a criminal case, a matter observed by law-enforcement personnel." Fed. R. Evid. 803(8)(A)(ii).

The Court finds the FDA inspection was a "matter observed while under a legal duty to report." Fed. R. Evid. 803(8)(A)(ii); *see, e.g.*, *United States v. Fryberg*, 854 F.3d 1126, 1131 (9th Cir. 2017) (holding that "[t]he pertinent question [as to what is a 'matter observed while under a legal duty to report'] is whether the creation and maintenance of the record at issue is appropriate to the function of the relevant government office, given the nature of the responsibilities assigned to that office" (internal citations omitted)). The FDA's inspection report consists largely of observations and, in that sense, is comparable to reports prepared by non-law enforcement civil government employees such as city building inspectors, medical examiners, and prison case managers. *See, e.g.*, *United States v. Hansen*, 583 F.2d 325, 333 (7th Cir. 1978) (building inspectors enforcing building code did not qualify as law enforcement personnel under Rule 803(8)(A)(ii)); *United States v. Rosa*, 11 F.3d 315 (2d Cir. 1993) (medical examiners required to investigate unnatural deaths and to refer situations indicating criminality to a district attorney did not qualify as law enforcement personnel under Rule 803(8)(A)(ii)); *Manocchio v. Moran*, 919 F.2d 770, 777 (1st Cir. 1990) (medical examiner's autopsy report should not be excluded under Rule 803(8)(A)(ii)); *United States v. Edelmann*, 458 F.3d 791, 813–14 (8th Cir. 2006) (report made by an inmate systems manager should not be excluded under Rule 803(8)(A)(ii) because the manager was not law enforcement personnel and the report was produced in the normal course of duties). There are portions of the report that go beyond mere observations and include some level of analysis by FDA inspectors; however, those portions comprise only a minor portion of the report. As noted below, the Court is open to continued discussions on this issue should Holmes wish to raise arguments to certain specific pieces of evidence within the FDA inspection evidence that involve such a high degree of observer analysis that they might not be admissible under Rule 803(8)(A)(ii). [3]

3 Holmes's reply brief inaccurately represents the holding of *United States v. Cerda-Ramirez*, 730 F. App'x 449, 452 (9th Cir. 2018). Holmes 573 Reply at 8. The Ninth Circuit's decision hinged at least partly on the presence of an adversarial setting, and not solely on whether an independent judgment was made by the observer. *See Cerda-Ramirez*, 730 F. App'x at 452.

Holmes argues that even if Rule 803(8)(A)(ii) applies, the FDA inspectors were acting as law enforcement personnel because the inspection was unannounced, the FDA has the power to levy criminal sanctions (including terms of imprisonment), and "[t]he [G]overnment's case agent for this prosecution is a Special Agent in FDA's Office of Criminal Investigations." Holmes 716 Reply at 5–9. Holmes argues that the FDA is similar to the IRS, which the Second Circuit has described as having a "law enforcement function. *Id*. at 7 (citing *United States v. Ruffin*, 575 F.2d 346, 356 (2d Cir. 1978)).

***9** For the purposes of determining whether the FDA inspectors acted as law enforcement personnel, the Court applies the case law of the Ninth Circuit and finds that the FDA inspectors did not act as law enforcement personnel. Under the Ninth Circuit's "narrow understanding of the law enforcement exception [of Rule 803(8)(A)(ii)]," "the purpose of the law enforcement exception is to exclude observations made by officials at the scene of the crime or apprehension, because observations made in an adversarial setting are less reliable than observations made by public officials in other situations." *Fryberg*, 854 F.3d at 1132 (citations omitted). The FDA inspectors, in carrying out their duties of inspecting the Theranos lab, do not appear to have been making observations in an adversarial setting that raises doubts about the reliability of the observations. *Compare id. with Ruffin*, 575 F.2d 346 (Second Circuit applied a relatively expansive reading of

the 'law-enforcement personnel' exclusion of Rule 803(8)(A)(ii)).

The FDA's inspection appears to have been at least to some extent unannounced, and in oral arguments before the court, the two parties presented differing accounts as to whether the inspection is more properly characterized as having been part of a for-cause reactionary process prompted by complaints and/or concerns regarding Theranos, or as part of a routine process that Theranos itself requested. May 5, 2021 Hr'g Tr., Dkt. 793, at 104:22-23 ("Mr. Looby (for Holmes): This [was] a for[-]cause inspection that was initiated by the FDA and [was] actually more or less unannounced."); *but see id*. at 118:14–120:3 ("The Court: So I asked Mr. Looby (Counsel for Holmes) a question about the timing of this inspection and whether it was a request or...voluntary. And I think he said no, it was not [voluntary]....Didn't Theranos...seek approval from the FDA in 2013 and then were was – between 2013 and 2015 obviously there were, I presume, some conversations [between Theranos and the FDA], and then ultimately unannounced the FDA shows up to do the inspection for that request I suppose for certification. Is that the event here? Mr. Leach (for the Government): That is largely correct, Your Honor....There was a dialogue between Theranos and the FDA throughout 2013 and 2014. The 2015 inspection is unannounced. The Court: Was [the FDA's] showing up [at the Theranos laboratory], it sounds like it was connected to [Theranos'] original request to approve [Theranos'] device. Mr. Leach: I guess that's a fair inference, Your Honor.")). Nevertheless, the inspectors who carried out the inspection were not part of a criminal division of the FDA. While the atmosphere at the California laboratory during the inspections may have been contentious, and while there may have been the latent threat of sanctions given the regulatory nature of the FDA, the collection of the FDA inspection evidence is more like the routine, ministerial work of the recording of the license plates in *United States v. Orozco*, 590 F.2d 789 (9th Cir. 1979), and less like the adversarial work of the administering of the immigration interview in *Orellana-Blanco*, or the filing of the criminal complaint and affidavit in *Cerda-Ramirez*.

Lastly, Holmes's Rule 803(8)(B) argument is undeveloped and unsupported. For the reasons given above, the Court declines to exclude the FDA inspection evidence on hearsay grounds at this time.

The motion to exclude FDA inspection evidence is **DEFERRED**. The Court acknowledges the possibility for further side bar discussions on this matter, should Holmes wish to specify certain exhibits within this collection of evidence and make new arguments as to why these particular exhibits should still be excluded.

C. Holmes's MIL to Exclude Evidence of CMS Survey Findings and Sanctions (Dkt. No. 574)

CMS "audits laboratories to identify non-compliance with [the mandates of the Clinical Laboratory Improvement Amendments of 1988 ('CLIA')]." Holmes's Mot. in Limine to Exclude Evidence of CMS Survey Finding and Sanctions Pursuant to Rules 401-403 and 801-803 ("Holmes 574 Mot."), Dkt. No. 574, at 1–2. Because Theranos "perform[ed] clinical diagnostic testing on human samples," its laboratories were required to be in compliance with CLIA. *Id*. at 1. In September and November 2015, CMS conducted a recertification and complaint survey of Theranos' Newark lab. *Id*. at 2. According to Holmes, usually a state agency carries out recertification surveys, but in this case CMS decided to carry out the survey "due to the media attention Theranos was receiving at the time and due to complaints CMS had received about Theranos."[4] *Id*. at 2 (citing Saharia Decl., Ex. 34, Dkt. No. 584 at 2-3). Holmes suggests "[i]t was unusual for CMS both to conduct the survey and to send 'central office personnel...out on the Theranos survey." *Id*. (citing Saharia Decl., Ex. 34, Dkt. No. at 3).

4 Holmes suggests that, in making this decision, CMS may have been influenced by Wall Street Reporter John Carreyrou. Dkt. No. 574 at 2, n. 1 (citing Saharia Decl., Ex. 34 at 3).

***10** On January 25, 2016, CMS issued a letter and a Form 2567 summarizing the findings of the survey. *Id*. These documents stated that "Theranos' California laboratory was in violation of various CLIA requirements," and "warned Theranos that if it did not remediate these deficiencies within 10 days, CMS would impose sanctions." *Id*. at 3. Subsequently, Theranos and CMS engaged in communications that included Theranos' "outlin[ing] steps it was taking to resolve CMS's claimed deficiencies." *Id*. (citing Saharia Decl., Ex. 27, Dkt. No. 583-1 at 2). CMS did impose sanctions on Theranos' Newark laboratory. *Id*. (citing Saharia Decl., Ex. 30, Dkt. No. 583-4). Shortly thereafter, CMS surveyed Theranos' Arizona laboratory, cited it for various CLIA violations and imposed sanctions. *Id*. (citing Saharia Decl., Exs. 31-33, Dkt. No. 584-1, 584-2). Theranos

appealed both sets of sanctions, but Theranos and CMS made settlements before the adjudication of these appeals. [5] *Id*.

5 Evidence regarding these settlements and "the remedial measures that Theranos...adopted in response to the CMS survey findings" are the subjects of a separate motion(s) to exclude evidence. Dkt. No. 574 at 3, n. 1.

Holmes moves to exclude "evidence relating to the findings of surveys of Theranos' clinical laboratories conducted by [CMS] in 2015 and 2016, including survey findings and sanctions imposed by CMS." Holmes 574 Mot. at 1. Holmes argues that the evidence of CMS survey findings and sanctions should be excluded as irrelevant, unfairly prejudicial, and inadmissible hearsay.

Relatedly, the Government moves to include "CMS'[s] January 26, 2016 Form CMS-2567, Statement of Deficiencies." United States' Mots. In Limine ("Gov't Mot.") at 8-10, Dkt. No. 588. The Government argues that the January 26, 2016 Form CMS-2567, Statement of Deficiencies — which appears to fall within the set of CMS evidence Holmes moves to exclude—should be admitted for reasons that overlap with the arguments provided in the Government's opposition to Holmes's motion to exclude the CMS survey. *See* Gov't Opp'n to Holmes 675 Mot. ("Gov't 574 Opp'n"), Dkt. No. 675. Accordingly, the Court will focus on the arguments both parties made regarding Holmes's motion to exclude the evidence of CMS survey findings and sanctions. The outcome of this analysis is also determinative of the arguments pertaining to the Government's MIL No. 6 to admit the January 2016 CMS form.

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Relevance

The Court finds that the evidence of CMS survey findings and sanctions meets Rule 401's low bar for relevancy. Although the purpose of the CMS survey was not to assess either the accuracy or reliability of Theranos technology, the CMS survey findings and sanctions indicate violations of federal regulations that themselves are meant to ensure, among other things, the accuracy and reliability of certain kinds of clinical laboratory work. The evidence therefore appears to be relevant to questions about Holmes's state of mind, intent, and knowledge regarding the alleged misrepresentations about the accuracy and reliability of Theranos' blood tests.

Holmes cites *PG&E*, where a court found that a report by the National Transportation Safety Board was inadmissible in an action against a company because, even though the report noted regulatory violations made by the company, the report did not pertain to the allegations against the company. 178 F. Supp. 3d 927 (N.D. Cal. 2016). That case, however, is distinguishable for the reasons the Government articulates. In *PG&E*, the court excluded a report about a company's culpability for causing an explosion because the company's alleged obstruction of the investigation was at issue, not the explosion. *Id.* at 947–48. Whereas a report about a company's role in causing an explosion may not be relevant to that company's alleged obstruction of an investigation, a report indicating a company's CLIA violations may be relevant to that company's alleged misrepresentations of the accuracy and reliability of its products.

***11** Holmes also argues that the evidence of CMS survey findings and sanctions cannot be used to show her intent for alleged actions that occurred prior to the CMS surveys, because there is no showing that she was aware of the information in the reports. The argument misconstrues the Government's point. The Government is not arguing that Holmes's actual knowledge of the evidence of CMS survey findings and sanctions indicates that Holmes must have known she was participating in a fraudulent scheme. The Government is instead arguing that the evidence tends to show Holmes's state of mind, knowledge, and intent regarding her representations to investors regarding the accuracy and reliability of Theranos' technology.

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Unfair prejudice

Holmes argues that the evidence of CMS survey findings and sanctions is unfairly prejudicial, raising the same points she stated to argue relevancy, which the Court will not revisit here. Holmes makes the additional argument that the potential for unfair prejudice is great primarily because (1) the jury will put special weight on the CMS survey findings and (2) the jury might improperly equate CMS's findings with the government's allegation that Theranos technology was not capable of producing accurate and reliable results. Holmes is particularly concerned with the Government's repeated references to the CMS's finding of "immediate jeopardy." Holmes cites to *United States v. Wolf*, 820 F.2d 1499, 1504 (9th Cir. 1987), *United States v. White Eagle*, 721 F.3d 1108,

1114 (9th Cir. 2013), *United States v. Christo*, 614 F.2d 486, 492 (5th Cir. 1980), and *United States v. Riddle*, 103 F.3d 423, 431 (5th Cir. 1997).

The Court does not see that the evidence in question raises the same kind of unfair prejudice concerns indicated in *Wolf*, *White Eagle*, and *Christo*. In each of these cases except *Riddle*, the courts found Rule 403 violations when parties relied on evidence of violations of civil regulations to prove similar criminal violations. Here, the Government is attempting to introduce evidence of violations of civil regulations for the purposes of showing Holmes's state of mind, intent, and knowledge, not for the purpose of arguing that Holmes is guilty of committing a criminal violation parallel to the civil violations indicated by the CMS survey findings and sanctions. *Riddle* is inapposite because in that case the court found that the evidence in question was largely irrelevant to the charges brought. 103 F.3d at 431. Having weighed the risk of unfair prejudice against the probative value of the evidence, the Court at this time finds that the evidence is more probative than prejudicial.

Inadmissible hearsay

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Holmes argues that evidence of CMS survey findings and sanctions is hearsay. Holmes's arguments are effectively the same hearsay arguments made with respect to the FDA inspection evidence, and the Court will not address them again here. [6] *See supra* Section III.B. Holmes relies on an additional case, *United States v. Murgio*, No. 15-cr-769(AJN), 2017 WL 365496, at *7, 9 (S.D.N.Y. Jan. 20, 2017), in support of her hearsay objection; however, the case is distinguishable. In *Murgio*, the court found that the evidence alleged to be hearsay not only included legal conclusions and evaluative conclusions, but also was itself based partially on evidence not directly observed by the relevant public agency. *See id.* at *9–10 ("[T]he Government itself admits that the findings in the [evidence alleged to be inadmissible hearsay] are based upon (1) the [agency's] own observations and records gathered during the course of [the] examinations...and (2) the [agency's] independent evaluation of evidence gathered in the criminal investigation, which the Government supplied to the [agency]." (internal quotation marks removed)). Moreover, *Murgio* appears to follow the Second Circuit's relatively expansive reading of the 'law-enforcement personnel' exclusion of Rule 803(8)(A)(ii), which contrasts with the Ninth Circuit's more narrow reading. *Compare Ruffin*, 575 F.2d at 356 *with Fryberg*, 854 F.3d at 1132.

6 Holmes raises one additional argument: that the Evidence of CMS Survey Findings and Sanctions itself contains out-of-court statements made by Theranos personnel that are inadmissible hearsay within hearsay. In response, the Government argues that the statements by Theranos employees that were included in CMS's Form 2567 report are not inadmissible hearsay because the statements were authorized admissions and statements of an agent or employee within the meaning of Federal Rule of Evidence 80[1](d)(2). This argument is addressed later in the context of the Government's MIL No. 8.

***12** For the reasons given above, the Court **DENIES** Holmes's motion to exclude the evidence arising out of the CMS surveys in question. The Court **GRANTS** the Government's motion to admit the January 26, 2016 Form CMS-2567, Statement of Deficiencies. The Court acknowledges the possibility for further side bar discussions on this matter, should parties wish to specify certain exhibits within this collection of evidence and make new arguments as to why these particular exhibits should still be excluded.

D. Holmes's MIL to Exclude Evidence Relating to Theranos' Interactions with Government Regulatory Agencies (Dkt. No. 575)

Holmes moves to exclude certain evidence relating to Theranos' interactions with government agencies. Holmes's Mot. in Limine to Exclude Certain Evidence Relating to Theranos' Interactions with Government Regulatory Agencies Under Rules 401-404 and 801-803 ("Holmes 575 Mot."), Dkt. No. 575, at 1. Specifically, she seeks to exclude three categories of evidence involving two agencies over a period of two years: (1) an on-site inspection performed by the California Department of Public Health ("CDPH") in December 2013; (2) interactions between Theranos representatives and the Centers for Medicare & Medicaid Studies ("CMS") in September 2015; and (3) Theranos' decision to employ a CMS-qualified laboratory director, Dr. Sunil Dhawan, in 2014 and 2015. *Id*. Holmes also refers to a fourth category of evidence that includes unidentified evidence of representations made by Theranos to other regulatory organizations. *See id*. at 16. The Court addresses each category in turn.

1. Evidence relating to the December 2014 CDPH inspection Under the Clinical Laboratory Improvement Amendments Act of 1988 ("CLIA"), 42

U.S.C. § 263a, CMS regulates all laboratory testing performed on human samples in the United States. Holmes 575 Mot. at 2. CMS deputizes certain accreditation responsibilities to qualified state agencies—in California, the CDPH's Laboratory Field Services section is responsible for accreditation and compliance of CLIA-certified laboratories. *Id.* As part of the accreditation and compliance process, CDPH generally performs biennial onsite inspections for CLIA laboratories in California. *Id*.

In December 2013, CDPH inspected a Theranos laboratory. *See id*. at 5. Pursuant to this inspection, CDPH produced a report that identified three deficiencies, which the Government seeks to introduce this report as evidence probative of Holmes's state of mind, intent, and knowledge regarding the status of Theranos' laboratories and technology. *Id*. (citing Decl. of Amy Saharia in Support of Holmes's Mots. in Limine and *Daubert* Mots. to Exclude Expert Testimony ("Saharia Decl."), Dkt. No. 579, Ex. 2 at 12–13 (Apr. 3, 2020 Gov't Supp. Rule 404(b) Notice)). The Government also seeks to introduce (1) an FBI report summarizing an interview of a Theranos CLIA lab employee, and (2) an email from Theranos employee Daniel Young to then-laboratory director Adam Rosendorff. *Id*. (citing Saharia Decl., Ex. 3 at 13, 65). The Government seeks to introduce this memorandum and email as evidence probative of Holmes's state of mind, intent, and knowledge, under the theory that the memorandum and email show that Balwani and others "misled an inspector into believing that the Theranos CLIA laboratory was limited to a single area." *Id*. (citing Saharia Decl., Ex. 1 at 7 (Mar. 6, 2020 Gov't Rule 404(b) Notice)).

Holmes argues that the CDPH inspection evidence should be excluded as irrelevant under Rules 401 and 402, as unfairly prejudicial under Rule 403, as improper propensity evidence under Rule 404, and inadmissible hearsay.

***13** Editor's Note: Tabular or graphical material not displayable at this time.

Relevance

Holmes argues the evidence is irrelevant for four reasons. First, she argues the CDPH report does not indicate that Holmes made misrepresentations about Theranos' ability to provide accurate and reliable results. Holmes 575 Mot. at 6. Second, Holmes contends the CDPH inspection findings do not tend to show that Theranos was unable to provide accurate and reliable results. *Id*. (citing Saharia Decl., Ex. 3 at 65). Third, Holmes says the Government has not sufficiently shown that the alleged misleading of the CDPH inspector amounted to a false representation, or that Holmes had sufficient knowledge or intent regarding that incident. *Id*. at 7– 8. Fourth, Holmes contends that "the evidence relating to...Balwani's supposed directions to staff [allegedly misleading the CDPH inspector] does not bear on the accuracy and reliability of Theranos' test results," suggesting that any directions regarding where to lead an inspector may have been made for legitimate and regulation-compliant reasons, such as avoiding the disruption of lab work. *Id*. at 8–9.

Holmes's arguments go to the weight of the evidence, not admissibility. The Court finds that the CDPH inspection evidence is relevant under Rule 401. The CDPH report appears to indicate violations of federal regulations that themselves are meant to ensure, among other things, the accuracy and reliability of certain kinds of clinical laboratory work. The fact that the CDPH later noted that the violations had been addressed satisfactorily does not negate the report's probative value regarding Holmes's state of mind, intent, and knowledge as to the accuracy and reliability of Theranos' laboratory procedures and blood tests. The FBI memorandum and Young's email also appear relevant to and probative of her knowledge, intent, notice, and absence of mistake regarding the status and capabilities of Theranos' laboratories and technology. Holmes's position at Theranos and her pre-inspection communications with Young connect her to the email.

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Unfair prejudice

Holmes argues that the CDPH inspection evidence is unfairly prejudicial under Rule 403 because it may give the jurors the "misimpression that the laboratory was unsafe" or confuse the jurors with "industry-specific jargon." Holmes 575 Mot. at 9–10. In particular, she says that without an expert witness to

properly interpret and contextualize the report, the jury would "overestimate its probative value by equating regulatory citations with proof of fraud...." Holmes Reply Br. in Supp. of Holmes's 575 Mot. ("Holmes 575 Reply"), Dkt. No. 718, at 9–10. Holmes relies on *United States v. Riddle*, in which the Fifth Circuit held that the district court erred in permitting extensive evidence about a federal regulator's appraisal of a bank's general health and its failure to comply with regulations. 103 F.3d 423, 431 (5th Cir. 1997).

The Court finds that the evidence in question does not raise the same unfair prejudice concerns indicated in *Riddle*. In that case the court found that the evidence in question was largely irrelevant to the charges brought. *See id.* As described above, the Court has determined that the CDPH report is relevant. While the CDPH report may contain technical information that may be difficult for jurors to interpret, such a challenge is unavoidable in a case involving purportedly innovative and advanced technology. Having weighed the risk of unfair prejudice against the probative value of the evidence, the Court at this time finds the CDPH inspection evidence is more probative than prejudicial. The parties will have the opportunity to examine and cross-examine witnesses to clarify and assist the jury in understanding the evidence.

***14** Editor's Note: Tabular or graphical material not displayable at this time.

Inadmissible character and propensity evidence

Holmes argues that the CDPH inspection evidence should be excluded under Rule 404. *See* Holmes 575 Mot. at 10. She references Rule 401 arguments, suggesting that "[t]he [G]overnment's theory of relevance hinges on propensity: the notion that, because others at Theranos allegedly misled CDPH officials in December 2013, [Holmes] is more likely to have possessed the specific intent to defraud investors and patients as alleged in the indictment." *Id*. Holmes contends that the evidence in question does not qualify as "inextricably intertwined" with the charged crime under the Ninth Circuit's interpretation of the concept as articulated in *United States v. Vizcarra-Martinez*, 66 F.3d 1006 (9th Cir. 1995). Dkt. No. 718 at 5 (citing *Vizcarra-Martinez*, 66 F.3d at 1012–13). Instead, she argues more generally that the evidence in question is "classic other-acts evidence that should be excluded as irrelevant or unfairly prejudicial." *Id*.

Assuming without deciding that the CDPH inspection evidence does not meet the Ninth Circuit's interpretation of the term "inextricably intertwined" with the charged crime, the evidence as described nevertheless appears probative of Holmes's intent, state of mind, and knowledge. Specifically, the evidence has a tendency to show her state of mind regarding Theranos' interactions with regulatory agencies, the extent to which she knew or should have known that Theranos was failing to meet certain federal regulations, and whether she intended to mislead investors regarding the accuracy and reliability of Theranos' technology. The Court therefore declines to exclude the evidence on Rule 404 grounds at this time.

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Inadmissible hearsay

Holmes argues that the CDPH inspection evidence is inadmissible hearsay in violation of Rule 803(8), as the report constitutes "factual findings from a legally authorized investigation" and it is not being used in a civil case or against the government in a criminal case. Holmes 575 Mot. at 10–11. This argument is effectively the same hearsay argument Holmes made in her motions in limine concerning FDA inspection evidence and evidence of CMS survey findings and sanctions. Holmes 573 Mot.; Holmes 574 Mot.

The Court declines to exclude the CDPH inspection evidence on hearsay grounds at this time for the same reasons it denied Holmes's MILs to exclude FDA inspection evidence and evidence of CMS survey findings and sanctions. *See supra* Section III.B, C. The evidence in question appears to be objective observations, rather than the factual findings of an investigation. The CDPH inspector, in carrying out the duties of inspecting the Theranos lab, did not make observations in an adversarial setting that raises doubts about the reliability of the observations. The inspector who carried out the inspection was not part of a criminal division of the CDPH. The collection of the CDPH inspection evidence appears to have been routine, ministerial, and non-adversarial. *See Orellana-Blanco*, 294 F.3d at 1150.

***15** Moreover, as explained in the Court's ruling on the Government's MIL No. 8, *see infra* Section IV.H, the Court sees insufficient reason at this time to exclude the statements of Theranos employees captured within or in response to the

CDPH report. The statements as described satisfy Federal Rule of Evidence 801(d)(2).

2. Evidence relating to Theranos' September 2015 communications with CMS

In September 2015, Theranos provided to CMS a document ("the CMS Letter") stating that the company's decision to use different devices in its CLIA laboratory "does not reflect on the reliability or accuracy of any platform." Holmes 575 Mot. at 11 (citing Saharia Decl., Ex. 3 at 64). The Government seeks to introduce this letter as Rule 404(b) evidence indicating an "intent to defraud" and "consciousness that full regulatory scrutiny would expose that Theranos' [proprietary device] was unable to provide accurate and reliable test results." *Id*. (citing Saharia Decl., Ex. 3 at 65); *see also* Gov't Opp'n to Holmes's 576 Mot. ("Gov't 575 Opp'n"), Dkt. No. 677, at 14. Holmes contends that the CMS Letter is irrelevant, unfairly prejudicial under Rule 403, and introduced for improper propensity arguments. Holmes 575 Mot. at 11–12.

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Relevance

Holmes argues that the CMS Letter is irrelevant for two reasons. Holmes 575 Mot. at 11– 12. First, she says that the Government has not connected her to the statement in the CMS Letter. *Id*. at 11–12. Second, Holmes contends that the Government has not shown that the CMS Letter evinces an intent to defraud or consciousness of guilt, but rather may indicate only negligence or some other "less culpable mental state." *Id*. at 12. In response, the Government points to evidence that Holmes monitored and directed Theranos' responses to the CMS survey. Gov't 575 Opp'n at 13–14 (citing Dkt. No. 596 at THER-2566768–769). The Government asserts that the CMS Letter is "an admission that Theranos was not even using its blood analyzer at the time of the [CMS] survey," which tended to show that the technology was not as Holmes claimed it was to investors and that Theranos could not consistently produce accurate and reliable tests. *Id*.

The Court finds that the CMS Letter meets Rule 401's low bar for relevance. Holmes's communications with Theranos employees and her involvement in the inspection process sufficiently links her to the CMS Letter, such that the CMS Letter is probative of Holmes's state of mind, knowledge, intent, and lack of mistake regarding the alleged misrepresentation of the accuracy and reliability of Theranos' technology. The CMS Letter also appears relevant for its truth —that is, it is relevant because it indicates the nature and extent of Theranos' use of its analyzer, a piece of technology about which Holmes made various representations. The Court agrees with the Government that *Miller* and *Brown* are inapposite. For the purposes of determining the relevancy of the CMS Letter, it is not necessary for the Court to decide here whether the Government has sufficiently established a foundation for making a hearsay exclusion argument. The Court finds no reason to exclude the evidence as irrelevant at this time.

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***16 Unfair prejudice**

Holmes argues that the CMS Letter would be unfairly prejudicial under Rule 403 in that its admission would "invite[ ] the jury to convict based on the acts of persons other than [Holmes]," since the Government has not connected Holmes to the CMS Letter. *See* Holmes 575 Mot. at 12–13. Holmes also complains that "it would mislead and confuse the jury to admit this document into evidence without substantial context on the responsibilities of CMS, the requirements under the CLIA statute, implementing regulations and relevant guidance, the nature of the specific disclosure requests made by CMS to Theranos, and the legal justification for those requests." *Id*.

As discussed above, the Court finds that the Government has sufficiently linked Holmes to the CMS Letter for the purposes of introducing the CMS Letter. The CMS Letter also appears relevant for its truth. While the evidence may be complicated and may require contextualization, such challenges are inevitable for a case involving allegations of misrepresentations of purportedly advanced technology. Moreover, communications from Theranos to CMS regarding the use of Theranos' technology, or lack thereof, appears probative as to Holmes's knowledge of the accuracy and reliability of Theranos' technology. Therefore, the Court at this time declines to exclude the CMS Letter. The probative value of the evidence outweighs any potential prejudicial effect to Holmes.

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Inadmissible character and propensity evidence

Holmes argues that the CMS Letter should be excluded per Federal Rule of Evidence 404 because the Government has not shown that the CMS Letter is connected to Holmes and has not explained how the CMS Letter "constitute[s] a false or misleading representation under CMS regulations." Holmes 575 Mot. at 13 (internal quotation marks omitted). Holmes argues that "this evidence does little more than show propensity, [i.e.], suggest that because [Holmes'] associates may have committed one 'bad act,' [Holmes] is likely to have committed another." *Id*.

For the reasons stated above, the Court finds that the Government has sufficiently demonstrated Holmes's connection to the CMS Letter. To the extent that the CMS Letter indicates a prior bad act, the Court finds that the CMS Letter as described is probative of Holmes's intent, state of mind, and knowledge. Specifically, the CMS Letter has a tendency to show Holmes's state of mind regarding Theranos' interactions with the regulatory agencies, the extent to which Holmes knew or should have known that Theranos' technology had deficiencies, and whether Holmes intended to mislead investors regarding the accuracy and reliability of Theranos' technology. The evidence also appears relevant for its truth. The Government does not appear to argue that the CMS Letter indicates that Holmes made a misrepresentation and therefore Holmes has a propensity for making misrepresentations or that the CMS Letter is admissible because it indicates a violation of CMS regulations.

3. Evidence relating to the hiring and retention of Dr. Dhawan

***17** In addition to regulating laboratory practices, CMS administers regulations concerning laboratory personnel, including laboratory directors. 42 C.F.R. § 493.1443. The Government seeks to introduce evidence concerning the employment of Dr. Sunil Dhawan, Theranos' former laboratory director. Holmes 575 Mot. at 13. Holmes now seeks to exclude this evidence as irrelevant, unfairly prejudicial, and introduced for improper propensity arguments. *Id.* at 13–16.

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Relevance

Holmes argues that the Dhawan evidence is irrelevant under Rule 401. Holmes 575 Mot. at 13–15. She asserts that the Government fails to show that the employment of Dr. Dhawan amounted to a violation of CMS regulations, and that even if the Government had so demonstrated, the evidence in question would still not be relevant for what she believes are "inflammatory Rule 404(b) purposes." Holmes 575 Reply at 14. She contends that the employment of Dr. Dhawan does not reveal anything about her control of Theranos.

The Government responds that it intends to introduce this evidence not to show that Holmes violated CMS regulations, but rather for her intent and state of mind. Gov't 575 Opp'n at 11, 12. The Government argues that Defendants' decisions to hire Balwani's friend who was previously in private practice rather than a laboratory manager, give him little responsibility pay him handsomely, and often not require him to be present at the laboratory all indicate that Defendants were not serious about keeping a professional laboratory and/or had a desire to place someone they could control in the position. *See id*.

The Court finds that the Dhawan evidence meets the low bar for relevance under Rule 401, because the evidence has a tendency to show Holmes's state of mind and intent regarding alleged misrepresentations about Theranos' technology. Specifically, the evidence tends to show Holmes's state of mind regarding the management of Theranos' CLIA laboratory, and whether Holmes intended to mislead investors regarding the accuracy and reliability of Theranos' technology. As the Government correctly observes, the evidence need not indicate a regulatory violation in order to be relevant. The Court finds Holmes is sufficiently connected to the hiring of Dhawan for the evidence of Dhawan's employment to be relevant.

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Unfair prejudice

Holmes argues that the Dhawan evidence is unfairly prejudicial, misleading, and confusing under Rule 403. *See* Holmes 575 Mot. at 15. Holmes argues that the evidence the Government seeks to introduce is unfair because it "preys on

lay impressions of the role a lab director should play, rather than what the law actually requires." *Id*.

Although the Government does not directly address Rule 403 arguments in its opposition brief, the Court finds the Government's arguments on relevance and probity persuasive. *See* Gov't 575 Opp'n at 11–12. Having weighed the risk of unfair prejudice against the probative value of the evidence, the Court finds that the evidence is more probative than prejudicial at this time. The Court does not find that the Dhawan evidence is meant to, or is likely to, mislead a jury about the nature of a lab director's role. In contrast, the probative value of the evidence as Holmes's state of mind and intent is clear.

Editor's Note: Tabular or graphical material not displayable at this time.

***18 Inadmissible character and propensity evidence**

Holmes argues that the Dhawan evidence should be excluded under Rule 404 for reasons similar to her arguments concerning Rule 401. *See* Holmes 575 Mot. at 16 (referencing "foregoing reasons [given in the motion]"; citing *Brown*, 880 F.2d at 1016). Holmes argues that the Government seeks to introduce this "bad act" as evidence that Holmes failed to properly address problems in Theranos' CLIA laboratory. *See* Holmes 575 Reply at 8–9 (citing Gov't 575 Opp'n at 11, 12). This argument is similar to her argument concerning the CDPH inspection evidence, stating that the evidence in question does not qualify as "inextricably intertwined [with the charged crime]" under the Ninth Circuit's interpretation of the concept. *Id.* at 5 (citing *Vizcarra-Martinez*, 66 F.3d at 1012–13).

The Dhawan evidence does not appear to indicate a prior bad act. To the extent that it does, and regardless of whether the evidence meets the Ninth Circuit's interpretation of the term "inextricably intertwined" with the charged crime, the evidence as described appears probative of Holmes's state of mind and intent. Specifically, the evidence tends to show her state of mind regarding the management of Theranos' CLIA laboratory, and whether she intended to mislead investors regarding the accuracy and reliability of Theranos' technology. The Government does not appear to argue that the Dhawan evidence is admissible because it indicates a violation of CMS regulations that in turn reveals a propensity for Holmes to engage in other wrongdoing. The Court declines to exclude the evidence on Rule 404 grounds at this time.

4. Evidence relating to other unidentified regulatory agencies

Holmes asserts that the Government's Rule 404(b) correspondence included a notice of intent to introduce evidence relating to "representations made to FDA, CMS, CDPH, and other regulatory organizations." Holmes 575 Mot. at 16 (citing Saharia Decl., Ex. 1 at 7; Ex. 2 at 12; Ex. 3 at 63) (internal quotation marks omitted). Because the Government has failed to identify any of the unspecified "other regulatory organizations," Holmes seeks to exclude such evidence. *See id*.; Fed. R. Evid. 404(b)(2)(A) (requiring "reasonable notice of the general nature of any...evidence that the prosecutor intends to offer at trial").

Neither the Government's opposition brief nor Holmes's reply address this issue further. The Court will not issue a broad exclusion at this time. If the Government seeks to introduce evidence not yet disclosed, it must provide notice to Holmes and the Court and include its reasons for late disclosure. The Court will revisit the issue with counsel at the appropriate time.

5. Summary

For the reasons given above, the Court **DENIES** the motion to exclude certain evidence relating to Theranos' interactions with government agencies. The Court acknowledges the possibility for further discussions on these matters, should the parties wish to specify certain exhibits under this broad category of evidence and offer new arguments as to why those particular exhibits should still be excluded.

E. Holmes's MIL to Exclude Evidence of Remedial Measures and Settlements (Dkt. No. 572)

***19** Holmes requests an "order precluding the [G]overnment from introducing any evidence of subsequent remedial measures taken by Theranos, including voiding or refunding of tests, and the settlements with CMS and the Arizona Attorney General Office." Holmes's Mot. in Limine to Exclude Evidence of Remedial Measures and Settlements Under Rules 401-403, 407, and 408 ("Holmes 572 Mot."), Dkt. No. 572, at 10. For the reasons stated below, the motion is granted in part.

1. CMS findings and settlement

On January 25, 2016, CMS issued a letter to Theranos summarizing its finding of a recent review of Theranos' laboratory in Newark, California, pursuant to the CLIA which specifies the legal requirements for engaging in medical testing and is broadly administered under the CMS. Saharia Decl., Ex. 12. The letter stated that as a result of the onsite survey of the laboratory, "it was determined that [Theranos] is not in compliance with all of the Conditions required for certification in the CLIA program." *Id*. at 2. In addition, the letter stated:

> [I]t was determined that the deficient practices of the laboratory pose immediate jeopardy to patient health and safety. (Immediate jeopardy is defined by the CLIA regulations as a situation in which immediate corrective action is necessary because the laboratory's non-compliance with one or more Condition-level requirements has already caused, is causing, or is likely to cause, at any time, serious injury or harm, or death, to individuals served by the laboratory or to the health and safety of the general public.)

Id. The letter listed five CMS findings Theranos was instructed to correct. *Id*. at 1–2. Three of the condition-level requirements concerned issues with Theranos laboratory personnel. *Id.* at 1. The other two condition-level requirements concerned Theranos' compliance with CLIA regulations governing laboratory issues. *Id*.

The letter included a 121-page "Form CMS-2567" with a list of numerous deficiencies. The Government highlights five of the listed deficiencies:

> (1) Theranos ran patient tests after failing QC (ECF No. 581-1 at 43-46); (2) QC results for multiple assays, for weeks on end, were at least two standard deviations from the mean (*id.* at 45-46, 105 S.Ct. 460); (3) QC results for multiple assays had coefficients of variation as high as 63.8% (*id.* at 55-56, 105 S.Ct. 460); (4) the overall percentage of QC samples on all tests on all devices was at or in excess of 20% (*id.* at 57-58, 105 S.Ct. 460); and (5) accuracy, precision, reportable range, and allowable bias for multiple assays did not meet even Theranos's criteria (*id.* at 80-81, 105 S.Ct. 460).

Gov't Opp'n to Holmes's 572 Mot. (Gov't 572 Opp'n"), Dkt. No. 673, at 3.

CMS did not include any findings regarding the accuracy or reliability of Theranos' blood tests. CMS warned Theranos that if it did not provide "a credible allegation of compliance and acceptable evidence of correction documenting that the immediate jeopardy has been removed and that action has been taken to correct all of the Condition-level deficiencies" within 10 days, CMS would impose sanctions. Saharia Decl., Ex. 12 at ECF p. 3.

In a letter to CMS dated April 1, 2016, Theranos Laboratory Director Dr. Kingshuk Das stated:

> The laboratory has undertaken aggressive corrective actions. For example, out of an extreme abundance of caution and based on its dissatisfaction with prior [quality assurance] oversight the laboratory ...voided all results reported for the assays run on the Theranos Proprietary System 3.5 (TPS) in 2014 and 2015 and all reported PT/INR tests run on the Siemens Advia BCS XP instrument [from] October 2014 through September of 2015.

***20** Saharia Decl., Ex. 27, Dkt. No. 583-1 at ECF p. 3. Elsewhere in the letter, Dr. Das stated:

> The laboratory has conducted a thorough re-review of QC data for each assay run on the TPS 3.5 from January 1, 2014 until the TPS 3.5 was fully retired in early-August 2015. As explained further in the attached patient assessment analysis, the laboratory is not satisfied with its old quality assessment's program's ability to effectively flag and promptly address QC imprecision, QC failures, and QC trends with the TPS 3.5....Based upon its re-review of QC data for the TPS 3.5, the laboratory has determined that its prior QA program failed to satisfactorily address these types of QC issues for assays run on the TPS 3.5 in 2014 and 2015. As corrective action, the laboratory has, out of an extreme abundance of caution, voided results reported for assays run on the TPS 3.5 in 2014 and 2015."

Id. at ECF pp. 14–15.

Despite Theranos' corrective actions, CMS imposed sanctions. Theranos appealed the sanctions, and on April 14, 2017, CMS entered a civil settlement ("the CMS Settlement") with Theranos, Dr. Sunil Dhawan, and Balwani. The preamble to the CMS Settlement recited, among other things, that Dr. Dhawan directed the Newark Laboratory during the relevant period; that Balwani owned the Newark Lab; that Theranos had decided to close the Newark Laboratory; that "Theranos, Dhawan, and Balwani, in order to avoid the costs and burden of litigation, and without admitting or contesting the underlying actions, desire to settle this matter and acknowledge that the imposition of sanctions against Theranos, Dhawan, and Balwani is solely as described in the Agreement." Saharia Decl., Ex. 29, Dkt. No. 583-3 at ECF pp. 2–3. The CMS Settlement: (i) resolved all outstanding legal and regulatory proceedings between CMS and Theranos; (ii) reduced Theranos' total civil monetary penalty to $30,000; (iii) prevented Theranos from owning or operating a clinical lab for two years; (iv) withdrew CMS's revocation of Theranos' CLIA operating certificates; and (v) withdrew Theranos' appeal of CMS's sanctions. *Id*. Holmes was not a party to the CMS Settlement.

2. Arizona Attorney General's Office settlement

After the CMS Settlement, the Arizona Attorney General's Office ("AGO") brought a consumer fraud action against Theranos that also resolved through a settlement. The Arizona AGO alleged that:

> 1) Between 2013 and 2016, Defendant sold approximately 1,545,339 blood tests to approximately 175,940 Arizona consumers, which yielded 7,862,146 test results.
>
> 2) Defendant ultimately voided or corrected approximately 834,233, or 10.6% of these test results.
>
> 3) The sales of the blood tests were made without the informed consent of the consumers because Defendant misrepresented, omitted, and concealed material information regarding its testing service's methodology, accuracy, reliability, and essential purpose.
>
> 4) Defendant intended for its customers to rely on its misrepresentations, omissions, and concealments in their decision to purchase its testing services.

Saharia Decl., Ex. 28, Dkt. No. 583-2 at ECF p. 3. Theranos expressly denied the Arizona AGO's allegations. *Id*. The settlement with the Arizona AGO included a consent decree ("the Arizona Settlement") requiring that Theranos: (i) not own, operate, or direct any CLIA lab in Arizona for two years; and (ii) pay $4.65 million in consumer restitution. *Id*. at 4. Theranos reimbursed each Arizona customer the full amount paid for testing—regardless of whether the results were voided or corrected. *Id*. at 5.

3. The Government's proffer of evidence

***21** The Government notified Holmes of its intent to introduce evidence of Theranos' voiding of test results "to show Theranos was unable to produce accurate and reliable test results." Saharia Decl., Ex. 3, Dkt. No. 580-2 at ECF p. 5. The Government's Rule 404(b) notice specifically points to five Theranos customers who allegedly received voided test results. *Id*. at 3–6. The Government also asserts that "[e]vidence Theranos voided tests is an admission its prior statements [regarding the accuracy and reliability of Theranos technology] were false." *Id*. at 69. The Government also intends to introduce evidence of voided tests to show "Defendants' intent to defraud patients by depriving them

of the information they believed they would receive when patronizing Theranos'[ ] services." *Id.* at 75–76. Holmes also expects the Government to introduce evidence of Theranos' decision to provide refunds to customers as part of the Arizona Settlement to show that Theranos' technology was not capable of producing accurate and reliable test results. *See* Dkt. No. 267 at 2–3.

4. Evidence of Theranos' voiding of tests

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Rule 407

Under Rule 407, evidence of subsequent remedial measures is not admissible to prove culpable conduct by the party taking those measures or "a defect in a product or its design," but is admissible for another purpose, such as impeachment. Fed. R. Evid. 407. The purpose of Rule 407 is to encourage parties to improve safety conditions "without fear that subsequent measures will be used as evidence against them." *Gauthier v. AMF, Inc.*, 788 F.2d 634, 637 (9th Cir. 1986). "An exception to Rule 407 is recognized for evidence of remedial action mandated by superior governmental authority...because the policy goal of encouraging remediation would not necessarily be furthered by exclusion of such evidence." *O'Dell v. Hercules, Inc.*, 904 F.2d 1194, 1204 (8th Cir. 1990); *see also In re Aircrash in Bali, Indonesia*, 871 F.2d 812, 817 (9th Cir. 1989) ("The purpose of Rule 407 is not implicated in cases involving subsequent measures in which the defendant did not voluntarily participate....In this case, Pan Am's management, although to be commended for its cooperation, nonetheless was legally obligated to cooperate with the FAA's investigation.").

Here, Holmes relies on Rule 407 to support her argument that Theranos made a voluntary decision to void test results, and therefore evidence of the void test results is inadmissible to prove culpability—i.e., to prove the Government's allegation that she falsely stated that Theranos' tests were accurate and reliable and as an admission that their prior statements about Theranos' technology were false. In contrast, the Government relies on the exception to Rule 407, asserting that the voiding of blood tests was not voluntary. Thus, the applicability of Rule 407 turns on whether Theranos' decision to void the test results was voluntary or involuntary—an issue the parties strongly dispute.

There is evidence in the record to support both parties' position. Holmes cites to a portion of a FDA Office of Criminal Investigation interview with CMS employee Sarah Bennett that states, "Theranos made the decision to void the test results; CMS didn't tell them to do that." Saharia Decl., Ex. 34, Dkt. 584-3 at ECF p. 7. Read in isolation, this statement tends to support Holmes's position. When it is read in a fuller context, however, it also lends support to the Government's position that CMS required Theranos to cooperate with the inspection, to take immediate action to fix deficiencies, to remove the immediate jeopardy Theranos was causing patients, and to come into condition-level compliance:

> In Theranos's written responses to CMS in which they attempted to show they had corrected the cited deficiencies, Theranos would send CMS a copy of a faxed sheet saying something was corrected along with a corrected report, but CMS could never marry the two together; so, CMS never knew if Theranos actually notified all of their affected patients. Bennett said that over 50,000 patient test results were implicated. To date, CMS doesn't know if all of the affected patients have been notified. Theranos made the decision to void the test results; CMS didn't tell them to do that. CMS tells the laboratory they must fix a deficiency and the laboratory decides how they're going to fit it.

***22** *Id*. Even if Theranos had a choice in how to "fix" the deficiency, it was nonetheless required to address the deficiency.

Holmes asserts separately that Theranos did not void tests in response to CMS's January 2016 finding of immediate jeopardy, but rather took that step voluntarily months after the 10-day deadline to cure. *Id*., Ex. 27 at 3. This argument overlooks the fact that CMS found Theranos' initial response to the January 2016 finding insufficient and that "the evidence did not support a credible allegation of compliance." *Id*., Ex. 27 at 1; Saharia Decl., Ex. 34 at 6. CMS sent Theranos another letter in March 2016 that "tells them exactly why their

response was not credible." *Id*., Ex. 34 at 6. Theranos' April 1, 2016 letter notifying CMS of the decision to void tests was sent in response to CMS's March letter. Therefore, the timing of Theranos' decision to void tests does not, without more, suggest that the decision was entirely voluntary.

Because there is a factual dispute over the voluntariness of Theranos' decision to void tests, it is premature for the Court to decide now whether evidence of the voided tests must be precluded under Rule 407.

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Rule 403

Holmes next contends that evidence of the invalidated test results is irrelevant because it was the product of an investigation into whether Theranos deviated from lab operating procedures and documentation, not from a finding that the tests were inaccurate or unreliable or that Theranos' tests negatively affected a statistically significant number of customers. Moreover, Holmes contends that evidence of the invalidated test results will confuse the issues in the case and invite the jury to assume that Theranos admitted that the testing data was invalid—an assumption Holmes contends would be misleading and highly prejudicial.

The Court agrees with the Government that Holmes's decision to void blood tests is relevant. She made the decision to void tests in the context of discussions with CMS regarding deficiencies in lab procedures, including quality controls and quality assurance programs. These deficiencies were so serious that CMS found that the Theranos lab posed "immediate jeopardy to patient health and safety." *Id*., Ex. 12 at 1. It is reasonable to infer that test results from a lab fraught with quality control and quality assurance issues are, at a minimum, unreliable. And it is reasonable to infer that Theranos' decision to void the test results after CMS issued its findings is an implicit acknowledgement that the test results were unreliable.

Holmes argues that Theranos did not specifically admit its lab produced inaccurate results. Nevertheless, that is a reasonable inference from Theranos' decision to void test results. As the Government points out, if Holmes had confidence in the test results, or if she could ascertain the correct value, there would have been no need to void the test results. Indeed, the Form CMS-2567 indicates that Theranos was able to ascertain corrected values for certain tests. *See id.*, Ex. 12 at ECF p. 80 ("VitD, HCG[,] and SHBG validation reports included 'Theranos-corrected' results").

***23** Holmes offers alternative explanations for voiding the tests, including that it was "due to uncertainty with how prior lab leadership operated the laboratory and in an abundance of caution." Holmes 572 Mot. at 4. Holmes attempted "to show a willingness to take seriously the cited issues in the Report, the majority of which concerned negligent lab practices such as failure to maintain proper documentation —issues that the [G]overnment's own witness stated are common among laboratories." *Id*. Although Holmes may have alternative explanations for voiding the tests that are unrelated to the accuracy and reliability of the tests, the fact remains that the circumstances surrounding the decision to void the tests are relevant to show whether Theranos was able to produce reliable and accurate test results. As such, evidence of Theranos' decision to void tests meets the "very low bar" of Rule 401. *United States v. Rodriguez-Soler*, 773 F.3d 289, 293–94 (1st Cir. 2014) (relevancy requirement is "a very low bar" that "is not very hard to meet").

Holmes next cites *PG&E* for the proposition that evidence of remedial measures a government agency imposes on a defendant is unduly prejudicial. 178 F. Supp. 3d 927. In *PG&E*, the defendant was charged with, among other things, violating federal safety standards for transportation of natural gas by pipeline. The court excluded remedial measures that the California Public Utilities Commission ("CPUC")—"an authoritative government agency"— specifically ordered, reasoning that although remedial measures aimed at charged Pipeline Safety Act regulations would be highly probative, there was a substantial risk that the jury might assume that if CPUC imposed the remedial measures, then PG&E "is deserving of punishment." *Id.* at 949. The court concluded that this risk substantially outweighed the probative value of the CPUC remedial measures. *Id*. (citing *Angelo v. Bacharach Instrument Co.*, 555 F.2d 1164, 1176 (3rd Cir. 1977)). Although evidence of Theranos' decision to void test results has some potential to be unduly prejudicial, this case is distinguishable from *PG&E* in that Holmes has taken the position that CMS did not require Theranos to void the test results; rather, Holmes asserts that Theranos did so voluntarily —a position that undercuts Holmes's claim of prejudice.

Holmes's most persuasive argument is that admitting evidence of Theranos' decision to void tests would be unfairly prejudicial because that decision was not made until 2016 and therefore is not probative of her intent during 2010-2015—the

years that are the subject of the indictment. The Court shares Holmes's concern that the jury could convict her for failing to uncover laboratory issues, a negligence standard, rather than for knowingly misrepresenting false, material information during the charged conspiracy.

Moreover, Holmes raises other legitimate concerns about admitting Theranos' decision to void test results, including (a) confusion of the issues because Theranos' lab practices were not placed at issue in the indictment, and (b) undue consumption of time because it would require Holmes to present extensive evidence about the decision to void the tests, including the regulatory backdrop for CMS's actions.

Accordingly, the Court defers ruling on the admissibility of Theranos' decision to void test results until the Government makes a proffer of evidence that clearly ties the events in 2016 to the charged conduct, as well as presents a factual basis for its assertion that Theranos' decision was involuntary for purposes of Rule 407.

5. CMS Settlement and Arizona Settlement

Rule 408 limits the admission of evidence of compromise offers and negotiations. It provides:

> (a) Prohibited Uses. Evidence of the following is not admissible – on behalf of any party – either to prove or disprove the validity or amount of a disputed claim or to impeach by a prior inconsistent statement or a contradiction:
>
> (1) furnishing, promising, or offering – or accepting, promising to accept, or offering to accept – a valuable consideration in compromising or attempting to compromise the claim; and
>
> ***24** (2) conduct or a statement made during compromise negotiations about the claim – except when offered in a criminal case and when the negotiations related to a claim by a public office in the exercise of its regulatory, investigative, or enforcement authority.
>
> (b) Exceptions. The court may admit this evidence for another purpose, such as proving a witness's bias or prejudice, negating a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution.

Fed. R. Evid. 408. "Rule 408 is designed to ensure that parties may make offers during settlement negotiations without fear that those same offers will be used to establish liability should settlement efforts fail." *Rhoades v. Avon Prods.*, 504 F.3d 1151, 1161 (9th Cir. 2007). If, however, statements made during settlement are introduced for a purpose unrelated to liability, then "the policy underlying Rule 408 is not injured." *Id.*

In response to Holmes's motion, the Government represents that it does not presently intend to offer evidence of the CMS Settlement or the Arizona Settlement. The parties also agree that Rule 408(a)(2) makes an exception for statements made in negotiations related to a claim by a public office in the exercise of its regulatory, investigative, or enforcement authority when offered in a criminal case. *See* Holmes 572 Mot. at 6; Gov't 572 Opp'n at 8. Thus, statements by Theranos and Holmes to the Arizona AGO in the course of its investigation and CMS in the course of its survey and subsequent proceedings are not subject to exclusion under Rule 408. At present, the Government has not identified any such statements that it seeks to admit.

Because the Government does not oppose Holmes's motion to exclude the two settlements, the Court grants her motion. Holmes's motion for an order precluding the Government from introducing any evidence of subsequent remedial measures taken by Theranos, including voiding or refunding of tests, and the settlements with CMS and the Arizona AGO is **GRANTED in part**. The Government is precluded from introducing the CMS Settlement and the Arizona Settlement (including the refunds associated with the Arizona Settlement). The Court **DEFERS** any ruling as to the admissibility of statements by Theranos and Holmes to the Arizona AGO in the course of its investigation and CMS in the course of its survey and subsequent proceedings. As to the admissibility of Theranos' decision to void the tests, the Court **DEFERS** ruling until the Government proffers evidence to show the voluntariness of Theranos' decision and to tie the events in 2016 to the charged conduct.

F. Holmes's MIL to Exclude Certain News Articles (Dkt. No. 578)

Holmes moves to exclude certain news articles under Federal Rules of Evidence 403 and 802. Holmes's Mot. in Limine to Exclude Certain News Articles Under Rule 403 and 802 ("Holmes 578 Mot."), Dkt. No. 578. Holmes seeks a blanket order excluding over fifty articles by journalists not testifying at trial. *Id.* at 1. The Court held a hearing on this motion on May 6, 2021. May 6, 2021 Hr'g Tr., Dkt. No. 794. Having considered the parties' papers, the arguments made at the

hearing, and the relevant legal authority, the Court issues the following order.

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***25 Articles not specifically identified and submitted to the Court** Holmes generally seeks a broad exclusion of "over 50 articles" written by "journalists who

will not testify at trial" (those being "journalists other than Mr. Parloff and Dr. Topol"). Holmes 578 Mot. at 1. Holmes only specifically identified and submitted to the Court seven of the fifty plus articles. "The failure to specify the evidence that a motion in limine seek[s] to exclude constitutes a sufficient basis upon which to deny th[e] motion." *Shenwick v. Twitter, Inc.*, No. 16-cv-05314-JST, 2021 WL 1232451, at *12 (N.D. Cal. Mar. 31, 2021) (quoting *Bullard v. Wastequip Mfg. Co. LLC*, No. 14-CV-01309-MMM, 2015 WL 13757143, at *7 C.D. Cal. May 4, 2015 (internal quotations omitted)). It would be premature to address a motion in limine when the defendant has not identified any "particular objectionable statement" she seeks to preclude. *Engman v. City of Ontario*, No. EDCV 10–284 CAS (PLAx), 2011 WL 2463178, at *4 (C.D. Cal. June 20, 2011).

Given that Holmes largely fails to identify the evidence that would be excluded should her motion be granted, the Court **DENIES** the motion without prejudice as to all the articles not specifically identified and filed with the motion and its accompanying declarations and exhibits. The Court next addresses the specifically identified articles in turn.

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Articles specifically identified and submitted to the Court (Saharia Decl., Ex. 48, Dkt. No. 586)
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> **"Blood, Simpler" (Saharia Decl., Ex. 48 at ECF pp. 32-49)** "Blood, Simpler" appeared in the December 15, 2014 issue of *The New Yorker*. Saharia

Decl., Ex. 48. It was published ten months prior to the article from *The Wall Street Journal* ("WSJ") which the Government says "exposed" Holmes's alleged fraud. Gov't Opp'n to Holmes's 578 Mot. ("Gov't 578 Opp'n"), Dkt. No. 667, at 2. The Government intends to use articles published prior to the WSJ article for the non-hearsay purposes of showing "the favorable press coverage of Theranos" in the public realm prior to the discovery of the fraud, and the articles' effects on the readers. *Id.* Additionally, the Government claims that Holmes and/or her employees disseminated some articles published prior to that WSJ article to potential investors and the public, though there is no indication in the record that the "Blood, Simpler" article was among them.

News articles themselves are generally held to be inadmissible hearsay as to their content. *Larez v. Los Angeles*, 946 F.2d 630, 642 (9th Cir. 1991). Articles that feature quotations from people other than their authors constitute hearsay within hearsay when the article and the quotations within are offered to prove the truth of the matter asserted, and therefore the articles and the quotations within are inadmissible unless both levels of hearsay fall under an exception to the rule against hearsay. *See id*.

The Government relies on judicial notice cases to provide support for its assertion that articles can be used to show the favorable press coverage available in the public realm. Generally, when courts take judicial notice of what information is "available in the public realm," they take notice of the fact that articles on the topics in question *were written*[7] , and do not take notice of the actual articles or their contents. In cases involving a market fraud theory,[8] courts take judicial notice of articles and/or their contents to show what information was available to the market, as all information available to the public impacts the market and stock prices regardless of whether people actually rely and act on that information. Because the Government intends to use the article itself and show that it had an effect on the reader(s)—investors and/or consumers were influenced by and/or relied on that information when making decisions—the judicial notice cases the Government cites are not applicable here.

7 *Von Saher v. Norton Simon Museum of Art at Pasadena*, 592 F.3d 954, 960 (9th Cir. 2010), *overruled on other grounds by Galbraith v. Cty. of Santa Clara*, 307 F.3d 1119, 1125–26 (9th Cir. 2002); *Ochoa v. Santa Clara Cty. Office of Educ.*,

No. 16-cv-03283-HRL, 2017 WL 11619097, at *1-2, 2017 U.S. Dist. LEXIS 131658, at *4–5 (N.D. Cal. Aug. 17, 2017).

8 *Basic Inc. v. Levinson*, 485 U.S. 224, 244–47, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988) (discussing the admission of news articles because they show what information the market was aware of, which—regardless of its truth— impacts the market, and adopting fraud on the market theory); *Heliotrope Gen., Inc. v. Ford Motor Co.*, 189 F.3d 971, 981 n.18 (9th Cir. 1999) (taking judicial notice "that the market was aware of the information contained in news articles" and of the contents of the articles).

***26** However, articles offered not for the truth of the matter asserted but to show their effect on the reader are not hearsay and are therefore not subject to exclusion. *See, e.g.*, *United States v. Payne*, 944 F.2d 1458, 1472 (9th Cir. 1991) (statement introduced not for the truth of the matter but rather to show the effect on the listener was not hearsay). Thus, the use of the article "Blood, Simpler" to show its effect on the reader constitutes a non-hearsay use.

Holmes argues that admission of this particular (overall positive) article would be unfairly prejudicial, given the author's "subjective opinions" [9] about Holmes and quoted statements [10] of concern and skepticism in the article. "The term 'unfair prejudice,' as to a criminal defendant, speaks to the capacity of some concededly relevant evidence to lure the factfinder into declaring guilt on a ground different from proof specific to the offense charged." *Old Chief*, 519 U.S. at 180, 117 S.Ct. 644. Evidence is unfairly prejudicial if it has "an undue tendency to suggest decision on an improper basis, commonly, though not necessarily, an emotional one." *Id.* (citation and internal quotation marks omitted). Neither statements about Holmes's appearance or mannerisms nor claims of concern or skepticism suggest guilt or innocence on an improper basis, and they would not provide the jury with grounds to make a determination that goes against offense-specific proof. Therefore, admission of this article would not be unfairly prejudicial.

9 Holmes says the author has "subjective opinions" about "how Ms. Holmes presents both in her physical presentation and how she presents when talking to rooms full of people." May 6, 2021 Hr'g Tr., Dkt. No. 794, at 99:4-8.

10 One quotation Holmes finds troubling is the statement "some observers are troubled by Theranos'[ ] secrecy." May 6, 2021 Hr'g Tr., Dkt. No. 794, at 99:2-3. Holmes is also concerned about "quotes from Quest Diagnostics executives taking issue with several of Theranos'[ ] claims about its technology and [their] saying broadly that fingerstick blood tests aren't reliable for clinical diagnostic tests." *Id*. at 99:9-12.

Holmes also argues generally that admission of any article would result in confusion of the issues. This particular article largely contains information about Holmes and her family's history, her mission in founding Theranos, and the company's work and goals, with a few questions and statements of concern or skepticism. This largely biographical article will not cause confusion of the issues regarding Holmes's alleged fraud.

Because any prejudicial effect is outweighed by the article's high probative value for the purpose stated—showing its effect on readers—there is no basis for this article's exclusion under Rule 403. A limiting instruction will issue at the appropriate time. The Court **DENIES** the motion as to the "Blood, Simpler" article.

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Remaining six identified articles (Saharia Decl., Ex. 48 at ECF pp. 2– 31, 50–58)

The Government stated it intends to use articles published between 2015 and 2016 "that portray Theranos negatively" only "sparingly," and not for the truth of the matter asserted in the articles but for the non-hearsay purpose of providing "*context*" for subsequent events. Gov't 578 Opp'n at 8 (emphasis added). In particular, the Government states that the jury's review of the WSJ article [11] that "exposed Theranos'[ ] deception" is "necessary in order to understand Holmes's response to that reporting in the months that followed—a time period that saw Holmes double down on her fraud and make additional misleading statements about recent press coverage." *Id.* at 8.

11 The Government calls this article an "important landmark...[that] shows when knowledge of the alleged fraud became public." May 6, 2021 Hr'g Tr., Dkt. No. 794, at 110:9-11.

***27** However, for the articles to provide context, one would need to look past the mere existence of the articles to the contents of the articles for their truth. If the authors of these articles do not testify to the articles' contents, the articles are inadmissible as hearsay, unless they fall within an exception to the rule against hearsay.

If "the inference the plaintiff [seeks] to draw[ ] depend[s] on the truth of [the third party's] statement," the statement is hearsay, regardless of the purpose for which the party proffering the evidence offers it. *Mahone v. Lehman*, 347 F.3d 1170, 1173 (9th Cir. 2003) (quotation and internal quotation marks omitted). But "[i]f the significance of an out-of-court statement lies in the fact that the statement was made and not in the truth of the matter asserted, then the statement is not hearsay." *Calmat Co. v. U.S. Dep't of Labor*, 364 F.3d 1117, 1124 (9th Cir. 2004). For the statement to truly be offered for a non-hearsay purpose, its significance must come solely from the fact the statement was made, and the truth of the statement must be entirely irrelevant.

The inference the Government seeks to draw depends on the truth of the articles' contents. The Government intends to show that, because the articles' contents were true, Holmes "double[d] down" on the fraud. Thus presented, the articles' significance lies not in the fact they were written, but in the truth of the matter asserted within them. These articles and their contents are inadmissible hearsay (and hearsay within hearsay) not subject to any exception. Therefore, the Court **GRANTS** the motion as to the remaining six articles.

For the foregoing reasons, the Court **DENIES** the motion without prejudice as to the articles not specifically identified and filed with the motion and its accompanying declarations and exhibits. Regarding the articles specifically identified and submitted to the Court, the Court **DENIES** the motion as to the "Blood, Simpler" article (Saharia Decl., Ex. 48 at ECF pp. 32–49) and **GRANTS** the motion as to the other six articles (*Id*. at ECF pp. 2–31, 50–58).

G. Holmes's MIL to Exclude Evidence of Settlements (Dkt. No. 571)

Holmes moves to exclude evidence regarding civil or regulatory settlements entered into by Theranos, Holmes, or Balwani, including evidence regarding the negotiation of those settlements and any evidence pertaining to Theranos' ongoing civil litigation.[12] Holmes's Mot. in Limine to Exclude Evidence of Settlements Under Rules 401-403 and 408 ("Holmes 571 Mot."), Dkt. No. 571. Holmes is party to multiple lawsuits arising from Theranos' alleged fraudulent schemes, some of which have settled and some of which continue to be litigated. *See Partner Invs. v. Theranos, Inc.*, (defendants agreed to settle the litigation with a payment); *Colman v. Theranos, Inc*., Case No. 16-CV-6822-NC, Dkt. No. 314 (N.D. Cal. July 24, 2018) (defendants agreed to a stipulation leading to the dismissal of the case); *see also* Jan. 8, 2021 Decl. of AUSA Robert S. Leach in Supp. of United States' Opp'ns to Def.'s Mots. in Lim. ("Leach Opp'ns Decl."), Dkt. No. 679, Ex. 2 (settlement agreement with investor Keith Rupert Murdoch); *id.*, Ex. 3 at THPFM0003022508 (discussing defendants' negotiated agreement with Safeway in which Safeway released its claims against Theranos in return for a payment); *Walgreens Co. v. Theranos, Inc.*, No. 16-CV-1040-RGA, Dkt. No. 26 (D. Del. Aug. 25, 2017) (stipulated dismissal upon settlement); *SEC v. Holmes*, No. 18-CV-1602-EJD, Dkt. Nos. 9, 10 (N.D. Cal. Mar. 27, 2018) (defendants agreed to settle allegations against them by paying monetary penalties in addition to agreeing to reduce corporate voting rights and individual equity); *In re Ariz. Theranos, Inc. Litig.*, No. 16-CV-2138 HRH (D. Ariz.) (ongoing class action litigation against defendants).

12 The Court took the motion under submission on the papers after the parties did not request oral argument.

***28** Holmes argues against the inclusion of settlement evidence on three grounds. First, she contends that Rule 408 prohibits any evidence of settlements and settlement negotiation. Even if Rule 408 does not apply, Holmes says such evidence of settlements is irrelevant under Rules 401 and 402. Holmes notes that neither she nor Theranos ever admitted liability in those settlements, nor did they admit to any of the allegations in the complaints of the lawsuits. Finally, Holmes argues that the prejudicial nature of the settlement evidence substantially outweighs any minimal probative value, rendering such evidence inadmissible under Rule 403. Specifically, she contends that admission of settlement evidence would lead to jury confusion, improperly influence the jury into believing that the settlements show a consciousness of guilt, or create prolonged unnecessary litigation on collateral matters during the trial.

The Government agrees that neither party should use evidence of settlements to prove the validity or invalidity of a disputed claim and maintains that any order should be limited to prohibiting the use of settlement agreements for that purpose. Nonetheless, the Government opposes

the motion insofar as it seeks to prevent the Government from using settlement evidence for purposes not prohibited by Rule 408, namely using conduct or statements from past litigation that are outside the scope of "compromise negotiations," using settlement evidence that arose from a public office exercising its enforcement authority, and for cross-examination purposes.

Rule 408 governs the admissibility of evidence of conduct or statements made during settlement negotiations. It provides that such evidence is not admissible when offered to prove liability but may be admitted for other purposes. Fed. R. Evid. 408; *see also Rhoades*, 504 F.3d at 1161. Other purposes for which settlement evidence is admissible and not prohibited under Rule 408 can include "proving a witness's bias or prejudice." *See Rhoades*, 504 F.3d at 1161 (citing *United States v. Technic Servs., Inc.,* 314 F.3d 1031, 1045 (9th Cir. 2002)).

Turning to the settlement evidence that Holmes seeks to prohibit in its entirety, Rule 408(b) is clear that there are instances in which settlement evidence is permissible, particularly when "proving a witness's bias or prejudice." Fed. R. Evid. 408(b). Assuming that such evidence does not run afoul of any other Federal Rule of Evidence (e.g., Rule 403), the Government is entitled to use such settlement evidence for purposes permissible under Rule 408(b). Gov't Opp'n to Holmes's 571 Mot. ("Gov't 571 Opp'n"), Dkt. No. 671, at 3, Dkt. No. 671 ("Cross-examination of witnesses may make one or more of the Settlement Agreements relevant to a witness's bias or credibility."). The Government suggests that it may seek to introduce Theranos' settlement agreements with Safeway and Walgreens to rebut any potential argument that Safeway or Walgreens believed that Theranos performed adequately under their service agreements. *Id.* at 4. It remains to be seen whether any of these scenarios will come to pass. At this stage of the proceedings, a broad limitation on the Government's ability to fully cross-examine witnesses would be inappropriate in the absence of information on exactly how and for what purpose any potential settlement evidence may elicited.

Furthermore, Rule 408 provides that does not bar "conduct or a statement made during compromise negotiations...related to a claim by a public office in the exercise of its regulatory, investigative, or enforcement authority." Fed. R. Evid. 408(a)(2). The Securities and Exchange Commission ("SEC") qualifies as such a public office. Thus, evidence relating to Holmes's conduct or statements made during the compromise negotiations with the SEC fall squarely within Rule 408's public office exception and are not inadmissible under Rule 408—although such evidence may still be inadmissible for other reasons, such as unfair prejudice under Rule 403. However, a Rule 403 analysis cannot be conducted in a vacuum without knowing how and for what purpose the evidence is offered.

***29** Because Rule 408 permits certain comment on ongoing litigation when unrelated to a compromise offer or negotiation, the Court declines at this time to completely bar the Government from commenting on or presenting evidence related to Holmes's ongoing civil litigation. The Government is not precluded from its use of Holmes's compromise negotiations with the SEC as conduct or statements made during settlement negotiations with a public entity exercising its enforcement authority, as those communications do not fall under Rule 408's prohibitions. Finally, the Court reserves judgment on the remainder of Holmes's motion as it pertains to the Government's desire to potentially use settlement evidence for impeachment purposes. The motion is **DEFERRED.**

H. Holmes's MILs to Exclude Anecdotal Evidence of Test Results, Customer Impact, Expert Testimony of Physician Witnesses, and the Laboratory Information System (Dkt. Nos. 561, 562, 563)

As evidence of the scheme to defraud doctors and patients alleged above, the Government anticipates presenting testimony from approximately eleven patients who received inaccurate tests from Theranos and nine treating physicians whose patients received inaccurate tests from Theranos, all during the period of the charged conspiracy.

In separate motions in limine, Holmes seeks to preclude these witnesses from providing "anecdotal testimony" regarding inaccurate results or testimony regarding the ramifications of inaccurate results on customers. Holmes's Mot. in Limine to Exclude Evidence of Anecdotal Test Results Under Rules 401-403 ("Holmes 563 Mot."), Dkt. No. 563; Holmes's Mot. in Limine to Exclude Customer Impact Evidence Under Rules 401-403 ("Holmes 562 Mot."), Dkt. No. 562. Holmes further seeks to exclude the expert physician witnesses entirely. Holmes's Mot. in Limine to Exclude Expert Opinion Testimony of Fact/Percipient Witnesses Under Rules 401-403 and 702 ("Holmes 561 Mot."), Dkt. No. 561. Relatedly, the Government's MIL No. 10 seeks to admit testimony from these (and perhaps other) patient witnesses regardless of

whether those patients paid for their test themselves. Gov't Mot. at 20–24.

Because these motions raise overlapping arguments as to relevance and prejudice, the Court addresses all four together as follows.

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Anecdotal evidence of test results (Dkt. No. 563)

As noted above, the Government plans to introduce testimony from both patients and physicians who received inaccurate test results from Theranos during the period of the charged conspiracy. Holmes seeks to exclude all such "anecdotal" testimony as irrelevant and unduly prejudicial under Rules 401-403.

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Relevance

Holmes argues that anecdotal patient or physician testimony about inaccurate results does not "tend to prove that 'Theranos's technology was, in fact, not capable of consistently producing accurate and reliable results.' " Holmes 563 Mot. at 5 (quoting TSI ¶ 16). According to Holmes, Theranos generated 7 to 10 million test results for patients. Both parties agree that all blood tests, regardless of laboratory, produce some amount of expected error. *See generally* Saharia Decl., Ex. 6 (Expert Report of Stephen Master explaining that some "bias" or deviation from pure accuracy "is a normal and expected feature of laboratory tests"). Holmes argues that the Government "cannot show that its anecdotal examples fall outside the expected error rate for laboratories; [and] it cannot show that Theranos' error rate was meaningfully different than that of other laboratories." Holmes 563 Mot. at 5. Thus, Holmes concludes that evidence of individual inaccurate results, without more, does not tend to prove that Theranos tests were inaccurate or unreliable overall, and is therefore not relevant to proving that her statements were false.

***30** The Court does not find this argument persuasive. The Government alleges that Holmes committed fraud by making misrepresentations about the accuracy and reliability of Theranos' tests, inducing customers to pay for tests. Testimony describing patients' inaccurate test results, therefore, tends to prove the fraud by showing that patients did not get what they paid for. Although these eleven inaccurate results may not amount to statistical proof that the Theranos tests were generally inaccurate, the Court finds that consideration to affect the weight of the evidence, not its admissibility. Evidence of even one inaccurate result tends to show that Theranos was producing inaccurate results, even if it does not fully prove the point. Holmes is correct to conclude that this evidence does not demonstrate that Theranos tests produced inaccurate results at an unacceptable rate, but that does not render the "anecdotal" testimony irrelevant.

Holmes next argues that the patient testimony should be excluded because there is no evidence about what caused the erroneous results. Inaccurate results might stem from mishandling, human error, patient-specific conditions like diet, or any number of other potential factors. A juror "cannot draw any conclusions about causation from isolated, anecdotal examples of incorrect or unexpected blood tests." *Id.* Holmes cites to *Daubert* decisions in which courts found various expert opinions unreliable because they were based on "anecdotal" evidence. For example, she cites *Vollrath Co. v. Sammi Corp.*, 9 F.3d 1455, 1462 (9th Cir. 1993), an antitrust case in which the plaintiff alleged attempted monopolization of the "stainless steel steamer" market. The *Vollrath* court found that the expert's opinion that stainless steel steamers could be treated as a product distinct from other steamers such that they constituted a market of their own to be unpersuasive, in part because "[t]here was no detailed examination of market data or any analysis of cost...The opinion was based on limited anecdotal evidence." *Id.*

The plaintiff in *Vollrath*, however, was required to define and prove the relevant market and the parties' market share as an element of the monopolization claim, which necessarily required concrete market data and analysis. The same is not true in the present case. Causation is not an element of wire fraud that the Government must prove. Each time a Theranos customer allegedly paid for an accurate and reliable blood test based on Holmes's representations and did not receive such a test, that experience on its own is evidence of the fraud.

Moreover, because expert witnesses are intended to help the jury understand the facts, courts act as a gatekeeper to ensure

that experts' opinion of those facts is reliable and based on sound scientific methodology. Holmes in this case appears to be arguing that the Court should similarly act as a gatekeeper to prevent the Government from presenting fact evidence and argument that is not based on sound scientific methodology. That is not the Court's role. The Court, therefore, finds the *Daubert*-related cases Holmes cites distinguishable.

Prejudice

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Holmes further asserts that "[e]ven if these anecdotes had some minimal probative value, the Rule 403 considerations would substantially outweigh that probative value." Holmes 563 Mot. at 5. Rule 403 allows the Court to exclude relevant evidence if its probative value is "substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury." Fed. R. Evid. 403.

Holmes argues that the patient testimony could confuse and mislead the jury about what is at issue in this case. "The jury will be tempted to infer from this evidence that Theranos was incapable of generating accurate and reliable test results—even though one cannot reliably draw that inference from this evidence." Holmes 563 Mot. at 6. Testimony about eleven inaccuracies (out of millions of tests) may have relatively low probative value towards proving that the tests were inaccurate overall, but for the same reason, they are unlikely to create unfair prejudice.

***31** Finally, Holmes objects that patient and physician testimony about receiving inaccurate test results are likely to be emotional and therefore highly prejudicial. For example, one proposed patient witness would potentially testify about receiving test results indicating that she had miscarried, when in fact, she later found out her pregnancy was still viable. As discussed further with respect to Holmes's motion to exclude evidence of customer impact below, the Court agrees with Holmes that such testimony would be unfairly prejudicial and of limited probative value. Evidence is unfairly prejudicial when it has "an undue tendency to suggest decision on an improper basis, commonly, though not necessarily, an emotional one." *See PG&E*, 178 F. Supp. 3d at 941 (citing *Old Chief*, 519 U.S. at 180, 117 S.Ct. 644). While the fact of inaccurate test results in itself is relevant to proving that Theranos tests were unreliable, the collateral consequences of receiving an inaccurate test result are not.

The Court finds that anecdotal evidence of test results is relevant and admissible. Accordingly, the Court DENIES the Motion. Patients, physicians, and other witnesses who may testify about receiving test results will not be permitted to testify about any physical, financial, or emotional harm they may have experienced beyond simply paying for the test.

Evidence of customer impact (Dkt. No. 562)

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Holmes brings this separate motion seeking to exclude evidence of collateral emotional effects suffered by Theranos customers who believe that they received erroneous results as well as hypothetical harms that can result from medical decisions based on erroneous results. Holmes notes that because this is a wire fraud case, the only harm that is relevant to the case is the financial harm allegedly caused by paying for an unreliable test.

As an initial matter, the Government recognizes, as it must, that Rule 403 would undoubtedly "step in" at some point to prevent certain evidence of such collateral consequence. *See*May 5, 2021 Hr'g Tr., Dkt. No 793, at 150:25–151:4. The Government nevertheless argues that this type of testimony must be allowed for three reasons: (1) customers experienced harm in the form of not only pure financial loss but also by not receiving the "benefit of the bargain" that they expected to receive, namely the ability to make timely and important medical decisions; (2) some evidence of impact on customers is relevant to show materiality; and (3) customer impact is relevant to Holmes's fraudulent intent.

The Court generally agrees with Holmes that the limited relevance and high risk of prejudice likely to result from evidence about the impact of inaccurate results; however, the Court also agrees with the Government that the Court need not take an "all or nothing" approach. At the May 5, 2021 hearing, the Court engaged in a line-drawing exercise with the parties, which Government counsel summarized as follows:

> Mr. Schenk:...If I can repeat back what the court said? I think if a patient were to take the stand and say, to use the court's example, I received a Theranos test and I thought I had cancer, or I thought I had a severe condition, and one thing I did in response to it was to

> go get other tests, and after I received a second test and then consulted with my physician, I determined, or my physician told me I didn't have cancer. I think that's appropriate and the court could limit it there. I agree with the Court, there is not the need then for the patient to say, there was two weeks between those two tests and here's how I felt during those two weeks.

May 5, 2021 Hr'g Tr., Dkt. No. 793, at 156:3–157:22. Holmes also agreed that as to the Rule 403 analysis, "that is potentially a fair line to draw." *Id.* at 157:4-10.

Accordingly, the Court **GRANTS** Holmes's motion to the extent it seeks to exclude emotional, graphic, or otherwise inflammatory evidence relating to the impact or potential impact on customers of inaccurate test results.

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> **Expert testimony of physician witnesses (Dkt. No. 561)** As noted above, the Government has disclosed as experts nine medical professionals

whose patients received allegedly inaccurate Theranos tests results during the period of the charged conspiracy. Holmes seeks to exclude testimony from these doctors because the doctors do not meet the standards for expert witness testimony under Rule 702, and their testimony is irrelevant and unfairly prejudicial. She further contends that the testimony should be excluded because the Government failed to provide adequate disclosures regarding the proposed testimony under Federal Rule of Criminal Procedure16.

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Rule 702

Holmes argues that pursuant to Rule 702, (1) these witnesses are not qualified to testify about the accuracy and reliability of Theranos tests overall, and (2) the opinions that they are qualified to give—i.e., opinions about their patients' specific test results—are irrelevant to this case. In its opposition brief, the Government clarified that it did not intend for the physician witnesses to opine about the accuracy or reliability of the tests overall, explaining that "the doctors on the [G]overnment's expert list will be called primarily as fact witnesses to testify about their experiences reviewing certain results from Theranos in connection with patients under their care." Gov't Opp'n to Holmes's 561 Mot. ("Gov't 561 Opp'n"), Dkt. No. 660, at 3. The Government further clarified that the physicians' testimonies will be limited to the specific results their own patients received from Theranos. The physicians will only act as expert witnesses to the extent they provide background information that the jury needs in order to understand the use and significance of the blood test being discussed and to explain why the doctor believed the test results to be inaccurate.

At the hearing on this motion, the Government affirmed these representations; however, the parties diverged on whether the physicians would be permitted to conclude that an inaccurate test result was due to "lab error." *See* May 5, 2021 Hr'g Tr., Dkt. No. 73, at 112:4–115:21. Because of the possible confusion involved in attributing an inaccurate result to "lab error," the Court finds it unnecessary for these physicians to use that particular phrase. More broadly, as established at the hearing, the physicians are not permitted to testify about accuracy or reliability of testing overall or about any flaw in the Theranos technology. *Id.* at 115:17-20.

Holmes also challenged certain physician's ability to provide any testimony about whether even an individual test results was inaccurate based on the physician's background and experience. The Court finds that a physician may testify about her patients' test results and her conclusions about those results as a matter of fact, not opinion, even where they involve an explanation of the witness's medical judgment. Holmes may challenge the physician's credibility or judgment through cross-examination. The Court finds no need for a *Daubert* hearing to assess these physicians' ability to offer what is essentially factual testimony.

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Relevance

Holmes's relevance arguments as to the physician witnesses is substantially the same as her relevance arguments with respect to anecdotal evidence, discussed above. The

difference is that these witnesses are offered as both fact and expert witnesses, meaning that not only must their testimony be relevant, but their opinions must also "fit the case." *Daubert v. Merrell Dow Pharms., Inc. (Daubert II)*, 43 F.3d 1311, 1321 n.17 (9th Cir. 1995); *Messick v. Novartis Pharms. Corp.*, 747 F.3d 1193, 1196 (9th Cir. 2014) (expert testimony "logically advance[ ] a material aspect of the proposing party's case") (citation omitted).

For the same reasons that the Court concluded that anecdotal evidence of inaccurate test results is relevant, the Court finds that the physician testimony sufficiently "fits" the questions that the jury must answer.

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Prejudice

Holmes argues that even if this expert testimony has some probative value, it should be excluded under Rule 403 because that value is outweighed by the prejudicial effect of the emotional charged anecdotes that these witnesses may share. Specifically, Holmes argues that the experts should not be permitted to hypothesize about "the potentially catastrophic medical consequences that could follow from inaccurate blood tests that were not flagged as inaccurate— even though those hypothetical consequences did not occur in this case." Holmes 561 Mot. at 20.

For example, the Government anticipates that Dr. Szmuc might provide testimony concerning the potential consequences of ectopic pregnancies, including rupturing, significant hemorrhaging "or the worst-case scenario of patient death." Dr. Linnerson might similarly testify that in cases of ectopic pregnancy, a doctor "must poison the embryo and cause it to dissolve in the tube to avoid danger to the mother." *Id.* at 21.

The Court finds these excerpts to be of little value to the jury and to present a significant risk of unfair prejudice. Much of this potential testimony is covered by the Court's ruling on customer impact evidence outlined above. For the same reasons and for the avoidance of doubt, the physicians will not be permitted to testify about emotional, graphic, or inflammatory harms that could hypothetically result from an inaccurate blood test. The physicians will, however, be permitted to provide general background on a test, including what it is used for, when it is prescribed, and what medical decisions may flow from the results.

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Rule 16

Lastly, Defendant argues that the Government has failed to provide adequate disclosures about the physician witnesses pursuant to Federal Rule of Criminal Procedure 16. Rule 16 requires the government to provide a "written summary of any testimony that the government intends to use under Rules 702, 703, or 705 of the Federal Rules of Evidence during its case-in-chief at trial." Fed. R. Crim. P. 16(a)(1)(G). The "summary provided...must describe the witness's opinions [and] the bases and reasons for those opinions." *Id.*; *see also United States v. Cervantes*, No. CR 12-792 YGR, 2015 WL 7734281, at *2 (N.D. Cal. Dec. 1, 2015) ("Rule 16 requires that the government summarize each specific opinion to be offered along with the basis for it."). This requirement "is intended to minimize surprise that often results from unexpected expert testimony, [to] reduce the need for continuances, and to provide the opponent with a fair opportunity to test the merit of the expert's testimony through focused cross-examination." Fed. R. Crim. P. 16 advisory committee's note to 1993 amendment.

***34** The Government served its Rule 16 summaries on March 6, 2020. Holmes asserts that for a number of the physicians, these disclosures do not identify the number of patients the physician will testify about, the patient names, or the test results on which the physician is basing the opinions. According to Holmes, she repeatedly requested that the government provide more information to no avail. In July 2020, Holmes moved to compel adequate summaries. Dkt. No. 435. At the hearing on that motion, the Court stated that "it may be necessary to have the government offer additional information in regards to some of the witness's testimony and the basis and reasons if that testimony is going to leave and move from treatment into other opinions that they wish to speak about." July 20, 2020 Hr'g Tr., Dkt. No. 463, at 59:12-18; *see also id.* at 59:26–60:3 ("I do think that the government is going to be required to produce some additional foundational information and background on some of this testimony."). The Court did not rule on the motion because the Government's decision to issue a superseding indictment would require revised disclosures in any event. *See id.* at 60:4-9.

The Government maintains that it has provided the Defendant with all of the information available to it. The Government

claims that there is no deficiency of information with respect to Drs. Zachman, Burnes, Couvaras, and Asin, though it acknowledges that "there is still information outstanding from several of these providers regarding the specific patients who received inaccurate Theranos tests." Gov't 561 Opp'n at 9. The Government further argues that it has made significant efforts to obtain the missing information but that these doctors are under extraordinary demands due to the pandemic. In its January 8, 2021 opposition brief, the Government noted that it "plans to serve Rule 17 subpoenas on the medical service providers immediately" and requested that the Court defer ruling on the motion until the witnesses have had time to produce the requested information. As of the May 6, 2021 hearing, the Government had not served Rule 17 subpoenas, and had provided some but not all of Holmes's requested additional information.

The Court agrees with Holmes that the disclosures are lacking in information necessary for her to adequately prepare for trial. The Government has represented that it will make every effort to timely supplement the disclosures. May 5, 2021 Hr'g Tr., Dkt. No. 793, at 105:25–106:2 ("It is our plan to continue those efforts [to obtain information] and also to provide updated disclosure to the defense listing the new details that we have obtained from those doctors"). In light of the Government's representation and the time remaining before trial, the Court finds no need to exclude any testimony on the basis of an inadequate disclosure at this stage.

The Court, therefore, **DENIES** Holmes's motion without prejudice, subject to renewal should the Government fail to provide updated disclosures in advance of trial.

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Laboratory Information System

Animating much of the conversation about the relevancy of anecdotal testimony in general is Holmes's overarching argument that the Government lacks the necessary scientific evidence to prove the scientific proposition that Theranos tests were inaccurate and unreliable. According to Holmes, the Government lacks that information because of its failure to investigate and preserve the Laboratory Information System ("LIS") database—a bespoke database that housed, among other things, all patient test results and all quality control data at Theranos. According to the Government, Theranos improperly destroyed that database while it was subject to a grand jury subpoena without providing a working copy of the database to the Government.

The parties generally dispute the importance of the database to the Government's case. *Compare* May 5, 2021 Hr'g Tr., Dkt. No. 793, at 47:20-21 (defense counsel stating that the "failure to obtain this evidence is a gaping hole in the Government's case"), *with id*. at 82:15-16 (Government counsel stating that "the LIS was not critical to the charging in this case nor is it critical to the proof at trial"). The parties also dispute the factual background leading up to the deconstruction of the LIS database. *See* Gov't 561 Opp'n at 2–8; Holmes Reply Br. in Supp. of Holmes's 561 Mot. ("Holmes 561 Reply"), Dkt. No. 575 at 7–20.

***35** The Court need not wade into the disputed issue of fault at this stage. The questions presently before the Court are (1) whether to preclude evidence of the destruction of the LIS database offered by the Government in its case-in-chief (*see* Holmes's Mot. in Limine to Exclude Bad Acts and False or Misleading Statements of Theranos Agents and Employees ("Holmes 565 Mot."), Dkt. No. 565, at 4); (2) whether to preclude Holmes from raising the Government's failure to obtain the LIS evidence in her defense; and (3) if Holmes is permitted to raise such a defense, whether the Government will then be permitted to offer evidence of Theranos' destruction of the database in response. The Court address each in turn.

First, the Government has argued that large-scale statistical analysis of Theranos' test results is not necessary to prove the elements of wire fraud in this case. *See, e.g.*, *id.* at 79:10–80:9 (Government explaining that while the LIS database would have been a "powerful tool" to identify patient victims and identify which assays Theranos was running and when, "the Government has been able to capture that information in various other ways"); *id.* at 80:14–81:2 (stating that "this case is not about overall failure rate" nor about "determining what percentage of Theranos' tests were inaccurate"). Moreover, the Government has not presented any evidence tending to show Holmes's involvement in what the Government would characterize as the nefarious destruction of the LIS database. As discussed in more detail above on Holmes's MIL regarding Rule 404(b) evidence, the Government must establish some connection between an alleged bad act and Holmes before evidence of that bad act becomes relevant. Thus, the Court finds that evidence tending to show Theranos' nefarious destruction of the LIS database, without more, is not relevant under Rules 401 and 404(b). The Court **GRANTS** Holmes's

motion to exclude such evidence without prejudice. The Government may seek to introduce such evidence upon a foundational showing establishing a connection to Holmes.

Second, the Government argues that Holmes should not be permitted to argue that the Government's evidence is "anecdotal" because it failed to conduct a statistical analysis of Theranos test results. The Government contends that such an analysis is not necessary, would likely not have been possible on the LIS database, and risks misleading the jury about what the Government is required to prove. Holmes maintains that fundamentally, she must be permitted to argue that the Government has failed to meet its burden of proof in this case. The Court agrees. Holmes has a right to put on a defense of her choosing, including an argument that the Government has failed to meet its burden of proof. *See, e.g.*, *Conde v. Henry*, 198 F.3d 734, 739 (9th Cir. 2000) ("precluding [defendant's] attorney from arguing his theory of the defense in closing arguments" "violated [defendant's] right to counsel"); *United States v. Solorio-Soto*, 300 F. App'x 487, 488–90 (9th Cir. 2008) (limitation on cross-examination "prevented [defendant] from arguing" that government's Rule 404(b) evidence did not establish element of the offense and violated his right to present a complete defense).

The Court declines to preclude Holmes from raising the lack of "statistical" or "scientific" evidence as a defense, from characterizing that missing evidence as critical to the Government's case, or from arguing about the statistical insignificance of individual patient or physician testimony. Thus, to the extent the Government's opposition brief seeks to preclude Holmes from offering such arguments, the Court denies that request.

Finally, the question remains whether, if Holmes argues that the LIS database is unavailable because of the Government's failure to obtain it, that argument opens the door to the Government presenting evidence of Theranos' culpability in the destruction of the LIS. At the motion hearing, the Court expressed its preliminary view that an argument of this nature from the Holmes would likely introduce a fact issue for the jury to decide. Whether it is necessary for the jury to hear evidence regarding fault in the destruction of the database will depend on what arguments Holmes raises at trial and whether she seeks any sort of jury instruction on the issue. The Court will defer ruling on this question unless and until it becomes relevant at trial.

***36** Editor's Note: Tabular or graphical material not displayable at this time.

Summary

In conclusion, the Court finds evidence of anecdotal testimony relevant and admissible, and therefore **DENIES** Holmes's motion to exclude evidence of anecdotal test results.

The Court **GRANTS** Holmes's motion to exclude customer impact evidence, but will permit witnesses to testify in accordance with the parameters laid out above.

The Court **DENIES** Holmes's motion to exclude expert physician witnesses without prejudice to renewal if the Government fails to timely supplement its Rule 16 disclosures.

Finally, the Court further **GRANTS** Holmes's motion to preclude evidence of Theranos' involvement in the destruction of the LIS database, unless and until the Government lays a proper foundation at trial or Holmes puts the factual dispute in issue.

I. Holmes's MIL to Exclude Bad Acts and False or Misleading Statements of Theranos Agents and Employees (Dkt. No. 565)

Holmes moves to preclude the Government from introducing "evidence of bad acts or false or misleading statements of Theranos agents or employees other than her alleged co-conspirators and alleged accomplices, at least absent a sufficient advance showing from the [G]overnment pursuant to Rule 104." Holmes Reply Br. in Supp. of Holmes's 565 Mot. ("Holmes 565 Reply"), Dkt. No. 708, at 4; *see also* Holmes 565 Mot. Holmes contends that the evidence is irrelevant, and even if it has some probative value, the combined prejudice, confusion, and time lost in mini-trials resulting from admitting the evidence would together substantially outweigh the limited probative value. In particular, Holmes provides the following examples of anticipated evidence and arguments regarding Theranos agents and employees that she contends the Government has not connected to any knowledge or conduct on her part.

1. "The government identifies the experiences of seven patients as evidence that Ms. Holmes knew Theranos was unable to provide accurate and reliable test results, [sic] but it does not identify any evidence that Ms. Holmes was ever informed about three of these patients' experiences. Ex. 3

at 5-6 (Sept. 28, 2020 Rule 404(b) Notice). For example, with respect to R.G., the government claims only that '[n]umerous employees reporting to Holmes and Balwani became aware of the test.' *Id.* at 6."

2. "The government again alleges that 'Defendants *and their agents* made statements directly to doctors in connection with Theranos's tests and specific results.' Ex. 3 at 12-15 (emphasis added). This portion of the supplemental 404(b) disclosure identifies numerous statements by unidentified 'Theranos representatives' that the government intends to introduce. Illustrative examples include the following: *id.* at 12 ('A Theranos representative told Dr. Jessica Bramstedt that Theranos would conduct micro-testing on blood samples drawn from the fingertip; that Theranos was equivalent to other major labs like LabCorp and Sonora Quest, and that when Theranos lost its lab license, it was merely a slap on the wrist that would have a temporary effect on the company.'(internal quotation marks omitted); *id.* ('Theranos representative Kimberly Alfonzo told Dr. Gerald Asin that Theranos could do all blood tests with a fingerstick draw...'); *id.* ('A Theranos sales representative told Dr. Nathan Matthews that Theranos's testing was accurate...'); *id.* at 13 ('Theranos representatives told Dr. Steve Linnerson that the company's device was FDA-approved and that it had met all the national laboratory standards...'); *id.* at 14 ('Results from each of these types of HbA1c tests were provided to doctors without explanation as to the types of analyzers used to conduct the assays, creating a situation where doctors did not have the information they needed to place the results in context.')."

***37** 3. "The government makes various allegations related to Theranos' process for setting reference ranges that have no connection to Ms. Holmes (or Mr. Balwani). *Id.* at 71, 105 S.Ct. 460."

4. "The government alleges that '[w]hen Theranos obtained critical test results for chloride, it conducted a redraw and/or rerun rather than reporting the critical value,' with no connection to Ms. Holmes. *Id.* at 73, 105 S.Ct. 460."

5. "According to the government, 'Results from...HbA1c tests were provided to doctors without explanation as to the types of analyzers used to conduct the assays, creating a situation where doctors did not have the information they needed to place the results in context. This was especially problematic in situations where a single patient had multiple Theranos assays conducted using different methods, yielding different results that falsely suggested to the doctor that the patient's analyte values had changed. This was the case with a patient treated by Dr. Phelan, who was the subject of internal emails at Theranos.' The government does not tie this allegation to Ms. Holmes."

6. "The government asserts, in inflammatory language, that Theranos 'senior managers' destroyed Theranos' database of patient data in 2018. *Id.* at 79-80, 105 S.Ct. 460. According to the government, Theranos produced the database to the government but failed to provide a password needed to access the database; Theranos employees and consultants then dissembled the hardware that housed the database. *Id.* The government claims that these actions 'place the government's evidence in context as part of a larger fraud scheme, one which Theranos was attempting to hide and conceal even after the indictment in this case.' *Id.* at 81, 105 S.Ct. 460. The government does not tie these wild accusations to Ms. Holmes, nor could it, as Ms. Holmes had not been part of company management for several months and had no involvement in responding to these requests."

7. "The government alleges that acts by David Boies, a lawyer for Theranos and Ms. Holmes, and by Theranos' then-General Counsel Heather King are evidence of Ms. Holmes' mental state. Specifically, it alleges that '[o]n or about September 8, 2015, David Boies, at Theranos's direction, wrote to the Editor-in-Chief of Dow Jones [which publishes the *Wall Street Journal*] in an attempt to quash [journalist John] Carreyrou's pending story' on Theranos. *Id.* at 60, 105 S.Ct. 460. The government further alleges that '[o]n or about October 8, 2015, Boies and Heather King (Theranos's General Counsel) spoke to the Dow Jones' Editor-in-Chief and others in an attempt to quash Carreyrou's pending story.' *Id.* The government makes no allegation about Ms. Holmes' role in these actions." Holmes 565 Mot.at 3–4.

It is well settled that "guilt" is an "individual and personal" matter, and thus vicarious liability "has no place in the criminal law as our Rules of Evidence recognize." *United States v. Cadden*, No. 14-10363-RGS, 2018 WL 2108243, at *6 (D. Mass. May 7, 2018); *see also Lady J. Lingerie, Inc. v. City of Jacksonville*, 176 F.3d 1358, 1367 (11th Cir. 1999) ("[D]ue process prohibits the state from imprisoning a person without proof of some form of personal blameworthiness more than [an agency relationship]."). A defendant may be liable for the actions of another in only limited circumstances, such as where there is conspiracy liability. *United States v. Tarallo*, 380 F.3d 1174, 1184 (9th Cir. 2004), *amended*, 413

F.3d 928 (9th Cir. 2005). Evidence of "guilt by association" is improper. *See United States v. Dunn*, 640 F.2d 987, 989 (9th Cir. 1981) (vacating conviction where government "concentrated on the criminal convictions of other members of [defendant's] family" and impeached witness through "the crimes of her brother").

***38** Here, the Government does not specifically address the so-called bad acts, with one exception. Instead, the Government focuses on actions that it alleges Holmes took herself. For example, the Government intends to call witnesses at trial to testify about Holmes's role in assembling and approving materials that went to potential and actual investors in the company. These materials contain the numerous allegedly false and misleading statements about Theranos' technology, including the number of tests it could perform and the level of accuracy it could achieve. The Government also intends to present testimony from investors regarding their conversations with Holmes and the ways she misled them about the regulatory status of Theranos and the military's purported use of the company's analyzer. Holmes also repeated to members of the media the allegedly false statements she delivered to potential investors.

The Government also intends to present evidence of Holmes's role in responding to customer inquiries. For example, the Government intends to present evidence that in August 2014, Holmes directed Theranos employees regarding how to respond to customer inquiries about withheld test results. Specifically, Theranos representatives were to respond that "CO2 results were not reported due to temporary unavailability of this test for this sample" and note that the company was growing as fast as it could. Gov't Opp'n to Holmes 565 Mot. ("Gov't 565 Opp'n"), Dkt. No. 662, at 3. In February 2015, Holmes allegedly approved a script for Theranos representatives to use when explaining changes to its Complete Metabolic Panel (CMP) tests to customers.

The problem with the Government's argument is Holmes's motion is not directed to evidence of her role in preparing materials for investors, her presentations to investors, or to her personal engagement with the media. Nor is Holmes's motion directed to evidence of her role in responding to customer inquiries. And indeed, evidence of Holmes's direct participation in these activities is relevant to the alleged fraud. *See, e.g.*, *United States v. Blitz*, 151 F.3d 1002, 1006 (9th Cir. 1998) (evidence of personal contact with prospective victims was sufficient to sustain conviction for knowing participation in fraudulent scheme); *United States v. Lothian*, 976 F.2d 1257, 1267–68 (9th Cir 1992) (evidence that defendant made misrepresentations to customers about company was sufficient to prove fraud); *United States v. Peters*, 962 F.2d 1410, 1414 (9th Cir. 1992) (upholding conviction for fraud because appellant knew of complaints from victims about money they were promised, continued to do administrative tasks, and deposited fraudulently acquired checks). Rather, Holmes seeks to exclude "bad acts" that she contends the Government has not connected to her.

The only other evidence the Government proffers to connect Holmes to the "bad acts" is her status as founder and CEO of Theranos. The Government contends that Holmes was involved in virtually every aspect of the company and that she possessed final authority over decisions on virtually any issue facing the company. In other words, Holmes exerted "influence" over all facets of the company's operations. Gov't 565 Opp'n at 3. For example, the Government contends that as CEO, Holmes was the primary contact for David Boies, and therefore "[i]t is implausible that Defendant did not play a significant role in influencing Boies's actions during that time period." *Id.* at 5.

The Government's proffered evidence is not enough to connect Holmes to Boies. To do so would invite the jury to potentially find Holmes vicariously liable for the actions of others based on nothing more than her "influence." The only case the Government cites in support of this "influence" theory is *United States v. Ciccone*, 219 F.3d 1078, 1083–85 (9th Cir. 2000). But the Government's attempt to analogize this case to *Ciccone* is strained. In *Ciccone*, the owner of a telemarking company designed a "pitch" for his solicitors to use in order to persuade people to send money to his company. *Id*. at 1080. On appeal, the defendant argued that there was insufficient evidence to permit a jury to convict because he did not call the victims; his solicitors did. *Id*. at 1084. The Ninth Circuit rejected that argument because there was evidence in the record that he did make some calls himself, and even if he did not himself make the calls, "[t]he defendant need not personally have mailed the letter or made the telephone call; the offense may be established where one acts with the knowledge that the prohibited actions will follow in the ordinary course of business or where the prohibited acts can reasonably be foreseen." *Id*. at 184, 117 S.Ct. 644 (quoting *Lothian*, 976 F.2d at 1262). *Ciccone* in no way suggests that the defendant was convicted based on evidence of his "influence" over his company. The Government may attempt to hold Holmes liable for her own acts, as in *Ciccone*. But it cannot attribute the acts of others to her without

evidence that causally connects her with those actions. *Lady J. Lingerie*, 176 F.3d at 1367; *see also United States v. Rank*, 805 F.2d 1037, at *4 (6th Cir. 1986) ("declin[ing] to adopt the government's theory, akin to a respondeat superior basis for criminal liability" for president and CEO of a company in a mail fraud case).

***39** Perhaps in implicit recognition of the need for evidence of a causal connection between Holmes and the so-called "bad acts," the Government represents that it is likely that further trial preparation will lead to former Theranos employees who "will have additional information about the control Defendant had over employee's knowledge of key facts and their responses to questions other posed about the company." Gov't 565 Opp'n at 5. Because pretrial preparation is ongoing, the Court is not inclined to issue a pretrial order precluding evidence of all "bad acts." Nevertheless, it is incumbent upon the Government to come forward with proof of a sufficient connection between Holmes and each "bad act" so that the Court may assess the relevance and potential prejudice of each "bad act." Fed. R. Evid. 104(b) ("When the relevance of evidence depends on whether a fact exists, proof must be introduced sufficient to support a finding that the fact does exist."). Further, Rule 104(c)(3) requires a hearing out of the presence of the jury to consider whether the Government has presented sufficient evidence of a connection to justify admissibility of any particular bad act, to avoid Rule 403 issues. Fed. R. Evid. 104(c)(3) ("The court must conduct any hearing on a preliminary question so that the jury cannot hear it if...(3) justice so requires."); *see also United States v. Evans*, 728 F.3d 953, 957 (9th Cir. 2013) (describing a Rule 104 pretrial hearing for such a purpose in the proceedings below). This approach will "insure[ ] that the jury will not be tainted by hearing prejudicial evidence—or learning of its existence—until the [Government] has demonstrated that it will be able to provide an adequate foundation for admission." *United States v. Branch*, 970 F.2d 1368, 1371 (4th Cir. 1992).

Holmes's motion is **DEFERRED** pending the Government's establishment of the necessary foundation for the evidence it seeks to introduce.

J. Holmes's MIL to Exclude Evidence of Theranos' Trade Secrets Practices (Dkt. No. 566)

Holmes next moves to preclude the Government from introducing evidence of Theranos' trade secrets practices. Holmes's Mot. in Limine to Exclude Evidence of Theranos' Trades Secrets Practices Under Rules 401-404 ("Holmes 566 Mot."), Dkt. No. 566. The motion primarily concerns three categories of evidence about Holmes playing a role in: (1) fostering a culture of secrecy and forcing employees and others to sign non-disclosure agreements; (2) restricting access to laboratory areas within Theranos; and (3) threatening or intimidating employees or former employees. *See* Saharia Decl., Ex. 1, Dkt. No. 580 at 4–6. The Government states evidence related to these categories "tends to show consciousness of guilt and tends to show a belief that transparency would expose the falsity of what [Holmes] claimed to investors, patients, and others." *See id*., Ex. 3, Dkt. No. 580-2 at 55, 57, 63. Moreover, the Government stated at the hearing that it "wants to offer this evidence to say that these were practices at Theranos to prevent the discovery of the fraud." May 6, 2020 Hr'g Tr., Dkt. No. 794, at 46:24–47:1.

Holmes argues that these actions largely reflect common measures that California law requires companies like Theranos to adopt to protect their trade secrets. According to Holmes, evidence concerning Theranos' trade secrets practices has no probative value and will confuse, mislead, and prejudice the jury because the noticed categories of evidence merely depict a company protecting its trade secrets. Holmes also argues that these categories of evidence are inadmissible character evidence under Rule 404(b) because they are too different and unrelated to the charged offense.

The Court first addresses Holmes's Rule 404(b) argument. Although Holmes correctly notes that evidence of another act is admissible evidence of intent only if the other act is "similar to the offense charged," a review of the three categories suggests that this evidence should not be considered "acts" for purposes of Rule 404(b). *United States v. Mayans*, 17 F.3d 1174, 1181 (9th Cir. 1994). The Ninth Circuit has held that "evidence should not be considered 'other crimes' or 'other act' evidence within the meaning of Rule 404(b) if 'the evidence concerning the 'other' act and the evidence concerning the crime charged are inextricably intertwined.' " *United States v. Dorsey*, 677 F.3d 944, 951 (9th Cir. 2012) (quoting *United States v. Soliman*, 813 F.2d 277, 279 (9th Cir. 1987)). This doctrine applies when the acts in question are so interwoven with the charged offense that they should not be treated as other crimes or acts for purposes of Rule 404(b). There are generally two categories of cases in which the Ninth Circuit has concluded that "other act" evidence is inextricably intertwined with the charged crime and therefore need not meet the requirements of Rule 404(b). *Vizcarra-Martinez*, 66 F.3d at 1012. First, evidence constituting a part of the transaction that serves as the basis for the criminal charge is admissible. *Id*. Second, "other act" evidence may

be admissible if necessary to permit the prosecutor to offer a coherent and comprehensible story regarding the commission of the crime. *Id*. at 1012–13. "[I]t is obviously necessary in certain cases for the government to explain either the circumstances under which particular evidence was obtained or the events surrounding the commission of the crime."

***40** *Id*.

Under these authorities, even if the identified categories of evidence dealing with trade secrets practices at issue were not part of the crime charged, they are not subject to exclusion because they allow the Government to offer a coherent and comprehensible story regarding the commission of the charged crime. The Government seeks to introduce this evidence to show that these practices at Theranos were intended to prevent the discovery of the alleged fraud. These acts relate to the alleged scheme to defraud as a whole.

Moreover, much of the evidence discussed in these categories is evidence that can be introduced not as Rule 404(b) evidence but as factual evidence. In particular, former employees of Theranos may testify largely about their observations and experiences while working at the company. Their personal experiences and observations related to some of the trade secrets practices Theranos implemented is not inadmissible character evidence for this purpose.

The Court finds that Rule 403 does not prohibit the admission of this evidence. The evidence the Government anticipates it will introduce is highly probative of a specific element of the charged offense—namely, Holmes's alleged scheme to defraud and the steps she took to continue the scheme. Holmes argues that presentation of evidence concerning Theranos' trade secrets practices would create a series of mini-trials as she would be unduly forced to introduce expert testimony to try to establish that Theranos' trade secrets practices were not improper. This disagreement about particular trade secrets practices and when and how they were employed is a factual dispute. Additionally, although evidence related to threatening or intimidating employees or former employees of Theranos may be prejudicial, the evidence is relevant as to how Holmes was operating the company and therefore does not rise to the level of unfair prejudice. Finally, the Court does note that for some of these practices, it will be incumbent upon the Government to come forward with a sufficient connection between Holmes and Theranos' implementation of particular trade secrets practices, including threatening and intimidating employees or former employees of the company.

For these reasons, Holmes's motion to exclude evidence of Theranos' trade secrets practices is **DENIED** at this time. Holmes may raise pertinent objections at trial if the Government has not established a sufficient connection between Holmes and Theranos' trade secrets practices.

K. Holmes's MIL to Exclude Certain Evidence and Argument Regarding Third-Party Testing Platforms (Dkt. No. 576)

In this motion Holmes moves to exclude evidence and argument that Theranos "tampered with" and "concealed" commercially available third-party diagnostic testing platforms. Holmes's Mot. in Limine to Exclude Certain Evidence and Argument Regarding Third-Party Testing Platforms Under Rules 401-403, 404(b), and 702 ("Holmes 576 Mot."), Dkt. No. 576. Holmes, however, is not arguing that the Government should be precluded from introducing evidence related to the modifications or the tests run on the modified testing platforms. Rather, Holmes argues the Government should be precluded from insinuating there was anything improper about such modifications or that the modifications violated the manufacturer's specifications or from presenting any evidence of the same. *Id.* at 4. Additionally, Holmes asserts the Government should be precluded from suggesting that the measures Theranos implemented to protect these trade secrets were improper or an attempt to "conceal" information. *Id*.

***41** The Government responded in its opposition and at the hearing that it does not intend to introduce testimony or argument that Theranos' modifications of third-party analyzers violated industry standards or manufacturer agreements, or that those modifications were wrong or unethical in and of themselves. Gov't Opp'n to Holmes's 576 Mot. ("Holmes 576 Opp'n"), Dkt. No. 666, at 2; May 6, 2021 Hr'g Tr., Dkt. No. 794 at 65:9-12. Still, while the Government will be able to present evidence related to modifications Theranos made to third-party testing platforms, the use of the phrase "tampered" goes beyond the scope of proposed witness testimony and opinions related to third-party testing platform modifications. The Government has not presented any opinions from qualified experts under Rule 702 to establish whether and to what extent certain modifications to third-party testing platforms may be considered "tampering."

Thus, while the Government can introduce evidence related to the modifications or the tests run on third-party platforms, it will not be able to frame its evidence and argument in a way to

suggest the third-party platforms were "tampered" with until and unless that has been proven by appropriate evidence.

Holmes also argues the Government should be precluded from introducing evidence about what was or was not "concealed" or shared with manufacturers of the third-party testing platforms. Holmes contends there is no probative value to this evidence, and it will only serve to unfairly prejudice her for conduct related to protecting trade secrets. For similar reasons discussed in Holmes motion to exclude evidence about Theranos' trade secrets practices, the Court finds this type of fact evidence to be probative and not so unfairly prejudicial it outweighs the probative value. Theranos' use of third-party platforms and what Holmes and Theranos disclosed about its use correlates to key events at issue in this case. The Court, therefore, finds evidence relating to what Theranos disclosed and did not disclose about modifications to third-party platforms is relevant and not unfairly prejudicial.

Accordingly, the Court **GRANTS IN PART** and **DENIES IN PART** Holmes's motion to exclude certain evidence and argument regarding third-party testing platforms.

L. Holmes's MIL to Exclude Evidence of Alleged Blaming and Vilifying of Competing Companies and Journalists (Dkt. No. 577)

The Government intends to present evidence under Rule 404(b) that Defendants blamed or vilified competing companies and journalists. *See* Holmes's Mot. in Limine to Exclude Evidence of Alleged Blaming and Vilifying of Competing Companies and Journalists Under Rules 401-403 and 404 ("Holmes 577 Mot."), Dkt. No. 577. Specifically, the Government identifies five acts that it intends to introduce at trial:

> 1) A Theranos employee will testify that Holmes and Balwani led a group of employees in a chant of "Fuck you, Sonora Quest," with the implication that competitors such as Sonora Quest and Quest were "behind the questioning of Theranos." Saharia Decl., Ex. 3 at 59.
>
> 2) A Walgreens employee will testify that Holmes stated that "Theranos' competitors were sending people into Walgreens to order esoteric blood tests in order to throw off the blood draw percentages." *Id.* at 61, 105 S.Ct. 460.
>
> 3) Another Walgreens employee will testify that "Balwani advised Walgreens that the reasons for the high number of venous blood draws included the cartridges not being ready for tests that were being ordered, LabCorp and Quest sending people in to order tests which required venous blood draws, and doctors ordering esoteric tests." *Id.* at 61–62, 105 S.Ct. 460.
>
> 4) A Theranos employee will testify that he learned at "an all-hands meeting" of an impending WSJ article by John Carreyrou. At that meeting, "the attendees were told the article made several allegations that were false, and that this story was being pushed by LabCorp and Quest." *Id.* at 62, 105 S.Ct. 460.
>
> ***42** 5) A Theranos employee will testify that Holmes and Balwani led a group of employees in a chant of "Fuck you, Carreyrou." *Id.* at 59, 105 S.Ct. 460.

Holmes argues that this evidence is irrelevant under Rules 401, 402 and 404, and that if the Government intends to introduce this evidence under Rule 404(b) as false statements, the Government has not complied with its obligation to identify evidence of falsity under Criminal Local Rule 16-1(c)(3). Holmes 577 Mot. at 3–4; Holmes Reply Br. in Supp. of Holmes's 577 Mot. ("Holmes 577 Reply"), Dkt. No. 720, at 1–4.

The Government concedes that the evidence concerning "Fuck you" chants is "somewhat inflammatory," but argues that Holmes's "extreme response to media criticism" is probative of her "*mens rea* and consciousness of guilt." Gov't Opp'n to Holmes 577 Mot. ("Gov't 577 Opp'n"), Dkt. No. 678, at 3–4. With respect to the statements Defendants made to Walgreens employees and the all-hands meeting concerning the impending WSJ article, the Government contends such statements are admissible "to provide 'a coherent and comprehensible story regarding the commission of the crime' " and that they are probative of Holmes's intent, knowledge, and consciousness of guilt. *Id.* at 4–5 (quoting *United States v. DeGeorge*, 380 F.3d 1203, 1220 (9th Cir. 2004)).

The Court agrees with Holmes that the chants have little probative value as to whether Theranos' technology was accurate or reliable, or whether Holmes made false statements to investors or customers. Fed. R. Evid. 401, 402. Whatever minimal probative value this evidence offers is outweighed by the potential for prejudice. Fed. R. Evid. 403.

As to the statements made at the all-hands meeting regarding the WSJ article and the statements Defendants made

to Walgreens employees, the Court finds significant the Government's inability to point to any evidence in its Rule 404(b) disclosure showing that those statements were false. The Government says only that "[t]he evidence at trial *will* show that these are misrepresentations, made to Walgreens in an attempt to explain why Theranos was failing to do what it claimed it could do" and that "[t]hese misrepresentations are therefore inextricably intertwined with the alleged investor fraud and should be admitted." Gov't 577 Opp'n at 4 (emphasis original). The Government does not explain what evidence will prove falsity, and the Court therefore cannot say at this time whether the statements should be excluded. The Court declines the Government's invitation to allow the Government to escape its Criminal Local Rule 16-1(c)(3) obligations by admitting the statements as part of an overall narrative, particularly when the Government has not adequately explained why statements about potential sabotage by Theranos competitors tends to shed any light on investor fraud.

Accordingly, the Court **GRANTS** Holmes's motion as to the chants, but **DEFERS** ruling on the statements to Walgreens employees and the all-hands meeting statements.

M. Holmes's MIL to Exclude Evidence of Alleged Violations of Industry Standards and Government Regulations (Dkt. No. 569)

In this motion, Holmes seeks to exclude evidence regarding Theranos' purported "[v]iolations of industry standards and government regulations or rules regarding research and development procedures, medical devices and clinical laboratory practices." Holmes's Mot. in Limine to Exclude Evidence of Alleged Violation of Industry Standards and Government Regulations Under Rules 401-403 ("Holmes 569 Mot."), Dkt. No. 569, at 1–2 (citing Saharia Decl., Ex. 1, Dkt. No. 580 at 7). The Government's 404(b) notice states, "[i]n furtherance of their scheme to defraud, Defendants disregarded and failed to conform to industry standards as well as government regulations or rules regarding research and development procedures, medical devices and clinical laboratory standards." Saharia Decl., Ex. 1, Dkt. No. 580 at 7. Specifically, Holmes seeks to exclude any testimony offered suggesting that Theranos violated any industry standard or federal regulation. *See* May 4, 2021 Hr'g Tr., Dkt. No. 792, at 170:14-18.

***43** Holmes, for example, points to the Government's intent to introduce as part of Dr. Rosendorff's testimony, evidence that after Theranos began using the Theranos blood analyzer ("Edison 3.5") in the CLIA lab in November 2013, Dr. Rosendorff advised Balwani by email: "we are currently not compl[iant] in terms of CLIA law." *See* Leach Opp'ns Decl., Ex. 45, Dkt. No. 681-9. Dr. Rosendorff also highlighted how Theranos had not established the upper end of reportable reference ranges for tests. *Id*. Holmes has identified four subcategories of evidence disclosed by the Government she believes are at issue in this motion and should not be introduced to suggest Theranos violated industry standards or federal regulations : (1) research and development validation studies; (2) clinical trials; (3) CMS and CDPH reports and correspondence; (4) Theranos' control over its laboratory. Holmes 569 Mot. at 4–5. To support her request, Holmes argues that (1) the Government's evidence of alleged violations of industry standards and government regulations requires impermissible legal opinions and (2) alleged violations of industry standards and government regulations are irrelevant and prejudicial.

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The Government's evidence of alleged violations of industry standards and federal regulations does not require impermissible legal opinions

Holmes is correct that experts may interpret and analyze factual evidence but may not testify about the law. *See S.E.C. v. Capital Consultant, LLC*, 397 F.3d 733, 749 (9th Cir. 2005). Indeed, testimony that is "couched...in the form of a legal conclusion—ostensibly based on what appears to be [the witness'] own survey of state laws...is improper and must be excluded." *Lukov v. Schindler Elevator Corp.*, No. 5:11-cv-00201 EJD, 2012 WL 2428251, at *2 (N.D. Cal. June 26, 2012).

Here, however, the Government is not seeking to introduce impermissible legal opinions related to important legal questions for the case. Instead, The Government want to introduce evidence, like Dr. Rosendorff's statements about CLIA regulations and industry standards, because they are relevant to central issues regarding notice to Holmes and her state of mind. Specifically, the Government seeks to use Dr. Rosendorff's statements about Theranos' compliance with industry standards and federal regulations to introduce into

evidence how Holmes responded when these issues were brought to her attention by Theranos' laboratory director. Gov't Opp'n to Holmes 569 Mot. ("Gov't 569 Opp'n"), Dkt. No. 670, at 5–6. Citing *United States v. Graf*, 610 F.3d 1148, 1164 (9th Cir. 2010), the Government argues this purpose is consistent with Ninth Circuit case law. In *Graf*, the court affirmed admission of statements relating to legal conclusions communicated to a defendant because the evidence was relevant to the defendant's state of mind. 610 F.3d at 1164.

Accordingly, while the Government cannot offer evidence detailing violations of industry standards or government regulations solely to support an element of the charged offense, the Court will allow statements made to Holmes which concerned perceived violations of industry standards and government regulations to be admitted. A curative instruction will be given to the jury dictating that this evidence is being offered only to show notice was given to Holmes and her state of mind. The evidence will not be introduced for the purpose of establishing that Theranos' laboratory practices violated industry standards or government regulations.

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Evidence of alleged violations of industry standards and federal regulations is relevant and not unduly prejudicial

Because the Government asserts that evidence relating to alleged violations of industry standards and government regulations relates to Holmes's knowledge and response to certain laboratory conditions, Holmes's Rules 401 and 403 arguments lack merit. Each of the subcategories identified by Holmes concern aspects of Theranos' laboratory practices, and are probative because of the notice given to Holmes about different aspects of the lab and her state of mind after she was given notice. The TSI pointedly puts this evidence at issue. The Court's curative instruction to the jury also helps to eliminate the risk of undue prejudice.

***44** Accordingly, the Court **DENIES** Holmes's motion to exclude evidence of alleged violations of industry standards and government regulations.

N. Holmes's MIL to Exclude Theranos Customer Service Spreadsheets (Dkt. No. 570)

Holmes moves on hearsay, prejudice, and improper character evidence grounds to preclude the Government from introducing Theranos' customer-service spreadsheets, which purportedly contain summaries of various customer-service communications. Holmes's Mot. in Limine to Exclude Theranos' Customer-Service Spreadsheets Under Rules 401-404 and 801-803 ("Holmes 570 Mot."), Dkt. No. 570. The Government intends to offer these spreadsheets to demonstrate that Holmes "knew that Theranos' tests...suffered from accuracy problems that rendered them unreliable and not suitable for informing clinical treatment decisions." Saharia Decl., Ex. 1, Dkt. No. 580 at 2; *id*, Ex. 3, Dkt. No. 580-2.

The Government opposes this motion, rejecting Holmes's argument that the customer-service spreadsheets are hearsay (and their contents double hearsay). According to the Government, the customer-service spreadsheets are admissible as business records and probative of Holmes's intent to defraud because they help show that Holmes had notice of "shortcomings" with the technology she was marketing to patients. Gov't Opp'n to Holmes's 570 Mot. ("Gov't 570 Opp'n"), Dkt. No. 665, at 1. Holmes argues the Government has not established she reviewed, was familiar with, or even had access to the spreadsheets. Holmes 570 Mot. at 6. In addition, Holmes argues the Court should preclude the Government from introducing the customer-service spreadsheets at trial pursuant to Rule 403. *Id.* at 7. In contrast, the Government argues Holmes is prematurely seeking to have the Court sustain objections to the purported business records before the Government has had the opportunity to obtain certificates of business records or call custodians at trial to meet the Federal Rule of Evidence 803(6) standard and lay foundation for how Holmes was kept informed of customer complaints. Gov't 570 Opp'n at 3–5.

Under Rule 803(6), business records fall within an exception to the hearsay rule. For a document to be considered a business record, the following criteria must be satisfied: "(A) the record was made at or near the time by--or from information transmitted by--someone with knowledge; (B) the record was kept in the course of a regularly conducted activity of a business, organization, occupation, or calling, whether or not for profit; (C) making the record was a regular practice of that activity; (D) all these conditions are shown by the testimony of the custodian or another qualified witness, or by certification that complies with Rule 902(11) or (12) or with a statute permitting certification; and (E) the opponent does not show that the source of information or the method or circumstances of preparation indicate a lack of trustworthiness." Fed. R. Evid. 803(6).

The Court cannot rule on the business records issue until trial. The Government states it intends to introduce the proper custodians and certificates and lay foundation connecting these spreadsheets to Holmes at trial. Gov't 570 Opp'n at 3–5. The Court does find, however, that the contents of the spreadsheets, i.e., the purported summaries of customer communications, can be introduced to show notice. Such evidence would not run afoul of Rule 801(c) because it would not be offered for the truth of the matter asserted that there were "shortcomings" with Theranos' technology. *See White v. Ford Motor Co.*, 312 F.3d 998, 1009 (9th Cir. 2002) (upholding the use of customer reports to show notice without concluding that the reports were admissible for their truth); *see also United States v. Moseley*, 890 F.3d 9, 13 (2d Cir. 2020) (evidence of "complaints which were called to a defendant's attention" are "relevant to the issue of the defendant's intent.").

***45** Although specific customer complaints included in the spreadsheets that focus on Theranos' testing cannot be considered to prove the truth of the matter asserted, complaints about Theranos' technology can be admissible to show Theranos received such complaints. Moreover, this evidence could help establish Holmes state of mind or knowledge related to specific allegations in the TSI.

With respect to Holmes's Rule 403 objection, her knowledge or notice is an essential element of the alleged scheme to defraud. However, introduction into evidence of the specific details of the customer complaints that address Theranos' tests would be a waste of time, could confuse and mislead the jury, and be prejudicial to Holmes. Accordingly, the Court would only allow the Government to present evidence that customer complaints focusing on Theranos' tests exist but will not be allowed to introduce the specific details of the complaints. The Court would also give the jury a limiting instruction that such evidence is admissible only for the purpose of establishing Holmes's notice of those complaints and cannot be used to establish there were actual issues with Theranos' technology or for any other purpose.

Accordingly, the Court declines to issue an order broadly precluding the customer-service spreadsheets or evidence that those summaries of customer communications about Theranos' testing technology exists and **DEFERS** ruling until trial.

O. Holmes's MIL to Exclude Certain Rule 404(b) Evidence for Lack of Expert Support (Dkt. No. 564)

Holmes next moves to exclude three subcategories of evidence disclosed in the Government's Rule 404(b) notice dealing with aspects of Theranos' laboratory practices: (1) multiplexing test results and disregarding outliers to mask inconsistency; (2) improperly setting and altering reference ranges; and (3) withholding important information from doctors and patients. *See generally* Holmes's Mot. in Limine to Exclude Certain Rule 404(b) Evidence For Lack of Expert Support Under Rules 401-403 and 701-702 ("Holmes 564 Mot."), Dkt. No. 564.

Holmes argues the Government cannot prove that Theranos' laboratory practices violated industry standards or were otherwise improper in part because these are issues "based on scientific, technical, other specialized knowledge," that require expert testimony. Fed. R. Evid. 701. Holmes adds that the Government has disclosed no such expert testimony and that no expert will be able to opine that these aspects of Theranos' laboratory practices rendered Theranos' tests inaccurate or unreliable. Thus, this evidence is irrelevant, any connection between this evidence and Holmes's intent is speculative, and the Court should exclude it under Rules 401-403 and 701-702.

Although included in the Government's Rule 404(b) notice, the Court recognizes the majority of evidence within these three subcategories as fact evidence not necessitating evaluation under Rule 404(b). These subcategories also correlate to key allegations raised in the TSI, or are probative to what Holmes's knew about laboratory practices and not unduly prejudicial.

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> **Multiplexing test results and disregarding outliers to mask inconsistency** With respect to the use of "multiplexing," the Government alleges that Theranos "operated

its analyzers according to a protocol that included running each individual test [six] times [on a given sample in parallel] and then multiplexing the test results in order to drive the final, reported result." Saharia Decl., Ex. 1 at 8. When a patient's sample was inserted into the Theranos device, six pipette tips would simultaneously draw six portions of blood from the larger sample. Each of those six portions would then be tested for the target analyte, i.e., the substance that was being measured. Those six tests would then yield six results. Theranos' algorithm would then review the

set of six numerical values and discard any that were outliers. The remaining values were then averaged, and the combined average value was reported to the patient. According to the Government, "this approach tended to mask consistency problems with Theranos' tests." *Id*. In support, the Government relies on statements regarding the efficacy of multiplexing made by Theranos' former lab director Dr. Adam Rosendorff. For example, Dr. Rosendorff would testify that the multiplexing process he used in real time as Theranos' laboratory director was "not good laboratory practice," "not ideal," and that "it would be better to run the assay a single time using a highly accurate and reliable method, and report that result." Saharia Decl., Ex. 3 (Sept. 28, 2020 Gov't Suppl. Rule 404(b) Notice); ; *see also id*., Ex. 5 at 13 (Rosendorff's belief that "[t]his process was not ideal because it *may* have tended to increase the appearance of precision beyond a lab test's true performance" (emphasis added)).

***46** Holmes argues this evidence would require an expert opinion rooted in sufficient data and a reliable methodology, to prove that Theranos' multiplexing method actually masked precision problems with Theranos' tests. *See* Fed. R. Evid. 702; *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579, 113 S.Ct. 2786, 125 L.Ed.2d 469 (1993). The Court does not agree, because an explanation of what multiplexing entailed does not involve the application of any technical algorithms or procedures. Dr. Rosendorff's background as a laboratory director gives him a sufficient basis on which to present his observations and beliefs about Theranos' use of multiplexing and his experience employing the method. Moreover, the change in Dr. Rosendorff's view of the multiplexing method is not a basis to disqualify him from testifying about multiplexing. Holmes is entitled to explore these issues on cross-examination. Accordingly, the Court finds that a blanket exclusion of evidence relating to Theranos' multiplexing method is not warranted at this time.

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Improperly setting and altering reference ranges For reference ranges, the Court also does not believe evidence the Government intends to offer on this topic requires expert analysis. The Government revealed in its 404(b) notice that Dr. Rosendorff may testify that he was involved in setting reference ranges for Theranos tests. Dr. Rosendorff may testify that Theranos launched its clinical testing services in 2013 without conducting a formal reference range study to determine the appropriate reference range values because Theranos was "in a hurry" to launch, and that it would have been preferable to establish reference ranges before the launch. Saharia Decl., Ex. 3 at 71-72. Separately, Dr. Rosendorff may testify that Holmes and Balwani were resistant to the idea of establishing and disclosing reference ranges that were specific for Theranos' capillary blood tests and distinct from the venous sample tests that Theranos ran on third-party devices. *Id*.

This testimony is based on Dr. Rosendorff's percipient observations while at Theranos as well as his judgment and experience as a certified laboratory director. Because the evidence will not be introduced to argue that Theranos' reference ranges were violating industry standards, the introduction of a scientific basis and methodology pursuant to Rule 702 is not needed. Therefore, the Court declines to issue a blanket exclusion of evidence relating to Theranos' reference ranges.

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Withholding important information from doctors and patients Lastly, the Government seeks to introduce evidence that Theranos "withheld" from doctors and patients information such as "what type of analyzer had been used for a given test," "the fact that Theranos' tests were not FDA approved," that Theranos "relied on third-party analyzers for many of its tests." Saharia Decl., Ex. 1 at 8. In its supplemental disclosure, the Government explains that Dr. Rosendorff advocated stating on laboratory reports whether the blood was collected by fingerstick or venous draw, but this was ultimately not done. *Id*., Ex. 3 at 74. Holmes argues this evidence should be excluded because the Government has not disclosed any reliable opinion to establish Theranos did anything improper or that its practices had any impact on the adequacy and reliability of its technology.

For reasons discussed above, the Court finds that evidence regarding information Theranos allegedly withheld from

doctors and patients should not be excluded for lack of expert opinion. The evidence presented is fact evidence about information Theranos disclosed and did not disclose to investors and patients. Although the Court notes Holmes's argument that the Government cannot use this evidence to establish Theranos was violating industry standards without proper expert opinion, the jury can consider what decisions Holmes and Theranos made about certain disclosures when evaluating Holmes's intent and the alleged scheme to defraud. Thus, because the evidence will be used as fact evidence, a blanket order at this stage excluding evidence relating to withheld information is not warranted.

***47** Accordingly, the Court **DENIES** Holmes's motion to exclude certain Rule 404(b) evidence for lack of expert support.

P. Holmes's MIL to Exclude Evidence and Argument as to the Purported Inaccuracy or Unreliability of Tests Not Identified in the Bill of Particulars (Dkt. No. 568)

Holmes next moves to preclude the Government from introducing at trial evidence and argument regarding the purported inaccuracy and unreliability of tests not identified in the Government's Bill of Particulars.[13] *See generally*Holmes's Mot. in Limine to Exclude Evidence and Argument by the Government as to the Purported Inaccuracy or Unreliability of Tests Not Identified in the Bill of Particulars ("Holmes 568 Mot."), Dkt. No. 568. Holmes is not seeking a blanket ruling precluding any mention of other tests offered by Theranos that were not included in the Government's Bill of Particulars. Holmes Reply Br. in Supp. of Holmes's 568 Mot. ("Holmes 568 Reply"), Dkt. No. 711, at 2. Rather, for tests not listed in the Bill of Particulars, Holmes requests that the Court require the Government to provide notice of exhibits and testimony related to these unidentified tests so that any anticipated issues can be raised outside of the presence of the jury.

13 The Court took the motion under submission on the papers after the parties did not request oral argument.

Recognizing that Holmes should not be forced to prepare unnecessary defenses for evidence the Government would not raise at trial, the Court ordered the Government to identify "the particular tests that the Government claims Theranos was not capable of consistently producing." Dkt. No. 330 at 16 (citing *United States v. Bortnovsky*, 820 F.2d 572, 574 (2d. Cir. 1987)). The Government's March 2020 Bill of Particulars ("the Bill of Particulars") identified twenty-five tests. Dkt. No. 377 at 25. The TSI also listed the same twenty-five tests. TSI ¶ 16. In June 2020, however, the Government's initial exhibit list included several exhibits which addressed tests not identified in the Bill of Particulars. Holmes states that the potential evidence addressing additional unlisted tests comes in many different forms including exhibits and potential witness testimony discussing test results data, individual patient results, and reruns of certain tests. Holmes 568 Mot. at 2.

The Government responds that it has no plans to introduce evidence or argument about tests, other than those disclosed in the indictment, for the purpose of "attacking their accuracy and reliability." Gov't Opp'n to Holmes 568 Mot. ("Gov't 568 Opp'n"), Dkt. No. 664, at 2. Nevertheless, the Government argues evidence regarding additional tests is still admissible for purposes unrelated to the accuracy and reliability of those tests. *Id*. The Government explains evidence related to additional unlisted tests could be used to demonstrate the number and types of tests that Theranos offered at a given time and which devices and methods Theranos used to perform those tests. *Id*. at 3. Similarly, the Government contends that evidence referencing additional unlisted tests is relevant to the extent it shows Theranos' general practices in connection with developing, offering, conducting, and reporting results of its assays. *Id*. at 3. The Court finds that the Government should not be precluded from introducing all evidence related to additional unlisted tests. Indeed, Holmes recognizes that there may be permissible purposes for the introduction of such evidence, which still comport with the Court's Order directing a Bill of Particulars about the tests that the Government claims Theranos was not capable of consistently producing. Holmes 568 Reply at 2.

***48** Accordingly, Holmes's motion to exclude evidence and argument regarding tests not listed in the Bill of Particulars is **GRANTED.** The Government is precluded from introducing any evidence or argument regarding the purported inaccuracy and unreliability of tests not identified in the Government's Bill of Particulars. The Government may still introduce evidence or testimony about tests not listed in the Bill of Particulars for purposes unrelated to the accuracy and reliability of those tests. The Government shall provide notice of exhibits or testimony that may involve tests not identified in the Bill of Particulars prior to their introduction so that the parties and Court can address any issues, in the context of specific evidence, outside the presence of the jury.

IV. GOVERNMENT'S MOTIONS IN LIMINE AND RELATED DEFENSE MOTIONS

A. MIL No. 1 to Preclude Defendant from Offering an Improper Defense of Blaming Her Victims and Selective Prosecution

The Government moves to preclude Holmes from offering a defense of blaming her victims for failing to exercise greater diligence in their dealings with Theranos. Gov't Mot. The Government further seeks to preclude Holmes from introducing a related defense regarding the Government's selective prosecution of Holmes and Theranos amongst a range of similar abuses perpetuated by other Silicon Valley startups. Holmes opposes both arguments asserted in the Government's motion. Holmes's Opp'n to Gov't Mots. In Limine ("Holmes Opp'n"), Dkt. No. 659. The Court addresses each argument in turn.

1. Victim blaming

The Government first argues that a fraud victim's naiveté or gullibility is not a defense to criminal charges under federal fraud statutes. According to the Government, excluding this defense is necessary to prevent distraction from the key issues of the case: "Defendant's intent to defraud and the falsity and materiality of her statements." Gov't Mot. at 1. However, Holmes argues such preclusion is overbroad because it will forestall the introduction of evidence on these very points. Holmes Opp'n at 2. Specifically, Holmes contends that evidence of circumstances surrounding a victim's engagement with Theranos directly relate to the element of "materiality" and could potentially be used for impeachment purposes.

"Materiality of falsehood" is an essential element of wire fraud. *Neder v. United States*, 527 U.S. 1, 25, 119 S.Ct. 1827, 144 L.Ed.2d 35 (1999). The test to determine materiality is whether the statement "has a natural tendency to influence, or was capable of influencing, the decision of the decision-making body to which it was addressed." *United States v. Peterson*, 538 F.3d 1064, 1072 (9th Cir. 2008) (quoting *Kungys v. United States*, 485 U.S. 759, 770, 108 S.Ct. 1537, 99 L.Ed.2d 839 (1988)). This is an objective test. *Id*.

It is well settled that a victim's negligence is not a defense to wire fraud. *United States v. Lindsey*, 850 F.3d 1009, 1015 (9th Cir. 2017). Unlike common law fraud, reliance upon the defendant's misrepresentations has no place in criminal fraud cases. *Neder*, 527 U.S. at 25, 119 S.Ct. 1827. Moreover, "[i]t is immaterial whether only the most gullible would have been deceived by the defendants' scheme." *Ciccone*, 219 F.3d at 1083 (quoting *United States v. Hanley*, 190 F.3d 1017, 1023 (9th Cir. 1999)) (alteration in original). However, evidence of the circumstances surrounding a victim's entanglement in the fraudulent scheme may be admissible for other purposes. Indeed, documents and other information available to the parties can be useful for determining materiality. *United States v. Bogucki*, No. 18-cr-00021-CRB-1, 2019 WL 1024959, at *4 (N.D. Cal. Mar. 4, 2019). In *Bogucki*, the court granted defendant's Rule 29 motion for acquittal after finding no reasonable jury could find the defendant made materially false statements. *Id.* at *7. In reaching this decision, the court considered five pieces of evidence, including call transcripts and PowerPoint presentations. *Id.* at *4-6. While the *Bogucki* court ultimately found this evidence did not satisfy the materiality requirement, this highlights the necessity of evaluating the information available to victims in order to determine if the alleged false statements had the capacity to mislead. Relatedly, as Holmes notes, a victim's knowledge of the fraud could serve as relevant impeachment evidence. *United States v. Yang*, No. 16-cr-00334-LHK, 2019 WL 5536213, at *3 (N.D. Cal. Oct. 25, 2019). The Court agrees that the way "victims reacted to alleged misrepresentations...is highly relevant to their credibility." 659 Opp'n at 2.

***49** Based on the foregoing, the Court **GRANTS** the Government's motion to the extent Holmes attempts to utilize victim blaming as a defense. However, the Court **DENIES** the Government's motion with respect to precluding Holmes from introducing admissible impeachment evidence and other admissible evidence bearing on materiality. The Court will review and hear from the parties as to any specific evidence sought to be introduced prior to its presentation during the trial.

2. Selective prosecution

The Government seeks to further preclude Holmes from introducing a defense focused "on the culture of Silicon Valley startups." Gov't Mot. at 3. In particular, the Government asks to exclude potential evidence regarding other startup founders engaging in similar exaggerated and "dramatic promises to generate...capital." *Id*. While not entirely clear, the Government appears to assert these claims amount to an improper selective prosecution defense. This request is overbroad.

A selective prosecution claim is an "assertion that the prosecutor has brought the charge for reasons forbidden by

the Constitution." *United States v. Armstrong*, 517 U.S. 456, 463, 116 S.Ct. 1480, 134 L.Ed.2d 687 (1996). To establish a prima facie showing of selective prosecution, a defendant must establish:

> (1) that, while others similarly situated have not generally been proceeded against because of conduct of the types forming the basis of the charge against him, he has been singled out for prosecution, and (2) that the government's discriminatory selection of him for prosecution has been invidious or in bad faith, i.e., based upon such impermissible considerations as race, religion, or the desire to prevent his exercise of constitutional rights.

United States v. DiStefano, 129 F. Supp. 2d 342, 347 (S.D.N.Y. 2001).

At the hearing, the Government indicated its concerns that Holmes would argue that her conduct was in line with Silicon Valley startup culture and thus she was singled out for prosecution where other entrepreneurs were not. Holmes disavowed advancement of a selective prosecution argument at trial, and the Court takes her at her word.

The Government further expressed concern that Holmes would comment on the culture of Silicon Valley startups, including aggressive marketing or exaggeration. The Court recognizes that evidence in this case will undoubtably touch on the nature of startup companies, including financing, funding, industry protocols, and other issues common to the technology industry in Silicon Valley. The Court will permit general fair comment on the marketing of new ventures, including statements concerning investment and the nature of the firm, product, or technology.

B. MIL No. 2 to Preclude the Defense from Referencing Punishment in Front of The Jury

The Government moves to preclude any reference by the defense to Holmes's alleged or potential punishment during any trial stage (including jury selection, opening statements, examination of witnesses, and summation). The Government seeks to preclude these references to punishment as irrelevant and/or unfairly prejudicial under Federal Rules of Evidence 401, 402, and 403. The Government provides examples of both overt and subtle references to punishment that it seeks to preclude during trial. An overt example of a reference to punishment could be "[t]he defendant is facing a prison term if convicted." Gov't Mot. at 4. In contrast, the Government's examples of subtler references to punishment include statements such as "the Defendant is facing a lot of time," "the case has serious consequences for the Defendant," "the Defendant's liberty is at stake in this trial," or "your decision will have consequences for a long time to come." *Id*. The Government maintains that once a jury is exposed to statements regarding Holmes's potential punishment or other such consequences, this information cannot be forgotten nor can the circumstances be remedied by a curative instruction.

***50** Holmes acknowledges that would be inappropriate for her to reference any potential imprisonment before the jury. However, she disagrees with the Government's motion to the extent it seeks to prohibit the "subtler" references to punishment that the Government has identified, such as "the case has serious consequences for the Defendant" or "the Defendant's liberty is at stake in this trial." Holmes Opp'n at 5; Gov't Mot. at 4.

Both sides are correct. "It has long been the law that it is inappropriate for a jury to consider or be informed of the consequences of their verdict." *United States v. Frank*, 956 F.2d 872, 879 (9th Cir. 1992). Any commentary to the jury on a defendant's potential penalty or punishment "draw[s] the attention of the jury away from their chief function as the sole judges of the facts, opens the door to compromise verdicts, and confuses the issues to be decided." *United States v. Olano*, 62 F.3d 1180, 1202 (9th Cir. 1995); *see also Shannon v. United States*, 512 U.S. 573, 579, 114 S.Ct. 2419, 129 L.Ed.2d 459 (1994); *Zal v. Steppe*, 968 F.2d 924, 930 (9th Cir. 1992) (stating that any verdict "must be based on the law and evidence, not on jury nullification as urged by either litigant").

However, "[s]ubtle references such as the one mentioned above are not really referencing punishment." *United States v. Williams*, No. 3:13-cr-00764-WHO-1, 2017 WL 4310712, at *8 (N.D. Cal. Sept. 28, 2017). In *Williams*, the court's primary focus was whether the defense should be allowed to reference the punishment of cooperating witnesses for impeachment purposes, which is not a question before this Court. Nevertheless, *Williams* is instructive in its ruling that "defendants are precluded from referencing the particulars

of any past or potential punishment in an attempt to elicit the sympathies of the jury." *Williams*, 2017 WL 4310712, at *8. Further, the *Williams* court reasoned that some subtler references to punishment, such as stating that "this case has serious consequences for the defendant," are "not really about punishment." *Id*.

During the hearing the Court discussed the issue with counsel and granted the Government's motion from the bench. The Court recognized, however, that comments of counsel about the serious task the jurors will undertake with this case and the opportunity to remind them of their oath to serve are appropriate. The Court indicated it would allow Holmes to make careful, cautious, and appropriate comments when talking about the nature of the case to the jury.

The Government's MIL No. 2 to preclude the defense from referencing punishment in front of the jury is **GRANTED**.

C. MIL No. 3 to Preclude an Improper Advice-Of-Counsel Defense

The Government moves to preclude Holmes from asserting "an improper advice-of-counsel defense." Mot. at 5. More specifically, the Government seeks to preclude both (1) testimony suggesting that attorneys made statements to Holmes or that she relied upon such statements to negate intent; and (2) a formal advice-of-counsel defense and the associated jury instruction. *Id*.

An advice-of-counsel defense "is not regarded as a separate and distinct defense but rather as a circumstance indicating good faith which the trier of fact is entitled to consider on the issue of fraudulent intent." *Bisno v. United States*, 299 F.2d 711, 719 (9th Cir. 1961). In order for Holmes "[t]o qualify for an advice of counsel instruction, the defendant must show that there was full disclosure to his attorney of all material facts, and that he relied in good faith on the specific course of conduct recommended by the attorney." *United States v. Ibarra-Alcarez*, 830 F.2d 968, 973 (9th Cir. 1987). Furthermore, when a defendant presents an advice-of-counsel defense, she waives her previous attorney-client privilege as to the communications at issue. *See Hunt v. Blackburn*, 128 U.S. 464, 470, 9 S.Ct. 125, 32 L.Ed. 488 (1888); *see generally Bittaker v. Woodford*, 331 F.3d 715, 718 (9th Cir. 2003).

***51** Here, the Government indicates that Holmes has provided no notice to the Government of any intent to assert an advice-of-counsel defense and that Holmes has not waived any attorney-client privilege as a prerequisite to asserting such a defense. Gov't Mot. at 5. As such, the Government argues, it is appropriate to preclude her from asserting an advice-of-counsel defense at this stage. *Id*. Even in the absence of a properly asserted advice-of-counsel defense, the Government is concerned that Holmes may attempt to elicit testimony from her attorneys that suggest that they made certain statements to her upon which she detrimentally relied. *Id*. Regardless, the overarching focus of the Government's motion is to preclude any defense efforts to elicit statements by attorneys, made to the Holmes or other Theranos employees, as evidence negating Holmes's allegedly fraudulent intent. *Id*. at 5–6, 119 S.Ct. 1827.

Holmes contends that barring an advice-of-counsel defense long before proposed jury instructions are due and before the Government presents its case-in-chief is premature. Holmes Opp'n at 6. She also suggests that much of Theranos' dealings with its many attorneys will likely be highly relevant to the Government's case and thus it would be improper to preclude all testimony by Holmes or others concerning statements attorneys made to them. *Id*. Holmes additionally notes that the Government has indicated its intent to introduce evidence of certain nonprivileged attorney-client communications, and therefore it would be inappropriate to preclude Holmes from commenting on statements her attorneys may have made to her. *Id*. In response, the Government states that it is concerned only with statements made by attorneys used as evidence to negate intent. United States' Reply in Support of its Mots. In Limine ("Gov't Reply") at 3, Dkt. No. 726.

The Court finds that ruling on this motion would be premature at this juncture. Holmes will have an opportunity to defend herself against the Government's allegations with appropriate legal theories and within the confines of the law. Prior to invoking an advice-of-counsel defense, however, Holmes must establish the foundational prerequisites for the advice-of-counsel defense, namely: (1) waiver of the applicable attorney-client privilege, (2) demonstrating that there was a full disclosure to her attorney of all material facts, (3) and that she relied in good faith on the specific course of conduct the attorney recommended.

For the reasons stated above and at the hearing, the Government's MIL No. 3 is **DEFERRED**.

D. MIL No. 4 to Preclude a Defense Argument That the Government's Charging Decisions Were Influenced by Coordination with Journalists or Competitors

The Government seeks to preclude Holmes from arguing that its charging decisions were influenced by "coordination" with journalists or competitors. Gov't Mot. at 6. In particular, the Government seeks to preclude any argument that its investigation or charging decisions were unduly influenced by the input of other lab testing companies, such as Quest or LabCorp, or journalists, such as John Carreyrou. First, the Government argues that there is no factual basis for such an argument because it did not actually coordinate with any lab testing companies or journalists. Specifically, the Government represents that no attorney or agent on the prosecution team has ever had a substantive conversation with Quest, LabCorp, or Mr. Carreyrou in connection with this case. Second, the Government argues that any evidence regarding its charging decisions is irrelevant under Federal Rule of Evidence 402.

In response, Holmes contends the Government's investigatory process is relevant and should be presented to the jury. According to Holmes, " 'media attention' related to Mr. Carreyrou's back-channel communications with CMS about Theranos caused CMS to use different procedures for surveying Theranos than it normally would have used." Holmes Opp'n at 8 (citing Saharia Decl., Ex. 34 at 3). The FDA's interview report with CMS employee Sarah Bennett recounted Ms. Bennett's explanation:

> ***52** Normally, re-certification surveys are conducted by the state agency, but because of the media attention associated with Theranos, the decision was made to send [CMS employee Gary] Yamamoto and Bennett. John Carreyoru [sic] (a reporter for the Wall Street Journal) had been in contact with CMS about an article he was writing on Theranos. Carreyoru [sic] talked to Dyer about the article. He has never spoken with Bennett. The CMS regional office conducts federal jurisdictional surveys....Bennett was a natural to ask to do the survey because she has survey experience, and she had done it twice before.

Id. at 3. Relying exclusively on Bennett's explanation above, Holmes contends that "[t]he existence of secret communications between Carreyrou and government investigators undoubtedly bears on the 'quality of the investigation' on which the government developed its case." Holmes Opp'n at 8.

Evidence regarding the Government's investigation may be relevant and admissible at trial. *United States v. Sager*, 227 F.3d 1138, 1145 (9th Cir. 2000). For example, "[d]etails of the investigatory process potentially affect[ ] [the investigating agent's] credibility and, perhaps more importantly, the weight to be given to evidence produced by his investigation." *Id*.; *see also United States v. Howell*, 231 F.3d 615, 625 (9th Cir. 2000) (explaining utility of evidence that "raises[s] the opportunity to attack the thoroughness, and even good faith, of the investigation").

Here, the Government does not seek exclusion of evidence regarding the investigatory process. Instead, the Government seeks only to exclude a defense argument that its charging decisions were influenced by "coordination" with journalists or competitors. The only evidence of "coordination" Holmes proffers is Bennett's interview with the FDA. Bennett's interview, however, is not evidence of "coordination" with journalists or competitors. Instead, Bennett explains that a reporter contacted CMS, and that the decision was made to have two CMS employees conduct the certification survey rather than the state agency. In the absence of evidence of actual coordination, neither *Sager* nor *Howell* support Holmes's position. In *Sager*, the defense sought to question the Postal Inspector about "aspects of his investigation" into possible fraudulent charges on a credit card issued to Trevor Post ("Post"). *Sager*, 227 F.3d at 1143. The trial judge interrupted defense counsel and questioned the relevance of the cross-examination and eventually instructed the jury: "What I am telling you is that you are not here to grade his investigation. You are here to grade the product of that investigation, that is, the evidence." *Id*. The Ninth Circuit held that the trial court committed error, reasoning that "[t]o tell the jury that it may assess the product of an investigation, but that it may not analyze the quality of the investigation that produced the product, illogically removes from the jury potentially relevant information." *Id*. at 1145. In the present case, however, precluding Holmes from arguing that there was no "coordination" based on Bennett's interview with the FDA will not remove from the jury potentially relevant information.

In *Howell*, the defendant claimed that the prosecutor's failed to inform the defense of material mistakes in two police reports. *Howell*, 231 F.3d at 623–24. On appeal, the *Howell* court rejected the government's contention that it had no duty to disclose the mistake to the defense. *Id*. at 625. Here, in contrast, the Government is not seeking to exclude evidence of any mistake in the investigation.

***53** The Government's MIL No. 4 to exclude the defense's argument that the charging decisions were influenced by "coordination" with journalists or competitors is **GRANTED**. Nothing in this Order is intended to preclude Holmes from presenting evidence or argument regarding the details, thoroughness, or good faith of the criminal investigation.

E. MIL No. 5 to Preclude Defendant From Presenting an Improper Good Faith Defense

The Government next moves to preclude Holmes from "presenting an improper good faith defense." Gov't Mot. at 7–8. In its motion, the Government notes the following:

> [Holmes] might attempt to present evidence or argument that she should be acquitted because she acted in good faith. Defendant might claim, despite her deception of investors, that she always intended to make those victims' investments profitable, such that the victims would suffer no loss when all was said and done.

Id. at 7. The Government argues that "[this] argument—and any argument along those lines— should be barred, as they do not constitute recognized legal defenses to charges and are therefore improper and irrelevant." *Id*. (citing *United States v. Benny*, 786 F.2d 1410, 1417 (9th Cir. 1986) ("While an honest, good-faith belief in the truth of the misrepresentations may negate intent to defraud, a good-faith belief that the victim will be repaid and will sustain no loss is no defense at all"); *United States v. Hickey*, 580 F.3d 922, 931 (9th Cir. 2009)).

In opposition, Holmes states that "[t]he law of this Circuit draws a distinction between a good-faith belief in the truth of a misrepresentation (which can negate fraudulent intent) and a good-faith belief that a knowingly fraudulent scheme will eventually lead to a favorable outcome for the victim." Holmes Opp'n at 8 (comparing *United States v. Ghilarducci*, 220 F. App'x 496, 501 (9th Cir. 2007) (as an example of the former), with *Tijani v. Holder*, 628 F.3d 1071, 1077 (9th Cir. 2010) (as an example of the latter)). Holmes argues the Government's request "would be overly broad and would conflate the two [different kinds of] good-faith arguments." *Id*. at 9, 119 S.Ct. 1827. Holmes cites to *United States v. Barreiro*, where the court denied a similar motion to preclude the defendants' good-faith defense argument, stating that "[the defendants] [were] entitled to argue that they lacked intent to defraud because they believed, in good faith, that any alleged misrepresentations were true and that [the alleged scheme] was a legitimate business." No. 13-CR-00636-LHK, 2015 WL 7734139, at *1 (N.D. Cal. Dec. 1, 2015) (citation omitted).

The Government states it is not attempting to preclude Holmes from arguing that she had a good-faith belief that her alleged misrepresentations were true. *See* Gov't Reply at 5–6 ("An argument that [Holmes] thought she was telling the truth is obviously permissible....The [G]overnment fully expects that [Holmes] will deny intentionally misleading victims regarding the achievements of Theranos").

The Court agrees with the Government (and with Holmes) that a defendant may not provide as a defense the argument that the defendant knowingly made false misrepresentations but nevertheless had a good-faith belief that the defendant's victims would be repaid or otherwise suffer no harm. *See Benny*, 786 F.2d at 1417. *Barreiro* is inapposite because in that case the court denied a motion to preclude the argument that "[the defendants] thought that they were acting lawfully." *Barreiro*, 2015 WL 7734139, at *1. Here, the Government's motion is not as broad, and seeks to preclude only the argument that Holmes knowingly made misrepresentations but had a good-faith belief that her alleged victims would be repaid or otherwise suffer no harm.

***54** For the reasons above, the Court **GRANTS** the Government's MIL No. 5 to preclude Holmes from presenting an improper good faith defense outside of Ninth Circuit precedent.

F. MIL No. 6 to Admit CMS's January 26, 2016 Form CMS-2567, Statement of Deficiencies

The Government seeks to admit CMS Form CMS-2567, dated January 26, 2016, which lists the deficiencies observed

during CMS's September 2015 recertification and survey of Theranos' Newark laboratory. Gov't Mot. at 8–10. As described above concerning Holmes's MIL to exclude evidence of the CMS survey findings, the Court GRANTS the Government's MIL No. 6 to admit the CMS January 2, 2016 Form CMS-2567, Statement of Deficiencies. *See supra* Section III.C.

G. MIL No. 7 to Admit Text Messages Between Holmes and Balwani Offered by The Government

The SEC conducted a parallel investigation into Theranos. On September 6, 2016, the SEC issued a subpoena to Theranos requesting production of communications between Holmes and Balwani beginning January 1, 2010. Nov. 20, 2020 Decl. of AUSA Robert S. Leach in Support of United States' Mots. in Limine ("Leach Decl."), Dkt. No. 588-1, Ex. F. On July 7, 2017, an attorney from Wilmer Cutler Pickering Hale and Dorr LLP ("WilmerHale"), who represented Theranos at the time, produced to the SEC a document Bates-numbered TS1036239 through TS1036827 (the "SEC Spreadsheet"), which he represented to be "a spreadsheet containing business-related text messages, iMessages, and Skype exchanges between Elizabeth Holmes and Sunny Balwani." *Id*, Ex. G. On July 11 and 13, 2017, Holmes testified under oath before the SEC. During her testimony, the SEC Spreadsheet was marked as an exhibit and the following exchange occurred:

> Q Exhibit 221 purports to be an Excel file that includes a number
>
> of rows of font. The starting Bates number is TS-1036239. Have you seen Exhibit 221 before?
>
> A I think I've seen some of the content in it. I've never seen it

like this.

Q Does this – I'll represent to you that these are – this is the file that Theranos provided to the SEC pursuant to subpoena which is supposed to reflect the text messages between you and Mr. Balwani on your Theranos-issued cell phone.

A Yep.

Q Do you have any reason to believe that this isn't a true collection of those text messages from your work cell phone?

A No.

Id., Ex. H ("SEC Testimony") at ECF p. 13 (SEC Testimony 376:4-19). Subsequently, a second WilmerHale attorney submitted to the SEC a declaration under penalty of perjury certifying records of regularly conducted activity, which stated: "I certify that the document produced at TS-1036239 through TS-1036827 is a spreadsheet containing Theranos business-related text messages, iMessages, and Skype exchanges between Ms. Holmes and Mr. Balwani. These messages and exchanges were sourced from images taken of Ms. Holmes'[s] business phones, as well as messaging applications on Ms. Holmes' computer." Leach Decl., Ex. I.

On November 7, 2017, in response to a grand jury subpoena, WilmerHale produced to the FBI a document Bates-numbered THER-2566547 through THER-2567135 (the "DOJ Spreadsheet"), which WilmerHale represented to be "a spreadsheet reflecting text messages sent to and from Elizabeth Holmes and Ramesh Balwani as collected from Elizabeth Holmes's Company-issued devices. These text messages were originally produced at TS-1036239 through TS-1036827 and are being reproduced today with revised redactions pursuant to the guidelines discussed on our October 2, 2017 call with Mr. Schenk and Mr. Bostic." *Id*., Ex. K. The DOJ Spreadsheet generally has fewer redactions from the SEC Spreadsheet.

***55** The Government now seeks an order admitting portions of the SEC and DOJ Spreadsheets containing certain text messages between Holmes and Balwani. The Government references six specific excerpts and requests that the Court admit "any similar ones offered by the government" as well. Gov't Mot. at 11–14. At the May 6, 2021 hearing, the Government clarified that it was not seeking a blanket order admitting the entirety of both spreadsheets but anticipates introducing additional excerpts as they become relevant at trial. Holmes objects to admission of the excerpted spreadsheets on the grounds that neither their relevance nor their authenticity can be determined at this stage. Holmes Opp'n at 13.

1. Relevance

The Government seeks to introduce six excerpts from between November 2013 and October 2015. These dates correlate to key events at Theranos within the charging period, about which the Government plans to introduce other evidence. For example, the Government seeks to introduce an excerpt from November 19, 2014, which was around the time Theranos' former lab director, Dr. Adam

Rosendorff, expressed his misgivings about the company and was eventually terminated. *See*Gov't 575 Opp'n at 3–4 (explaining that Dr. Rosendorff told Holmes on November 14, 2014 that he felt "really uncomfortable with...what is happening right now in this company...I am feeling pressured to vouch for results that I cannot be confident in."). In the text exchange days later, Mr. Balwani wrote a number of texts to Holmes generally relating to the "lab" and leadership of the lab (e.g., "Need to focus on op. Getting hurt in market"; "Lab...need[s] director level people"; "We need[t]he lab and call center fixed"; and "New lab dirs., lab manager like Tracy"). Holmes expressed agreement (e.g., "Fundamentally we need to stop fighting fires by not creating them...Need to fix root cause here...Yes...Exactly"). Likewise, the November 28, 2014 texts (including Mr. Balwani's statement that the "Normandy lab is a fucking disaster zone") were close in time to Dr. Rosendorff's departure. Given the temporal proximity of the messages to the events involving Dr. Rosendorff, and the centrality of those events to the Government's case, the Court finds this excerpt relevant.

Each of the remaining excerpts are similarly correlated to key events at issue in this case, or else are on their face plainly relevant to Holmes's knowledge. Holmes did not raise specific relevance objections to any particular excerpts at the hearing. The Court, therefore, finds that the excerpts provided are relevant to show, at a minimum, Holmes's knowledge.

2. Authenticity

"To satisfy the requirement of authenticating or identifying an item of evidence, the proponent must produce evidence sufficient to support a finding that the item is what the proponent claims it is." Fed. R. Evid. 901(a); *see United States v. Aldaco-Lopez*, 956 F.2d 1168 (9th Cir. 1992). The Government need only make a prima facie showing of authenticity "so that a reasonable juror could find in favor of authenticity or identification." *United States v. Blackwood*, 878 F.2d 1200, 1202 (9th Cir. 1989) (per curiam) (quoting *United States v. Black*, 767 F.2d 1334, 1342 (9th Cir. 1985), *cert. denied*, 474 U.S. 1022, 106 S.Ct. 574, 88 L.Ed.2d 557 (1985) (quoting 5 J. Weinstein & M. Merger, Weinstein's Evidence, ¶ 901(a) [01] at 901–16 to –17 (1983)).

The Government argues that there is sufficient evidence to support a finding that the spreadsheets are in fact compilations of messages between Holmes and Balwani from Holmes's Theranos-issued devices because (1) it was Holmes's counsel that produced the spreadsheets to the SEC and DOJ, attesting to their authenticity; and (2) Holmes did not challenge the authenticity of the spreadsheets at her SEC deposition.

***56** Holmes argues that WilmerHale did not represent Ms. Holmes in her personal capacity, rather, it represented Theranos as corporate counsel. The transcript of Holmes's SEC deposition testimony shows that there were two sets of outside counsel present at the deposition: counsel from Cooley LLP, who represented "Ms. Holmes in all capacities," and counsel from WilmerHale, who represented "the company and Ms. Holmes as CEO." Leach Decl., Ex. H at ECF p. 5 (SEC Testimony at 12:8-13:19). While there is some ambiguity about the extent of WilmerHale's representation of Theranos and Holmes "as CEO," the Court is not prepared to interpret WilmerHale's production of the spreadsheets as an admission from Holmes that they are authentic. Indeed, Holmes indicated in her SEC deposition testimony that she had never seen the spreadsheets before.

Holmes further argues that because WilmerHale did not represent her in a personal capacity, the certifications of the spreadsheets and the cover letters accompanying the productions are inadmissible hearsay and therefore cannot be used to authenticate the spreadsheets. The Court agrees. Because the spreadsheets contain data from multiple devices compiled by attorneys with the ability to select and redact material at will, the Court finds that the documents require authentication. Without some admissible evidence explaining how the spreadsheets were compiled, the Court cannot determine authenticity at this stage. The Court notes, however, that the burden on the Government to produce such evidence is slight. *United States v. Whitworth*, 856 F.2d 1268, 1282–83 (9th Cir. 1988) ("Evidence is admissible under Rule 901(a) once a prima facie case has been made on the issue"). Once a prima facie case has been made, "the matter is committed to the trier of fact to determine the evidence's credibility and probative force." *Id.*

Accordingly, the Court **DENIES** the Government's MIL No. 7 without prejudice. The Government may renew its motion upon its introduction of additional evidence as to authenticity.

H. MIL No. 8 to Admit Statements By Theranos And Theranos Employees And Agents Offered by The Government

In MIL No. 8, the Government moves to admit two categories of statements. First, the Government moves to admit against Holmes "relevant statements by Theranos agents and employees on matters within the scope of that relationship

and while it existed," asserting that these statements are admissible under Federal Rule of Evidence 801(d)(2)(D). Gov't Mot. at 17. Second, the Government moves to admit against Holmes "statements by Theranos that she authorized or manifested that she adopted or believed to be true," namely interrogatory responses that Theranos made in civil litigation. The Government contends that the interrogatory responses are admissible under Federal Rule of Evidence 801(d)(2)(B) and (C). *Id*.

The Federal Rules of Evidence define hearsay as: "(A) statement, other than one made by the declarant while testifying at the trial or hearing, offered in evidence to prove the truth of the matter asserted." Fed. R. Evid. 801(c). Federal Rule of Evidence 801(d)(2) excludes from the hearsay definition (and thus the rule against hearsay) statements offered against an opposing party and (A) made by the party in an individual or representative capacity; (B) one the party manifested that it adopted or believed to be true; (C) made by a person whom the party authorized to make a statement on the subject; (D) made by the party's agent or employee on a matter within the scope of that relationship and while it existed; or (E) made by the party's coconspirator during and in furtherance of the conspiracy. Fed R. Evid. 801(d)(2) & 802.

Here, the Government relies on Rule 801(d)(2)(D) to seek admission of statements by Theranos agents and employees. In *United States v. Kirk*, 844 F.2d 660 (9th Cir. 1988), the government charged the founder of a time share venture with conspiracy, wire fraud, and other offenses. Defendant Kirk "ran the day-to-day operations" and exercised "control over the time share scheme." *Id.* at 661. On appeal, the defendant argued, among other things, that the district court erred in admitting hearsay testimony of the company's salespeople. The Ninth Circuit concluded that the statements were admissible as nonhearsay statements of agents or employees under Fed. R. Evid. 801(d)(2)(D). *Id.* at 663. Similarly, in *United States v. Gibson*, 690 F.2d 697, 699 (9th Cir. 1982), the government brought mail fraud, wire fraud, and other charges against Gibson, the founder, sole shareholder, chairman, and president of Gibson Marketing International, Inc. ("GMI"), which sold franchises and franchise distributorship rights. *Id.* at 697. At trial, the government introduced evidence of statements by GMI employees and salesmen against Gibson. On appeal, the Ninth Circuit found no error in admitting the statements. The Ninth Circuit held that testimony by investors as to statements made by GMI employees were not hearsay, and even if the testimony did fall within the hearsay definition, the testimony was admissible under either Rule 801(d)(2)(D) (statements by an agent) or Rule 801(d)(2)(E) (statements by a co-conspirator). *Id.* at 701.

***57** Although *Kirk* and *Gibson* support the Government's position, it is premature for the Court to issue a categorical ruling admitting any and all testimony of Theranos agents and employees on matters within the scope of that relationship and while it existed. Under general agency principles, Theranos employees were not Holmes's agents; they were Theranos' agents. *See Boren v. Sable*, 887 F.2d 1032 (10th Cir. 1989) (an employee's "mere occupation of a subordinate position in the corporate chain of command" is sufficient to establish an "agency relationship" for the purpose of admission under Rule 801(d)(2)). The Government does not cite, and this Court is unaware of, any case supporting the admission of the statements of hundreds of employees to a corporate CEO under Rule 801(d)(2)(D). Moreover, in *United States v. Bonds*, 608 F.3d 495, 504 (9th Cir. 2010), the Ninth Circuit instructed that to determine whether statements are admissible under Rule 801(d)(2)(D), a court must "undertake a fact-based inquiry applying common law principles of agency." *NLRB v. Friendly Cab Co., Inc.*, 512 F.3d 1090, 1096 (9th Cir. 2008); *see also U.S. v. Agne*, 214 F.3d 47, 54–55 (1st Cir. 2000) ("Whether the statements of a corporate employee may be admitted against a corporate officer depends upon the relationship between the employee and the officer; 'if the factors which normally make up an agency relationship are present the evidence should not be excluded simply because the statement is offered against a corporate officer, rather than the corporation.' "). Under common law principles of agency, an agent is one who "act[s] on the principal's behalf and subject to the principal's control." *Bonds*, 608 F.3d at 506 (quoting Restatement (Third) Agency § 1.01). "To form an agency relationship, both the principal and the agent must manifest assent to the principal's right to control the agent. *Id.* The Government has not attempted to make this showing for all of the hundreds of Theranos employees.

As to the interrogatory responses, the Government specifically seeks admission of Theranos' admissions that: Theranos earned less than $500,000 from blood testing revenue from 2013 to 2015; that its contracts with the Department of Defense were limited to three agreements producing de minimus revenue; that it modified third-party analyzers in order to process blood tests; that only 12 tests were ever run on a Theranos-manufactured device in its clinical lab; and that Theranos ceased all testing on Theranos-manufactured devices by June 2015. *See* Leach Decl., Ex. P at 35–38, Ex. Q at 22–24, 36-39, at Ex. R

22–23. These admissions were made by Theranos in a prior civil suit, *Partner Investments v. Theranos*, C.A. No. 12816-VCL. *Id*., Exs. P, Q, R. The Government contends that the interrogatory responses are admissible under Rule 801(d)(2)(B) and (C) on the theory that Holmes authorized her company's interrogatory responses and manifested that she adopted or believed them to be true. The Government reasons that "Holmes was a co-defendant in the lawsuit at the time the statements were made and her own interrogatory responses made reference to Theranos' statements (*see, e.g.*, Leach Decl., Ex. N at 16–18)—compelling the inference that she authorized her company's statements and manifested that she adopted or believed them to be true." Gov't Mot. at 17.

The Government has presented some evidence tending to show Holmes authorized Theranos' interrogatory responses in the *Partner Investments* suit and manifested that she adopted or believed them to be true. Specifically, during her deposition in a separate suit brought by the SEC, Holmes was shown Theranos' interrogatory responses, and conceded "I certainly was engaged with our legal team on responding to them" and added "I'm sure I talked with our team about them." Feb. 16, 2021 Decl. of AUSA Robert S. Leach in Supp. of United States' Reply in Supp. of its Mot. in Limine, Dkt. No. 727, Ex. U at 143; *id.* at 149 ("I worked with our legal teams as we worked to respond to PFM"). Holmes's involvement in preparing Theranos' interrogatory responses in the SEC litigation is circumstantial evidence that she was also involved in and authorized preparing Theranos' responses in the *Partner Investments* litigation. However, this proffered evidence, without more, is insufficient to support admission of the under Rule 801(d)(2)(B) and (C).

The Government next contends that Holmes's "coordination with Theranos" and the repeated cross-references to Theranos' responses in her own interrogatory responses that give rise to the inference that she knew of and approved Theranos' responses. Gov't Reply at 13. However, as Holmes points out, she and Theranos were represented by separate counsel in the *Partner Investments* litigation and prepared separate responses to interrogatories. The cross-referencing tends to show some coordination, but is no basis to conclude that Holmes adopted all of Theranos' responses.

***58** The Government also relies on the fact that Theranos' interrogatory responses were signed by Holmes's brother and some of the most senior officers of the company whom she supervised. Familial status is not enough to show Holmes authorized her brother's responses. Furthermore, at present, there is no evidence whatsoever that Holmes authorized her brother or the other senior officers to prepare the company's interrogatory responses.

The Government's MIL No. 8 is **DEFERRED** pending the Government's establishment of the necessary foundation for the evidence it seeks to introduce.

I. MIL No. 9 to Exclude Self-Serving Hearsay Statements Made And Offered By Holmes

The Government represents that through its investigation, it "has collected extensive evidence of previous statements by Defendant regarding Theranos' technology, business relationships, financial health, regulatory status, and other key topics," which the Government will seek to introduce at trial. Gov't Mot. at 17. The Government now moves to prevent Holmes from similarly introducing "witness testimony or direct evidence of self-serving statements she has made to the press, to victims, or in her testimony to the SEC." *Id.* at 18.

Holmes argues that this motion is premature because the Government has not identified any particular statements that it seeks to exclude, and because the admissibility of Holmes's out-of-court statements will necessarily depend on the purpose for which they are offered at trial. Holmes Opp'n at 19. Holmes also argues that certain of her hearsay statements may be admissible under the common law rule of completeness or Federal Rule of Evidence 106.

Under Federal Rule of Evidence 801(d)(2)(A), an out-of-court statement is admissible if (1) made by the defendant and (2) offered against the defendant. Fed. R. Evid. 801(d)(2)(A); *see also United States v. Pelisamen*, 641 F.3d 399, 410 (9th Cir. 2011) (defendant's own statements made during television interview admissible over hearsay objection). It is also well-settled that a defendant may not "place [her] exculpatory statements before the jury without subjecting [herself] to cross-examination." *United States v. Ortega*, 203 F.3d 675, 682 (9th Cir. 2000) (affirming exclusion of defendant's "non-self-inculpatory" statements as hearsay).

The Court agrees with the Government that Rule 801(d)(2)(A) applies only to party-opponent statements and that under *Ortega*, Holmes is not permitted to introduce exculpatory statements without testifying in court. At the hearing, Holmes represented that she understood and would adhere to this rule. *See* May 6, 2021 Hr'g Tr., Dkt. No. 794, at 4:14-5:2 ("We agree with your honor that *Ortega* implements Rule 801 which prohibits us from introducing Ms. Holmes'[s]

statements if they are hearsay...of course, we intend to comply with *Ortega*.").

Accordingly, bearing in mind *Ortega* and other Ninth Circuit precedent, the Court will not rule at this time that all of Holmes's out-of-court statements are inadmissible hearsay. "The admissibility of a particular statement depends on the content of the statement and the purpose for which the party seeks to introduce that statement into evidence." *Yang*, 2019 WL 5536213, at *4. Without additional context, the Court cannot say that a currently unidentified out-of-court statement by Holmes would be hearsay, let alone that an exception to hearsay does not apply. For the same reason, the Court defers addressing Holmes's arguments regarding the rule of completeness or Federal Rule of Evidence 106 until the Court has before it particular statements and context to consider.

***59** Accordingly, the Court **GRANTS** the Government's motion (to the extent that Holmes's out-of-court statements are inadmissible for the reasons stated in Rule 801 and *Ortega*). The Government may object in due course to specific evidence submitted at trial. Holmes shall provide the Government and Court fair warning when she believe the issue is about to arise at trial, so the Court can then address the issue outside the presence of the jury.

J. MIL No. 10 to Admit Relevant Testimony From 'Non-Paying' Patient Witnesses (Dkt. No. 588)

Testimony from non-paying patient witnesses concerning their experience with Theranos testing is relevant and admissible for the reasons described above with respect to Holmes's MIL to exclude anecdotal evidence of test results. *See supra* Section III.H.1. Accordingly, the Court **GRANTS** the Government's MIL No. 10. Patients, physicians, and other witnesses who may testify about receiving test results will not be permitted to testify about any physical, financial, or emotional harm they may have experienced beyond simply paying for the test.

K. MIL No. 11 to Order Defendant to Produce Reverse *Jencks* Including Any *in Camera* Proffers

The Government asks the Court to order Holmes to produce witness statements under Rule 26.2(a) of the Federal Rules of Criminal Procedure. During the May 6, 2021 hearing, Holmes represented that the Rule 26.2(a) materials were produced that morning. The Government's MIL No. 11 is **DEEMED MOOT**.

IT IS SO ORDERED.

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United States District Court, S.D. New York.

Sarah PALIN, Plaintiff,

v.

The NEW YORK TIMES COMPANY and James Bennet, Defendants.

17-cv-4853 (JSR)

|

Signed 03/01/2022

Synopsis

Background: Politician filed suit against newspaper publisher and editor, asserting libel claims arising from allegedly defamatory editorial prompted by shooting of members of Congress earlier that day, but in which editor added language asserting "clear" and "direct" "link" between prior mass shooting "attack," that injured congresswoman and killed others, and "political incitement" generated by graphic advertisement circulated months earlier by politician's political action committee (PAC) that superimposed rifle crosshairs over map of several congressional districts, after which newspaper issued two corrections stating no such link had been established. Jury trial was held, and defendants moved for judgment as matter of law, following close of evidence and prior to start of jury deliberations.

Holdings: The District Court, Jed S. Rakoff, J., held that:

pre-publication research process did not demonstrate actual malice;

editor's lack of recollection did not demonstrate actual malice;

editing and fact-checking processes belied inference of actual malice; and

editor's emails and texts were inconsistent with actual malice.

Motion granted.

Procedural Posture(s): Motion for Judgment as a Matter of Law (JMOL)/Directed Verdict.

Attorneys and Law Firms

For Plaintiff: Kenneth G. Turkell & Shane B. Vogt (Turkel Cuva Barrios, P.A.), Shawn Preston Ricardo & Michael McGee Munoz (Golenbock Eiseman Assor Bell & Peskoe LLP).

For Defendants: David L. Axelrod, Jay Ward Brown, Thomas Byrne Sullivan, & Jacquelyn Nicole Schell (Ballard Spahr LLP), Dana Green (The New York Times Co.).

OPINION

JED S. RAKOFF, U.S.D.J.:

***1** At trial, plaintiff Sarah Palin wholly failed to prove her case even to the minimum standard required by law. Accordingly, defendants the New York Times Company (the "Times") and James Bennet moved to dismiss the case prior to the start of jury deliberations. After hearing extensive argument, the Court granted the motion shortly after the jury had begun its deliberations. This Opinion sets forth the reasons for that decision, as well as the reasons for how the Court then dealt with the deliberating jury.

By way of background, on June 14, 2017, defendant Times published an editorial, approved and materially revised by co-defendant Bennet, entitled "America's Lethal Politics" (the "Editorial"). The Editorial was prompted by the shooting earlier that day of Republican members of Congress, including Representative Steve Scalise. However, several sentences in the Editorial could be read to suggest that an earlier mass shooting -- an attack that occurred in Tucson, Arizona in 2011, grievously wounding Congresswoman Gabrielle Giffords and killing several others -- was prompted by a graphic advertisement circulated some months earlier by a political action committee ("SarahPAC") associated with Palin. The graphic (the "crosshairs map") featured a map of the United States with stylized rifle crosshairs superimposed over congressional districts that SarahPAC had targeted for replacing incumbent Democratic members of Congress with Republican candidates in the 2010 midterm elections. Giffords' district was one of 20 featured on the map.

Prior to publication of the Editorial, Bennet, the top editor on the Times' Editorial Board, had added language asserting

a "clear" and "direct" link between the 2011 shooting and the "political incitement" generated by the crosshairs map. Although the original author of the Editorial, several other editors, and a fact checker read the draft after Bennet's revision and before publication, none flagged the new language as inaccurate. Nonetheless, journalists and other readers began criticizing the "clear" and "direct" allegation immediately after the Times published the Editorial online. The Times ultimately issued two corrections (the first approximately 14 hours after the editorial was published online) stating that no such link had been established.

Shortly thereafter, Palin commenced this lawsuit, asserting that she had been libeled by Bennet and the Times in violation of New York defamation law. [1] After extensive delays occasioned by an intervening appeal and constraints arising from the COVID-19 pandemic, the Court held a seven-day jury trial starting on February 3, 2022. Following the close of evidence, but before the start of jury deliberations, defendants moved under Fed. R. Civ. P. 50(a) for judgment as a matter of law. Rule 50(a) provides, in general, that:

> If a party has been fully heard on an issue during a jury trial and the court finds that a reasonable jury would not have a legally sufficient evidentiary basis to find for the party on that issue, the court may:
>
> ***2** (A) resolve the issue against the party; and
>
> (B) grant a motion for judgment as a matter of law against the party on a claim or defense that, under the controlling law, can be maintained or defeated only with a favorable finding on that issue.

Fed. R. Civ. P. 50(a). The rule further provides that such a motion may be "made at any time before the case is submitted to the jury." Id. While Rule 50(a) does not expressly require a court to grant or deny the motion before jury deliberations begin, it clearly contemplates that a court will rule expeditiously. [2]

1 The parties subsequently agreed that Bennet and The New York Times Co. should be considered as a single unit for the purpose of assessing liability. See ECF 170 ("Jury Instructions") at 12. Accordingly, hereinafter, the Court uses "the Times" to refer to both defendants collectively, except where it is necessary to refer to Bennet or The New York Times Co. individually.

2 If the motion is denied, however, it can be renewed after the jury renders its verdict, pursuant to Fed. R. Civ. P. 50(b).

Because this was a serious and case-dispositive motion, the Court did not rule precipitously. Rather, the Court reserved judgment, first so that it could hear the lawyers' closing arguments and then, even after the jury had begun its deliberations late on Friday afternoon, so that the Court could receive further written and oral submissions from counsel. Ultimately, however, by the early afternoon of Monday, February 14, 2022, the Court had reached the firm conclusion that it would have to grant the motion for judgment as a matter of law and so informed the parties.

At that point, the Court could have simply entered final judgment in defendants' favor and dismissed the jury. Instead, however, the Court, while announcing its decision, explained that it would allow the jury to continue its deliberations, so that, if the Court of Appeals were to disagree with the Court's determination to dismiss the case as a matter of law, the appellate court would not have to send the case back for trial, since it would have the benefit of the jury's verdict. Moreover, as a technical matter, the Court could then issue its Rule 50 judgment, post-verdict, pursuant to Rule 50(b). While this approach was a bit unusual, neither side objected to it in the slightest.

Regardless of these procedural niceties, however, the Court never seriously considered hiding from the parties the firm determination it had reached to dismiss the case as a matter of law. This, as the Court noted at the time, would have been grossly unfair to both sides, who would have been left with the impression that the case was going to be determined by the jury's verdict when it was not. Tr. 1298-1299. [3]

3 "Tr. ___" citations refer to pages in the trial transcript.

Therefore, on the afternoon of February 14, 2022, the Court announced its conclusion that Palin had failed to prove, by the necessary clear and convincing evidence, that Bennet and The New York Times Co. had published the allegedly libelous statements with the state of mind known as "actual malice." Specifically, after reviewing all evidence adduced at trial in the light most favorable to Palin and drawing all reasonable inferences in her favor, the Court concluded that no reasonable jury could find by clear and convincing evidence that Bennet or The New York Times Co. knew at the time of publication that the allegedly libelous statements were

false or that Bennet thought that the challenged statements were probably false but recklessly proceeded to publish them anyway. The Court further indicated that it would likely issue a written opinion detailing the reasons for these conclusions. Tr. 1307. Hence, this Opinion.

***3** After the Court announced its determination to enter final judgment for the defendants as a matter of law, the Court, as noted, still allowed the jury to continued deliberating for the aforementioned reasons, stating that it would not formally enter the order dismissing the case until after the jury had rendered its verdict. Tr 1305-1306. As also noted, no party objected in the slightest to the Court's plan. Indeed, the parties were given four opportunities to object to the procedure -- when the Court made the initial proposal, Tr. 1256; when the Court indicated it was about to issue its ruling on the motion, Tr. 1295-1297; after that ruling was delivered, Tr. 1306-1307; and when the verdict was returned -- and never did so.

The only issue that was raised -- and then only by counsel for defendants -- was whether it was necessary to further inoculate the jury against the risk that it might learn of the Court's intended ruling through media reports. When the Court asked counsel what they recommended in this regard, plaintiff's counsel was of the view that the Court should do nothing and "leave things as is." Tr. 1307. But the Court was persuaded by defendants' counsel to again admonish the jury that "If you see anything in the media about this case, just turn away." Tr. 1308. Even though defendants' counsel had raised the possibility (presciently, as it turns out) that some jurors might receive "push notifications" of the Court's Rule 50 determination, Tr. 1307, neither side asked for any other relief than the aforementioned instruction, which was then given to the jury, and accordingly the Court had no occasion to consider any further steps. Tr. 1307.

The next afternoon, the jury returned a verdict of "Not Liable." In the Court's view, the verdict further validated the Court's legal conclusion that no reasonable juror could find by clear and convincing evidence that Bennet or the Times had acted with actual malice. However, this verdict was without immediate legal effect because the Final Judgment entered that day in favor of the Times relied independently on the Court's decision to grant the Rule 50 motion and dismiss the case as a matter of law. ECF 171.

After the jury had been excused, the Court's law clerk discovered, during a routine inquiry, that a few jurors had inadvertently received "push notifications" (alerts automatically generated by news apps installed on their smartphones) containing the bottom-line of the Court's intended Rule 50 determination. See ECF 172. Although these jurors were adamant that this knowledge had not affected their determination of the verdict in the slightest, the Court promptly notified the parties of this information. See id.

As detailed toward the end of this Opinion, the Court is of the firm view that a few jurors' pre-verdict awareness of news about the Court's intended Rule 50 decision did not nullify the jury's verdict in any respect. But the more fundamental point is that any effect the push notifications may have had is legally irrelevant. The Court had already determined to dismiss Palin's libel claim as a matter of law pursuant to defendants' Rule 50 motion, and the Final Judgment reflected that determination. Even if one indulges the implausible hypothesis that the jury would have returned a verdict for Palin absent the news alerts, the operative final judgment would still have been the same: dismissal of Palin's claim as a matter of law.

The Court now elaborates the reasons for that decision.

I. Factual Background

As explained further in § III.B, infra, the Court on a Rule 50 motion must view all evidence in the record in the light most favorable to the non-moving party, here Palin, and must draw all reasonable inferences to her benefit. The recitation of relevant facts below therefore reflects these presumptions.

A. The Allegedly Libelous Statements

***4** On June 14, 2017, defendant The New York Times Co. published the Editorial entitled "America's Lethal Politics" in response to the shooting that morning of Representative Steven Scalise and several other Republican members of Congress who had been holding a practice session in suburban Virginia for a charity baseball game. The Editorial identified the attack as part of a "sickeningly familiar pattern [that was] emerging" of members of Congress being targeted by people committing mass shootings. PX-1 at 1. [4] The Editorial's thesis was that this political violence emerged from the "readily available guns and ammunition" in the United States and from "deranged" people whose "derangement had found its fuel in politics" by virtue of the increasingly violent rhetoric used in American political discourse. Id. The "pattern" identified by the Editorial identified only one prior data point: the January 8, 2011 incident in which Jared Lee Loughner opened fire in a Tucson, AZ supermarket parking lot during a "Congress

on Your Corner" event hosted by Representative Gabby Giffords, killing six people (including U.S. District Judge John Roll and a nine-year-old girl) and grievously wounding the Congresswoman.

4 PX-___ citations refer to plaintiff's exhibits received into evidence at trial, and DX-___ citations refer to defendants' exhibits received into evidence at trial. Unless otherwise specified, all internal quotation marks, omissions, elisions, alterations, citations, and emphases are omitted from all sources cited herein.

In comparing the two shootings, the Editorial, in language that was added by defendant Bennet to an earlier draft, stated that there was a "clear" and "direct" "link" between Loughner's shooting and the "political incitement" arising from a graphic distributed in March 2010 by the political action committee ("PAC") associated with plaintiff Sarah Palin, who previously served as the Governor of Alaska and as the 2008 Republican candidate for Vice President. Specifically, plaintiff alleges that she was libeled by the following two paragraphs:

> In 2011, when Jared Lee Loughner opened fire in a supermarket parking lot, grievously wounding Representative Gabby Giffords and killing six people, including a 9-year-old girl, the link to political incitement was clear. Before the shooting, Sarah Palin's political action committee circulated a map of targeted electoral districts that put Ms. Giffords and 19 other Democrats under stylized crosshairs.
>
> Conservatives and right-wing media were quick on Wednesday to demand forceful condemnation of hate speech and crimes by anti-Trump liberals. They're right. Though there's no sign of incitement as direct as in the Giffords attack, liberals should of course hold themselves to the same standard of decency that they ask for the right.

PX-4. These paragraphs (the "Challenged Statements") were the fifth and sixth paragraphs in the twelve-paragraph Editorial. Id. "America's Lethal Politics" was published online on The New York Times website at approximately 9:45 p.m. on June 14, 2017, PX-1, and appeared as the first of three editorials in the June 15, 2017 print newspaper, PX-4. Neither Palin, nor SarahPAC, nor the map of targeted congressional districts was referenced elsewhere in the Editorial or in the headline. See id.

Palin alleges that these two paragraphs contain two defamatory statements. The first paragraph, Palin argues, asserts that her PAC's circulation of the so-called crosshairs map was "clear" incitement of Loughner's shooting of Representative Giffords and others. See ECF Jury Instructions at 14. The second paragraph, Palin argues, asserts that the circulation of the crosshairs map served as "direct" "incitement" of the "attack," or, in other words, that the map caused Loughner to act. See id.

Palin contends that both of these paragraphs contain unsupported or unsupportable factual errors concerning the purported causative role of Palin's PAC's "crosshairs map." Although the crosshairs map was widely blamed for inciting Loughner's violence against Giffords in the days following that shooting, it was subsequently determined that Loughner suffered from mental illness and no link between Loughner's attack and the crosshairs map was ever established. DX-111 at 3-4. Rather, it was determined that Loughner acted because of his own personal demons and mental illness. Accordingly, Palin alleges, it was defamatory for the Editorial to assert that the crosshairs map was either a "clear" or "direct" incitement to Loughner's shooting. [5]

5 Although not central to Palin's case, it may also be noted that the Challenged Statements describe the map as having "put Ms. Giffords and 19 other Democrats under stylized cross hairs," PX-4, thereby suggesting that the crosshairs appeared over images or words signifying the politicians themselves. However, the map in fact placed the stylized crosshairs over these 20 Democrats' congressional districts on a map of the United States, which was positioned above a list of the politicians' names. See DX-61.

B. The Original Drafting of the Editorial

***5** On the morning of June 14, 2017, James Hodgkinson opened fire on a group of Republican congressmen, who were practicing in suburban Virginia for an upcoming charity baseball game, wounding four persons, including Representative Scalise. See Tr. 107; PX-4; DX-12. The idea of writing an editorial on the shooting was first raised in a brief email sent at 10:46 a.m. by Elizabeth Williamson, a member of the Times' Editorial Board based in Washington, who covered national politics. DX-9; Tr. 78-79. The email went to Bennet and two other editors on the Editorial Board, Robert Semple and Nicholas Fox. DX-9. A few minutes later, in an email titled "POSSIBLE shooter's POSSIBLE social

media pages pro-Bernie, anti-Trump," Williamson circulated a set of links to Facebook, LinkedIn, and Twitter profiles that her research suggested belonged to the suspected shooter. DX-13. At 11:49 a.m., after then-President Donald J. Trump had delivered a statement on the shooting, Semple responded by email approving Williamson's proposal to begin drafting an editorial on the shooting, suggesting that the piece focus on gun control. DX-14. Then, at 12:04 p.m. another editor, Linda Cohn, replied to Semple's email, noting that Hodgkinson had gone to high school in her hometown and writing that it was "hard to picture any anti-trump sentiment there." DX-16. Cohn also commented that she was "thinking back to what a giant story [G]abby Gifford[s] shooting was. Amazing that shooting congressmen doesn't seem so shocking now." Id. The record reflects that this was the first time a member of the Editorial Board linked the Virginia and Arizona shootings. Semple, who was a long-tenured member of the Editorial Board, reaffirmed his earlier approval, writing "OK we should definitely shoot for a piece, not huge, but a piece." Id.

Bennet's first contribution to the discussion came in a 12:41 p.m. reply to Williamson's email containing Hodgkinson's suspected social media profiles and copying Semple, Fox, and Cohn. DX-17. Suggesting an additional argument for the Editorial to make, Bennet wrote:

> Hey Elizabeth -- As Bob has said there's most likely a gun control point to be made here. The other question is whether there's a point to be made about the rhetoric of demonization and whether it incites people to this kind of violence. Hard for me to imagine that Bernie himself is guilty of anything like that. But if there's evidence of the kind of inciting hate speech on the left that we, or I at least, have tended to associate with the right (e.g., in the run-up to the Gabby Giffords shooting) we should deal with that.

Id. Williamson then agreed to begin writing a draft, noting that she had spoken to Semple. DX-18.

As the assigned writer, Williamson had primary responsibility for research, which included both factual reporting and research on opinions previously expressed by the Editorial Board to maintain consistency with those earlier positions. Tr. 88-89. Williamson testified that on June 14, 2017, she "was researching the political rhetoric that was circulating in our discourse in the run-up to the 2011 shooting in Arizona," not "the shooting itself" or "the state of mind of the gunman." Tr. 174.

To assist Williamson in her research, Semple directed the Board's editorial assistant, Phoebe Lett, to search through prior editorials and send Williamson "four basic gun control pieces (dealing mainly with the plenitude of weapons and porous controls) that also happen to mention Gabrielle Giffords." See DX-21; DX-19. [6] Williamson replied to Lett at 1:40 p.m. asking "is there one that references hate type speech against [Democrats] in the runup to [Giffords'] shooting? James referenced that." DX-22. Lett forwarded this request to Bennet, asking if he "happen[ed] to know which one she is talking about." DX-25. Bennet responded: "No -- I was just wondering if there was such a piece; that is, did we ever write anything connecting ... the Giffords shooting to some kind of incitement?" Id. After searching further, Lett responded "No, but Frank Rich did," providing a link to a January 15, 2011 Op-Ed column entitled "No One Listened to Gabrielle Giffords," DX-24. DX-25. Bennet replied 14 minutes later: "Good for us. Can you let Elizabeth know?" DX-25. Lett then relayed Rich's column to Williamson. DX-23. Viewing the evidence in the light most favorable to Palin, the Court presumes that Bennet read and understood this column by Frank Rich before the Editorial was published.

6 At trial, the four editorials hyperlinked in Lett's email were never shown to any witness, their content was never discussed before the jury, and they were never offered into evidence as part of any witness's testimony. The Court accordingly sustained an objection to plaintiff's counsel motion to admit pre-marked exhibits containing these four editorials when they were offered outside the presence of the jury immediately before closing statements were delivered. See Tr. 1060.
When asked if he had read these four editorials, Bennet testified that he did not recall reading any of them. Tr. 705. And Palin neither adduced any evidence from which the Court could infer that Bennet read these four editorials nor argued in summation that Bennet's knowledge at the time of publication was informed by these four editorials.
Therefore, the content of these four editorials is not in the record and, as a matter of law, none of the

> four is properly considered as a source for Bennet's pre-publication knowledge. This is so, even though the Court must view the evidence most favorably to Palin and draw all reasonable inferences in her favor.

***6** Rich's column, written one week after the Loughner shooting, discussed that attack and other acts of apparent political violence, arguing about they arose from a combination of violent political rhetoric, inadequate gun control, and an ineffective mental health safety net. See DX 24. Rich wrote that it was not yet known whether Loughner had seen the crosshairs map and that then-President Obama had "said, correctly ... that 'a simple lack of civility' didn't cause the Tucson tragedy" or the other incidents he had discussed, such as an earlier act of vandalism at Giffords' office. Id. at 1-2. However, Frank argued that these acts of violence were "inform[ed]" by "an antigovernment radicalism as rabid on the right now as it was on the left in the late 1960s." Id. at 2-3. Rich continued:

> That Loughner was likely insane, with no coherent ideological agenda, does not mean that a climate of antigovernment hysteria has no effect on him or other crazed loners out there. Nor does Loughner's insanity mitigate the surge in unhinged political zealots acting out over the last two years. That's why so many on both the finger-pointing left and the hyper-defensive right automatically assumed he must be another of them.

Id. at 3.

At 2:52 p.m., following Bennet's request, Lett forwarded to Bennet the four editorials that she had previously sent to Williamson. DX-26; DX-27. Lett then kept searching through past editorials and found two more relevant articles, which she emailed to Bennet at 3:01 p.m. and Bennet forwarded to Williamson two minutes later with the note "We dug a little further. Take a look at these two." PX-128. A few minutes later, Bennet separately forwarded the two additional editorials published in the days following the Loughner attack to a group including Semple, Williamson, Fox, and Cohn, writing "FYI -- these two are more relevant precedent for tonight's piece." PX-136. Semple replied, "just right. The Obama 'as we mourn' in particular." Id. Bennet testified that although he does not recall reading these two editorials, he concluded based on his review of this email traffic that he "must have read them, because [he] knew something about their content." Tr. 608. Viewing the evidence in the light most favorable to Palin, the Court presumes that Bennet read and understood these two editorials prior to publication.

The first of these two editorials, entitled "Bloodshed and Invective in Arizona," was published January 9, 2011, the day after the Arizona shooting. PX-134. It describes the Editorial Board's position on the relationships among gun control, violent political rhetoric, and mental illness and how these forces increase the risk of political violence and assassination attempts:

> Jared Loughner, the man accused of shooting Ms. Giffords, killing a federal judge and five other people, and wounding 13 others, appears to be mentally ill. His paranoid Internet ravings about government mind control place him well beyond usual ideological categories.
>
> But he is very much a part of a widespread squall of fear, anger and intolerance that has produced violent threats against scores of politicians and infected the political mainstream with violent imagery. With easy and legal access to semiautomatic weapons like the one used in the parking lot, those already teetering on the edge of sanity can turn a threat into a nightmare.

Id. at 1. "Bloodshed and Invective in Arizona" continues:

> It is facile and mistaken to attribute this particular madman's act directly to Republicans or Tea Party members. But it is legitimate to hold Republicans and particularly their most virulent supporters in the media responsible for the gale of anger that has produced the vast majority of these threats, setting the nation on edge. Many on the right have exploited the arguments of division, reaping political power by demonizing immigrants, or welfare recipients, or bureaucrats. They seem to have persuaded many Americans that the government is not just

> misguided, but the enemy of the people.

***7** Id. at 2.

The second of these editorials, entitled "As We Mourn," was published on January 12, 2011. PX-135. It addressed then-President Barack H. Obama's speech at a memorial service in Tucson for the victims of the Loughner attack:

> This horrific event, he said, should be a turning point for everyone -- "not because a simple lack of civility caused this tragedy -- it did not -- but rather because only a more civil and honest public discourse can help us face up to our challenges as a nation."

Id. at 1-2. [7] "As We Mourn" does not include any conclusive statement regarding the Arizona gunman's motivations or political convictions, if any.

7 "As We Mourn" continues:

> The president's words were an important contrast to the ugliness that continues to swirl in some parts of the country. The accusation by Sarah Palin that "journalists and pundits" had committed a "blood libel" when they raised questions about overheated rhetoric was especially disturbing, given the grave meaning of that phrase in the history of the Jewish people.

PX-135.

Bennet testified that on June 14, 2017, he relied on the research Lett conducted on his behalf, and that he never conducted his own factual research in connection with the Editorial. Tr. 610.

C. Bennet's Revisions

At 4:44 p.m., Williamson uploaded her draft of the Editorial to "Backfield," a section of the Times' content management system that stores drafts during the editorial process. Tr. 136-137. Williamson also notified Bennet, Semple, Fox, and Frank Clines (a member of the Editorial Board who covered gun policy). PX-143. After that point, Williamson made no further edits to the piece, Tr. 138, and Palin has not accused her of any actual malice.

The portion of Williamson's 4:44 p.m. draft that served as a precursor to the Challenged Statements reads as follows:

> That in 10 minutes a single gunman could wreak such carnage in a bedroom community a short drive from the Capitol is horrifying, but no longer surprising. Not all the details are known yet, but a sickeningly familiar pattern is emerging: a deranged individual with a gun-perhaps multiple guns-and scores of rounds of ammunition uses politics as a pretense for a murderous shooting spree. Mr. Hodgkinson was a Bernie Sanders supporter and campaign volunteer virulently opposed to President Trump, who among many anti-Trump messages posted "Time to Destroy Trump & Co." on social media in March.
>
> Just as in 2011, when Jared Lee Loughner opened fire in a supermarket parking lot, grievously wounding Representative Gabby Giffords and killing six people, including a nine year-old girl, Mr. Hodgkinson's rage was nurtured in a vile political climate. Then, it was the pro-gun right being criticized: in the weeks before the shooting Sarah Palin's political action committee circulated a map of targeted electoral districts that put Ms. Giffords and 19 other Democrats under stylized crosshairs.

PX-141.

The underlined word "circulated" in the latter paragraph of Williamson's draft was hyperlinked to an ABC News article that is dated January 9, 2011, the day after the Arizona shooting, and is entitled "Sarah Palin's 'Crosshairs' Ad Dominates Gabrielle Giffords Debate." DX-10; Tr. 144. The article discusses the debate in the wake of the shooting about whether Palin's distribution of the crosshairs map "may have fueled the gunman's rage," though it notes in the tenth paragraph that "[n]o connection has been made between this graphic and the Arizona shooting." DX-10 at 1-2. Bennet testified that he neither clicked on the "circulated" link in Williamson's draft nor read the ABC News article before the Editorial was published. Tr. 609-610.

***8** After Williamson circulated her draft, Cohn, one of the Editorial Board editors, reviewed the piece. While reading, she made notes on her reactions to the draft, for instance asking whether the referenced to Hodgkinson as "deranged" reflected "signs of mental illness" or was used "just in the sense that anyone who commits [a] mass shooting is deranged." PX140E at 1. Cohn re-saved the draft at 5:03 p.m. Tr. 526; PX-140E at 2. Then, after she had finished her read-through, Cohn went to Bennet's office and told him that she "was just a little confused about ... what we wanted out of this piece, where it was going.... [She] felt he needed to take a look

and weigh in." Tr. 520. Bennet recalls that Cohn "did not think it was a great draft." Tr. 636. Bennet agreed to take a look. Tr. 522; 636-637. Cohn testified that it was her decision to take Williamson's draft and pass it off to Bennet, and Bennet testified that he had never told either Williamson or Cohn that he wanted to edit the draft. Tr. 566, 715.

At approximately 5:03 p.m., after speaking with Cohn, Bennet opened and read through Williamson's draft. Tr. 637; DX-30 at 235. He testified that his impression of Williamson's draft was that it "read like a news story, rather than an opinion piece," and Bennet "felt like it wasn't capturing the shock of the attack and kind of the horror of what had happened." Tr. 716. Although his initial intent was to provide Williamson guidance on rewriting the Editorial, Bennet soon decided to do the revisions himself:

> I initially started drafting a note to Elizabeth at the top of the editorial, trying to provide some instruction on how I thought the piece should be rewritten. And at that point I realized how late in the day it was getting, and I was concerned about getting the piece done in time. So I couldn't tell you exactly what time this was, but I began just editing the piece myself.

Tr. 637. With respect to the time pressure, Bennet testified that the deadline to submit editorials for print publication the following day was approximately 8:00 p.m. Tr. 640.

Bennet testified that in reading Williamson's draft, he interpreted the paragraphs about the Arizona shooting as "the specific example that Elizabeth returned with of incitement or incendiary rhetoric, and I just trusted that it was ... an example of that based on her characterization." Tr. 719. Bennet further testified that he thought the relationship Williamson had posited between the crosshairs map and Loughner's "made sense" because he suspected that "when politicians get shot, ... it has something to do with politics," and "that an atmosphere of highly charged political rhetoric makes such ... terrifying events more likely." Tr. 719-720.

There are words and phrases in the language about which Palin complains that appeared in Williamson's original draft, such as "a sickeningly familiar pattern is emerging" and "Sarah Palin's political action committee circulated a map of targeted electoral districts that put Ms. Giffords and 19 other Democrats under stylized crosshairs." See DX-136 at 2. But Bennet added the key language that Palin argues conveys the allegedly defamatory meaning -- the assertion that Palin's actions "clear[ly]" and "direct[ly]" caused Loughner to commit a mass shooting. Id.

A redline of the Editorial, comparing Bennet's revision to Williamson's first draft, was accepted into evidence, and it succinctly illustrates Bennet's specific contributions to the two paragraphs containing the Challenged Statements:

> ~~Just as in~~ Was this attack evidence of how vicious American politics has become? Probably. In 2011, when Jared Lee Loughner opened fire in a supermarket parking lot, grievously wounding Representative Gabby Giffords and killing six people, including a ~~nine~~ 9-year-old girl, ~~Mr. Hodgkinson's rage was nurtured in a vile political climate. Then, it was the pro-gun right being criticized: in the weeks before~~ the link to political incitement was clear. Before the shooting, Sarah Palin's political action committee circulated a map of targeted electoral districts that put Ms. Giffords and 19 other Democrats under stylized ~~crosshairs.~~
>
> ***9** ~~In the aftermath of Wednesday's shooting, the political right and left and both sides in the gun debate dove into their respective foxholes~~ cross hairs.
>
> Conservatives and right-wing media ~~demanded that~~ were quick on Wednesday to demand forceful condemnation of hate speech and crimes by anti-Trump liberals ~~get~~ . They're right. Though there's no sign of incitement as direct as in the Giffords attack, liberals should of course hold themselves to the same standard of decency that they ask of the right.

Id. [8] Bennet testified that as he worked on the Editorial, he did not know whether or not Loughner had seen the crosshairs map, nor did he research that question. Tr. 720. As Bennet explained:

> I was functioning as the editor, not the reporter on the piece, so I wouldn't normally do the reporting in a situation like this, particularly when we were on a tight deadline. But also ... I didn't think then and don't think now that the map caused Jared Loughner to act. I

> didn't think we were saying that, and therefore ... [it] didn't enter my mind to research that question.... My goal was to make it, you know, a clearer argument and ... [a] more compelling description of what happened that day, a more vivid description of what happened that day.

Tr. 721.

8 As in a standard redline, plain text represents material from Williamson's initial draft, underlined text represents additions by Bennet, and ~~strikethroughs~~ represent deletions by Bennet.

D. Further Editing

Bennet saved his draft in Backfield at 7:21 p.m. DX-30 at 178. He then emailed Williamson, alerting her that he had finished revising her draft:

> I really reworked this one. I hope you can see what I was trying to do. Please take a look. Thank you for the hard work today and I'm sorry to do such a heavy edit.

PX-163. Bennet testified that his request to "[p]lease take a look" was indicating to Williamson that she should review the piece for fact checking. Tr. 638. As Bennet explained at trial:

> [T]his is why we send playbacks to writers, because they are the ones who reported the story. They are the ones who are in possession of the facts. And it is important for them to review pieces to make sure that edits haven't introduced errors.

Tr. 639. Williamson testified that, after receiving this email, she "glanced at" the Editorial and replied to Bennet, writing, among other things, that the draft "Looks great." Tr. 274; DX-38. She suggested no edits to Bennet's draft. Id.

Cohn re-claimed the pen around 7:23 p.m. and began editing Bennet's draft of the Editorial. Tr. 571. She continued working on the piece, making changes for clarity and accuracy until approximately 7:57 p.m. Tr. 571-573; DX-30 at 136. During that time, Fox and Lepping were reviewing the piece as well, though they had to relay their changes to Cohn, since only one person was able to edit the Backfield version at a time. Tr. 572; 575-576; PX-155. Cohn testified that she reviewed the Challenged Statements and did not perceive there to be any problem with the language in those paragraphs. Tr. 574-575. Nor did she approach Bennet to discuss those paragraphs. Tr. 575.

***10** Then, at 7:58 p.m., just after storing the latest version of the Editorial reflecting Bennet's revisions, Cohn emailed a "playback," or a static copy of the latest draft, to Williamson for her review. [9] Tr. 576-577. Cohn explained that she sent the playback to Williamson because, although Cohn "assumed that James Bennet had sent one since at that point he was really editing the piece, [she] was playing it safe since [she] had been the original editor on the piece." Tr. 577. The reason Cohn wanted to be sure Williamson received a playback was so Williamson "could make sure that everything in there was correct and that ... the changes seemed fair to her, that ... there was nothing that she wanted to object to either in terms of facts or tone." Id. Cohn did not receive any further edits or comments from Williamson. Tr. 577-578.

9 Cohn described the practice of sending a writer a "playback with changes" as "send[ing] a copy to the writer so ... the changes would show up ... so they could go back and look and get back to [the editors] if there were any issues or problems with it." Tr. 577.

Shortly after Bennet filed his draft of the Editorial to Backfield, Eileen Lepping, the Editorial Board's principal fact checker, also began her process of fact checking and editing. Tr. 395. Lepping testified that she fact checked the draft Editorial line-by-line. Tr. 416, 421-422. However, she continued editing the piece as Cohn and Bennet also edited and revised it. Tr. 400-401. While fact checking the Editorial, Lepping clicked through the "circulated" hyperlink to the ABC News article, and "scan[ed] it for the facts that [she] was looking for at the moment," meaning specific details such as times, dates, that it was Palin's PAC that had circulated the map, and the number of congressional districts identified. Tr. 399, 422-423. One correction Lepping made around 7:34

p.m. was to edit words indicating the relative timing of the crosshairs map's publication (March 23, 2010, see DX-62; DX-63) and the Arizona shooting (January 8, 2011) from "in the weeks before the shooting" to "in the months before." [10] See PX-153; Tr. 399-403. Lepping testified that she did look at the crosshairs map itself, though she missed the inaccuracy regarding the location of the stylized crosshairs, an error which had already appeared in Williamson's 4:44 p.m. draft. Tr. 406-407. Lepping further testified that she does not recall fact checking the phrase "the link to political incitement was clear" in the first paragraph. Tr. 405. Nor did she fact check the phrase "Though there's no sign of incitement as direct as the as in the Giffords attack" in the second paragraph. Tr. 407. At that point, with the 8:00 print deadline nearing, Lepping testified that she "was doing more of a quick check of names and dates and things like that." Tr. 426. However, Lepping said she was able to confirm all of the facts she did check, and no one instructed her not to check any aspect of the piece. Tr. 426-427. At the end of her edit, Lepping sent a playback to Semple, who had a practice of reading the final versions of editorials before they ran and reaching out if he had any concerns; but Semple did not raise any concerns to Lepping about "America's Lethal Politics." Tr. 428-429.

10 This text was changed yet again, sometime after Lepping completed her edit at approximately 7:56 p.m. that night: the published version reads "Before the shooting." Tr. 404-406. Lepping testified that she did not know who made that further edit. Tr. 406.

After Cohn and Lepping's review, the copy editors assigned to the editorials page that night -- Bruce Levine and Joe Rakowski -- also edited the piece. Tr. 578. Additional fact checking occurred at this step, with Levine correcting the number of victims hit by Hodgkinson's bullets from five to four, since the fifth victim was determined to have been hit by shrapnel. See PX-178. Levine made this edit by comparing the draft Editorial to the article on the Virginia shooting prepared by the news department for the following day's paper. Tr. 579. Still, no fix was made to the Challenged Statements.

E. Publication

***11** The Times published "America's Lethal Politics" on its website at approximately 9:45 p.m. on June 14, 2017. [11] Tr. 640-641. The Times' Twitter accounts posted two tweets promoting the Editorial on the evening of June 14, 2017. PX-3; DX-500 ¶¶ 16-20. "America's Lethal Politics" was the lead article on the editorial page in the June 15, 2017 print edition of The New York Times. [12] PX-4. And the Editorial was featured on the Times' website homepage through June 15, 2017, although it no longer appeared on the homepage as of 3:00 p.m. June 15, 2017. DX-126; DX-127; DX-500 at 1.

11 The online version of the Editorial received 150,257 page views before the first correction was posted, and 133,572 page views (after it was corrected) for the remainder of the first week after publication. DX-500 ¶ 13; DX-128.

12 610,531 copies of the June 15, 2017 print edition of The New York Times, which included the Editorial, were printed. DX-500 ¶ 8.

F. Corrections

At 10:35 p.m., less than one hour after the Editorial was published online, Bennet received an email from Ross Douthat, a conservative columnist for the Times' Opinion section who covers national politics, among other topics. Tr. 820. Douthat's email was a response to an email from Bennet complimenting Douthat's latest column. PX-174 at 2. In his email, Douthat criticized the factual basis for the Challenged Statements:

> I feel I would be remiss if I didn't express my bafflement at the editorial that we just ran on today's shootings and political violence. There was not, and continues to be so far as I can tell, no evidence that Jared Lee Loughner was incited by Sarah Palin or anyone else, given his extreme mental illness and lack of any tangible connection to that crosshair map, the Tea Party or other right-wing cause. Whereas the shooter today, as our editorial concedes, seems to have had a clear partisan, anti-Trump purpose. That doesn't mean that liberals or "The Resistance" were in any way responsible for this horror; I don't buy those kind of arguments at all, in either case. But our editorial seems to essentially reverse the fact pattern as I understand it, making it

> sound like *Loughner* had the clearer connection to partisan rhetoric, when to the best of my knowledge he had none. I don't understand that claim at all, and I don't understand why we're making it.

Id. at 1. Bennet responded at 11:09 p.m.:

> Thanks, and I'll look into this tomorrow. But my understanding was that in the Giffords case there was a gun sight superimposed over her district; so far in this case we don't know of any direct threat against any of the congressmen on the field. That's not to say any of it is ok, obviously, or that the violence in either case was caused by the pol[i]tical rhetoric. But the incitement in this case seems, so far, to be less specific.

Id. Bennet testified that when he read Douthat's email he "took away from [it that Douthat] was reading the editorial to say that Loughner was incited by Sarah Palin or somebody else, and that is not the message we intended to send." Tr. 645.

In addition to replying to Douthat by email, Bennet testified that he "checked Twitter, because this ... obviously rang a big alarm for me and, yes, I saw other media people at that point tweeting that we had gotten it wrong," making similar points to Douthat's. Id. at 645-646. Shortly thereafter, Bennet sent a text message to Williamson: "Are you up? The right is coming after us over the Giffords comparison. Do we have it right?" DX-46. Williamson, however, had gone to sleep and did not respond until the morning. Id. Bennet testified that he spent time reading the criticism of the Editorial that was appearing online and tried to sleep but was unable to get much rest, because he was "so upset and confused." [13] Tr. 747-748.

13 Plaintiff's counsel asked Bennet if Douthat's email prompted Bennet to make any effort to take the Editorial offline while the Times was investigating its accuracy. Bennet said he made no such effort because at the time, "The New York Times ... had a rule against so-called unpublishing stories; that if you published a story, you couldn't then just pull it down." Tr. 648. Bennet also noted that the Editorial was irrevocably set to run in the June 15, 2017 print edition. Tr. 649. Plaintiff's counsel adduced no evidence suggesting that Bennet could have taken the Editorial down at that time or that he lacked awareness of this "unpublishing" policy at the time, so there is no inference that can reasonably be drawn from Bennet's decision not to pursue this.

***12** At 5:08 a.m. on June 15, 2017 Bennet emailed Williamson and Lepping with the subject line "Giffords:"

> Hey guys -- We're taking a lot of criticism for saying that the attack on Giffords was in any way connected to incitement. The claim is that this was fully investigated and debunked in the months after the attack, and the shooter was found to have acted only because of his personal demons. I don't know what the truth is here but we may have relied too heavily on our early editorials and other early coverage of that attack. If so, I'm very sorry for my own failure on this yesterday. In any case I'd like to get to the bottom of this as quickly as possible this morning and correct the piece if needed. Can you two please put your heads together on this first thing this morning? Please skip the morning meeting if necessary.
> JB

PX-191. Later that morning, Williamson and Bennet spoke by phone; Williamson described Bennet's demeanor on the call as reflecting that he was "clearly crestfallen that this had happened." Tr. 183; see PX-190. Williamson ("EB") and Bennet ("JB") also exchanged text messages about the apparent error:

> EB: Hey I'm sorry James. I should have read those [para]grafs more closely and asked more questions. That's on me. Will get a [correction] drafted soonest. E.
>
> JB: No worries. I feel lousy about this one -- I just moved too fast. I'm sorry.

JB: Now what I need from you/Eileen soonest is a rock-solid version of what we should say -- that an investigation showed NO link to incitement, or NO DIRECT link or NO CLEAR link. I don't want to soften if it we don't need to -- if there was no link we should say so.

EW: On it. We'll do the right thing

DX-46; PX-188; Tr. 182-183.

Williamson and Lepping began researching the issue shortly thereafter to determine if a correction was required, skipping the Editorial Board's morning meeting as directed. Tr. 172. Williamson described the Times' corrections policy as "if we were alerted of an error, the policy would be to as swiftly as possible ascertain the correct facts and write the correction and post it." [14] Tr. 206-207. At 7:18 a.m., Williamson emailed her Editorial Board colleague, Jesse Wegman, who had noted criticism of the Editorial on Twitter the night before, asking "What in your view would be the most reliable assessment of the politics link (or not) in the Loughner case? Am thinking court records/assessment of his state of mind." Williamson's focus was correcting the description of the map itself; the bulk of the research and the correction drafting was done in New York. Tr. 173, 185. That morning, Lepping was responsible for researching whether a link had ever been established between the crosshairs map and Loughner's attack. Tr. 410. Lepping testified that she found a police report online indicating that the shooting "wasn't politically connected." [15] Id. Cohn, working under direction from Bennet and Wegman, drafted the corrections. Tr. 552-553. The first correction, positioned below the online version of the Editorial, was published at approximately 11:15 a.m. on June 15, 2017, Tr. 659, and it read as follows:

> ***13** An earlier version of this editorial incorrectly stated that a link existed between political incitement and the 2011 shooting of Representative Gabby Giffords. In fact, no such link was established.

PX-5 at 3. At the same time, the two paragraphs containing the Challenged Statements was revised to read as follows:

> Was this attack evidence of how vicious American politics has become? Probably. In 2011, Jared Lee Loughner opened fire in a supermarket parking lot, grievously wounding Representative Gabby Giffords and killing six people, including a 9-year-old girl. At the time, we and others were sharply critical of the heated political rhetoric on the right. Before the shooting, Sarah Palin's political action committee circulated a map that showed the targeted electoral districts of Ms. Giffords and 19 other Democrats under stylized cross hairs. But in that case no connection to the shooting was ever established.
>
> Conservatives and right-wing media were quick on Wednesday to demand forceful condemnation of hate speech and crimes by anti-Trump liberals. They're right. Liberals should of course be held to the same standard of decency that they ask of the right.

Id. at 2. [16] The Times' Opinion Section and its main Twitter accounts also tweeted out the correction. PX-7. The evidence showed that Bennet was involved in drafting the Twitter posts, and that he edited the proposed language to add the apology that "[w]e're sorry about [the error]" and thanked readers for "call[ing] us on the mistake." DX-53 at 1; Tr. 1033. [17]

14 The applicable "Corrections" policy from The New York Times' "Guidelines on Integrity" states in full:

> Because our voice is loud and far-reaching, The Times recognizes an ethical responsibility to correct all its factual errors, large and small. The paper regrets every error, but it applauds the integrity of a writer who volunteers a correction of his or her own published story. Whatever the origin, though, any complaint should be relayed to a responsible supervising editor and investigated quickly. If a correction is warranted, fairness demands that it be published immediately. In case of reasonable doubt or disagreement about the facts, we can acknowledge that a statement was "imprecise" or "incomplete" even if we are not sure it was wrong.

PX-18; see also Tr. 299-300.

15 Lepping's testimony about the investigative conclusions she read in the police report was offered for, among other things, the truth of the

matters asserted in the report. Plaintiff's counsel never offered the police report, which they had pre-marked as an exhibit and included in the pre-trial exhibit list, see ECF 157 at 55. As such, Lepping's testimony regarding what the report concluded about Loughner's mental state was objectionable hearsay to the extent it was offered for its truth. But since no objection was interposed by defendants, the testimony was received in evidence for all purposes.

16 The record contains an email from Wegman to Williamson sent at 12:44 p.m. on June 15, 2017 discussing the correction to the text of the Editorial. In it, Wegman writes, "I made the case that talking about Palin and Giffords in the same [para]graf at all risked seeming like we were still trying to sneak the link in, but James pointed out that in order to write the next [para]graph, we had to put it in there to explain." PX-204 at 1. Plaintiff's counsel, however, elicited no testimony providing context for this statement, and plaintiff's counsel did not rely on any inferences from this document during summation or in argument on the Rule 50 motion.

17 There was considerable debate at trial about whether the Times has a policy against offering apologies in connection with corrections. See, e.g., Tr. 675, 1036. Plaintiff's counsel raised this issue in connection with the assertion that Palin never received an apology from the Times or Bennet. The Court need not, and does not, resolve the factual issues regarding any apology policy at the Times or whether Palin received an apology, neither of which is materially relevant to the matter at hand. However, it is undisputed that on June 15, 2017, Bennet received a request for comment from CNN's senior media reporter regarding the Editorial's inaccuracy, and that Bennet provided draft comments to the vice president of the New York Times Co. for communications for her to relay back to the CNN reporter. See DX-60. The reporter had asked, inter alia, whether the Times would "be issuing an apology to Sarah Palin for wrongly linking her to the shooting of Giffords." Id. at 2. Bennet's response to this question was "I'm not aware that Sarah Palin has asked for an apology, but yes, I, James Bennet, do apologize to her for this mistake." Id. However, Bennet's statement of apology was not ultimately relayed to CNN, and so it was never published. See PX-236.

***14** Later, the Times issued a second correction to replace the first, addressing the remaining error regarding the description of the map. That second correction read:

> An editorial on Thursday about the shooting of Representative Steve Scalise incorrectly stated that a link existed between political rhetoric and the 2011 shooting of Representative Gabby Giffords. In fact, no such link was established. The editorial also incorrectly described a map distributed by a political action committee before that shooting. It depicted electoral districts, not individual Democratic lawmakers, beneath stylized cross hairs.

PX-6. This second correction also ran at the bottom of the editorial page in the June 16, 2017 print edition of the newspaper. PX-10.

II. Procedural Background

A. Prior Proceedings

Palin initiated this lawsuit by filing a one-count complaint on June 27, 2017. ECF 1. Defendants moved to dismiss the complaint on July 14, 2017. ECF 24. The Court subsequently determined that it was a "close question" whether the complaint had pled sufficient allegations of actual malice. ECF 35. Therefore, without objection from the parties, the Court held a brief evidentiary hearing on August 16, 2017, at which the Court ascertained who were the authors of the Editorial and other basic facts that provided context for assessing the plausibility of the inferences upon which the complaint relied to state a libel claim. See ECF 35 at 2. The Court then determined that Palin had not plausibly pled actual malice and dismissed the complaint. Id. Palin appealed that order and the Second Circuit reversed, holding that the plausibility hearing contravened Fed. R. Civ. P. 12(d). See Palin v. New York Times Co., 940, F.3d 804, 812-813 (2d Cir. 2019).

Following remand, Palin filed the operative, first amended complaint on December 30, 2019. ECF 70. The Court subsequently granted defendants' motion for partial judgment on the pleadings, dismissing Palin's claim for disgorgement of advertising revenues specifically associated with the Editorial. ECF 83. On June 12, 2020, the parties filed cross-motions for summary judgment. ECF 94, 95. The Court denied these motions on August 28, 2020 and set the case for trial February 1, 2021. ECF 117.

Defendants subsequently filed a motion for reconsideration on the basis of an intervening change in substantive law: New York State's November 10, 2020 amendment of its libel statute to expressly require a public figure such as Palin to prove actual malice by clear and convincing evidence. ECF 119. On December 29, 2020, the Court granted defendants' motion for reconsideration and held that the amendment to New York's so-called "Anti-SLAPP Statute," [18] N.Y. Civil Rights L. § 76-a(2), applies to this action. Consequently, Palin's burden to prove actual malice as to falsity by clear and convincing evidence is not only required by the First Amendment to the United States Constitution but also by New York State statutory law. ECF 125.

18 "Anti-SLAPP" refers to statutes enacted to prevent libel claims from operating as Strategic Lawsuits Against Public Participation ("SLAPP suits") that would otherwise create a risk of litigation tending to wrongly inhibit public discourse.

B. The Trial and Rule 50 Motion

***15** Unfortunately, the COVID-19 pandemic's cycles of intensification and abatement resulted in several epidemiological "surges" at times set for trial, requiring repeated adjournments to comply with the pandemic protocols of the Southern District of New York. After these delays, trial was set to commence on January 24, 2022. But on the eve of trial, Palin contracted COVID-19 and so was barred by the pandemic protocols from entering the courthouse. See Minute Entries 1/24/2022. Finally, on February 3, 2022, a jury was empaneled, and the trial commenced.

Following the close of evidence on Thursday, February 10, 2022, defendants moved for judgment as a matter of law under Fed. R. Civ. P. 50(a) on four issues, each of which was necessary for Palin to prove the essential elements of their liability on her single claim of libel. [19] See Tr. 1053. These included the two aspects of the "actual malice" element, actual malice as to falsity and actual malice as to defamatory meaning, as well as the "of and concerning" and falsity elements. Tr. 1054-1055. Oral argument proceeded in at least five sessions outside the presence of the jury over three days, and counsel made written submissions of relevant caselaw citations over the intervening weekend, see ECF 174 at 5-9.

19 The Court notes that the Times made the Rule 50 motion at the earliest available time. The Times did not call any witnesses of its own or otherwise present an affirmative case after Palin rested. This follows from the Court's individual rules of practice, which provide that each witness may only be called once but can be examined at that time by both sides on any issue.

Meanwhile, while the Court continued to reserve judgment on the Rule 50 motion, the jury began deliberations on the afternoon of Friday, February 11, 2022. That evening, following relevant argument and a close review of caselaw cited by counsel, the Court denied the prong of defendants' Rule 50 motion directed at the "of and concerning" element of Palin's libel claim. Tr. 1228.

Argument then turned to the portion of the actual malice element concerning whether Bennet knew or recklessly disregarded the Challenged Statements' falsity prior to publication. Id. The Court was initially skeptical of defendants' position, on the basis that the jury might make adverse determinations as to Bennet's credibility and draw adverse inferences about his pre-publication state of mind therefrom. See, e.g., Tr. 1232. However, defense counsel drew the Court's attention to a Second Circuit libel case, Contemp. Mission, Inc. v. New York Times Co., which holds, in sum, that in light of the clear and convincing evidence standard, a plaintiff must adduce some affirmative, "concrete evidence from which a reasonable juror could return a verdict in h[er] favor" to establish a jury question on actual malice, and that it is "[i]t is not enough for the plaintiff merely to assert that the jury might, and legally could, disbelieve the defendant's denial of legal malice." 842 F.2d 612, 621-622 (2d Cir. 1988); see Tr. 1235-1241. Over the weekend, the Court studied the relevant caselaw, including the numerous citations provided by counsel.

During argument regarding defendants' pending Rule 50 motion on the morning of Monday, February 14, 2022, the Court indicated that it was leaning toward agreement with defendants' position on the issue of actual malice as to falsity, but that, to make sure, it would hear further argument on the

issue. The Court further advised the parties that if the Court determined that defendants' Rule 50 motion was meritorious, it would still let the jury reach a verdict so that the case might not need to be retried if the Court's judgment as a matter of law were reversed on appeal.[20] As previously noted, neither party objected in the slightest to this proposal either at that time, during either of the two following sessions of oral argument, or even later that afternoon when the Court indicated it was about to announce its decision on the actual malice prong of the Rule 50 motion. See Tr. 1256-1295.

20 See Tr. 1256 ("So I think it comes down to a single issue. By the way, were I to grant the motion -- and I haven't decided yet, but were I to grant the motion, I would still let the jury continue to reach a verdict so that the Court of Appeals, if they disagree with my determination, would still have the jury's verdict before them and we wouldn't have to retry the case. But I don't mean to suggest by that that I've made a decision. I just wanted to flag what would be the result if I did grant the motion.").

***16** Later that afternoon, the Court reconvened outside the presence of the jury. First, the Court denied the prong of defendants' motion concerning the falsity element. Specifically, it held that there was sufficient evidence, including unobjected-to testimony from Lepping about her research for the corrections (see n. 15, supra) from which a reasonable jury could conclude that Palin had carried her burden to establish the Challenged Statements' falsity by clear and convincing evidence. See Tr. 1295-1297. Then, after discussing the requirements of Rule 50, the Court explained its determination that no reasonable jury could find that Palin had carried her burden to prove by clear and convincing evidence that Bennet had known or recklessly disregarded the Challenged Statements' falsity prior to publication. Tr. 1299-1305. The Court further stated that it would permit the jury to continue its deliberations, and it would formally enter its Rule 50 judgment as a matter of law after the jury returned its verdict. Tr. 1298, 1305. There were no objections.[21]

21 Plaintiff's counsel has since suggested that the Court recognized an objection to this procedure when it stated, after delivering the substance of its Rule 50 decision, that "needless to say, the plaintiff is deemed to have objected to my decision, and that is preserved for appeal as well." Tr. 1306. But plaintiff's interpretation grossly misconstrues the record. The full context of the quoted remark reflects that it concerned only the legal substance of the Court's Rule 50 decision, which plaintiff's counsel had addressed at length, and that the Court was merely recognizing plaintiff counsel's presumed reassertion of those prior objections to the substance of the Court's Rule 50 decision. Because neither party had ever objected to the Court's proposal not to discharge the jury after delivering its Rule 50 decision, there was no prior objection to the procedural aspect of the Court's action that the Court could have recognized as reasserted.

At the end of the day and after announcing its ruling on the Rule 50 motion, the Court reconvened counsel and asked whether either side sought a further instruction about avoiding media coverage of the trial or whether "we should just leave things as is." Tr. 1307. Plaintiff's counsel declined to ask for any instruction, stating "We leave things as is." Id. However, defense counsel requested an instruction, raising the risk posed by "push notifications that get sent out to people's phones." Id. The Court ultimately recalled the jury and again admonished the jurors not to look at anything regarding the trial, not to speak with anyone about the trial, and "if you see anything in the media about this case, just turn away."[22] Tr. 1308.

22 The jury was instructed to turn away from media coverage repeatedly throughout the trial, including when it was empaneled, Tr. 71; after an incident in which a member of the public cheered Palin and denigrated The Times while jurors were waiting for the elevator, Tr. 500, 512; and by email over a weekend recess, ECF 174.

The following afternoon, the jury delivered a verdict of not-liable, which was confirmed in a poll of each individual juror. See ECF 173; Tr. 1324-1325. The Court then informed the jury about its ruling on the Rule 50 motion and discharged the jury. Tr. 1326-1327. The Court entered final judgment later on February 15, 2022. ECF 171.

After the jury was excused, the Court directed its law clerk to speak with the jury about any problems it might have had with the Court's instructions of law or any suggestions they might have for improvements. This has been the Court's routine practice for over 25 years and more than 300 jury trials, and it has led to material improvements. For example, as suggested by a jury several years ago, the Court now always provides the jury with a "short-form" version of its instructions of law

at or near the very start of the trial, as it did in this very case. However, in the course of their post-verdict discussion in the instant case, a few of the jurors volunteered to the law clerk that they had previously become aware of the bottom line of the Court's February 14 ruling, because, notwithstanding that they had assiduously adhered to the Court's instruction to avoid media coverage of the trial, they had received "push notifications" on their smartphones containing a few words to the effect that the Court intended to dismiss the case. ECF 172. Although the same jurors made a point of affirmatively expressing to the law clerk that their limited knowledge had not affected their deliberations in the slightest, the Court, upon learning of this conversation, promptly disclosed it, in writing, to the parties and the public. Id.

III. Legal Framework

***17** As explained, the Court entered Final Judgment for defendants as a consequence of their Rule 50 motion for judgment as a matter of law. ECF 171. Specifically, the Court granted the Rule 50 motion with respect to Palin's failure to adduce evidence from which any rational jury could find by clear and convincing evidence either that Bennet and the Times published the Editorial knowing that it contained a false statement of fact about Palin or that Bennet and the Times published in reckless disregard of the Editorial's truth or falsity. Therefore, the Court sets forth in this section the legal frameworks governing the substantive and procedural aspects underlying its judgment.

A. Elements of Liability for Libel of a Public Figure

A claim of libel arises from the publication of a false defamatory statement made in writing or print. To establish liability for such a claim under here-applicable New York law, Palin, who is a "public figure," was required to prove four essential elements concerning any allegedly libelous statement: [23]

(1) It was a statement of fact that the ordinary reader of the publication would understand, when taken in the context in which it appears, to convey a defamatory meaning, Mahoney v. Adirondack Pub. Co., 71 N.Y.2d 31, 38, 523 N.Y.S.2d 480, 517 N.E.2d 1365 (1987);

(2) An ordinary reader would reasonably understand the statement to be "of and concerning" the plaintiff personally, rather than referring to another person or entity, Three Amigos SJL Rest., Inc. v. CBS News Inc., 28 N.Y.3d 82, 86, 65 N.E.3d 35 (2016);

(3) The statement was materially false, Rinaldi v. Holt, Rinehart & Winston, Inc., 42 N.Y.2d 369, 380, 397 N.Y.S.2d 943, 366 N.E.2d 1299 (1977); and

(4) At the time of publication, the Times (and Bennet, in particular) had the state of mind known as "actual malice," Harte-Hanks Commc'ns, Inc. v. Connaughton, 491 U.S. 657, 666, 109 S.Ct. 2678, 105 L.Ed.2d 562 (1989).

While a plaintiff may prove the first two elements by a preponderance of the credible evidence, the elements of falsity and actual malice must be proven by clear and convincing evidence. See Rinaldi, 42 N.Y.2d at 379, 397 N.Y.S.2d 943, 366 N.E.2d 1299. Also, the parties agreed, based on the record and the scope of respondeat superior liability under New York law, to treat Bennet and The New York Times Co. as a single unit with any finding of liability or non-liability applying equally to both defendants. Tr. 462-464 (charge conference); Jury Instructions at 12 (corporate liability). As for damages, since the Challenged Statements, as construed by Palin, were defamatory per se, damages were presumed, and proof of special damages was not required as an element of liability. [24]

23 Although a fifth element, publication, is also an essential element of a libel claim, defendants here conceded that the challenged statements were published, so this was never in dispute. See Tr. 466.

24 During argument concerning the jury charge, the Court denied defendants' motion in limine that sought a ruling that the Challenged Statements were not defamatory per se. See ECF 159; Tr. 682. Under New York law, "[a]ny written or printed article is libelous or actionable without alleging special damages if it tends to expose the plaintiff to public contempt, ridicule, aversion, or disgrace, or induce an evil opinion of him in the minds of right-thinking persons, and to deprive him of their friendly intercourse in society." Rinaldi, 42 N.Y.2d at 379, 397 N.Y.S.2d 943, 366 N.E.2d 1299. The assertion that Palin's actions played a "clear" or "direct" role in causing Loughner to commit a mass shooting undoubtedly falls within this definition of a libelous per se statement. See Tr. 896-897 (describing death threats Palin and her children

received after the accusation was first made in 2011).

The First Amendment's guarantees of freedom of speech and of the press prohibit imposition of liability for libel of a public figure unless the plaintiff proves that the defendants acted with "actual malice." Sullivan, 376 U.S. at 279-280, 84 S.Ct. 710; see also Harte-Hanks Commc'ns, 491 U.S. at 666, 109 S.Ct. 2678 (confirming that the Sullivan rule applies to public figures). [25] It is undisputed that Palin is a public figure for the purposes of this lawsuit. See Gertz v. Robert Welch, Inc., 418 U.S. 323, 345, 94 S.Ct. 2997, 41 L.Ed.2d 789 (1974) (defining public figures as those who "have thrust themselves to the forefront of particular public controversies in order to influence the resolution of the issues involved" and thereby "invite attention and comment"). Therefore, to prevail, Palin must prove by clear and convincing evidence that Bennet and the Times published the Editorial "with knowledge that it was false or with reckless disregard of whether it was false or not." Sullivan, 376 U.S. at 280, 84 S.Ct. 710. [26]

25 Palin has consistently maintained that New York Times v. Sullivan, 376 U.S. 254, 84 S.Ct. 710, 11 L.Ed.2d 686 (1964) either is no longer good law or does not apply to this case, and thus that the First Amendment does not require her to prove that Defendants published with actual malice. The Court has repeatedly rejected these contentions, which are fully preserved for appellate review. See, e.g., ECF 117 at 11-13.

26 A central plank of the defense was Bennet's assertion that he did not intend the Editorial to convey that the crosshairs map directly caused Loughner to commit the Arizona shooting. This issue largely turns on Bennet's intent in using the word "incitement." On summary judgment, the Court accepted defendants' argument that Bennet could not have actual malice as to the Editorial's purported falsity unless he was also aware that readers would interpret his words to convey the allegedly false meaning. See ECF 117 at 13-15. Accordingly, the Court held that Palin was required to prove two necessary aspects of actual malice by clear and convincing evidence: actual malice as to falsity and actual malice as to defamatory meaning. See id. at 18-19. To prove actual malice as to defamatory meaning, Palin was required to show that Bennet either intended to convey the alleged defamatory meaning or that he was aware that ordinary readers would probably understand his words to convey the allegedly defamatory meaning and he published anyway. See Jury Instructions at 20.

Although defendants' Rule 50 motion contended that Palin had failed to prove by clear and convincing evidence the aspect of actual malice concerning defamatory meaning, the Court did not address this prong of defendants' motion during oral argument. See Tr. 1263. It therefore forms no part of the Court's reasoning as set forth below and is deemed denied as moot.

***18** New York State's "Anti-SLAPP" statute independently requires a plaintiff in Palin's position to prove actual malice, i.e., to have "established by clear and convincing evidence that any communication which gives rise to the action was made with knowledge of its falsity or with reckless disregard of whether it was false." Civil Rights L. § 76-a(2). The Court has already held that the current version of this statute, amended November 10, 2020, applies retroactively to this action. See ECF 125. Therefore, the Court's entry of judgment as a matter of law for Palin's failure to prove actual malice rests independently on both federal law, via the First Amendment, and on New York State statutory law, via Civil Rights L. § 76-a(2).

As explained above, the Court denied Defendants' Rule 50 motion with respect to all elements except actual malice, and then only granted the motion with respect to the aspect of actual malice concerning Bennet's knowledge or reckless disregard of the Challenged Statements' falsity. It was also clear from argument that Palin was not seriously contending that Bennet published the Editorial with actual knowledge that the Challenged Statements were false; rather, Palin argued that she established actual malice by virtue of reckless disregard.

The cornerstone of the reckless disregard standard for actual malice is that the plaintiff must prove by clear and convincing evidence, that the "defendant in fact entertained serious doubts as to the truth of his publication." St. Amant v. Thompson, 390 U.S. 727, 731, 88 S.Ct. 1323, 20 L.Ed.2d 262 (1968). And, as the New York Court of Appeals has explained, "there is a critical difference between not knowing whether something is true and being highly aware that it is probably false. Only the latter establishes reckless disregard in a defamation action." Liberman v. Gelstein, 80 N.Y.2d 429, 438, 590 N.Y.S.2d 857, 605 N.E.2d 344 (1992). Liability is

therefore barred unless Palin adduced clear and convincing evidence supporting the conclusion that, at a minimum, "a false publication was made with a high degree of awareness of probable falsity." Id. Proof of negligence does not suffice to establish actual malice: "reckless conduct is not measured by whether a reasonably prudent man would have published, or would have investigated before publishing." Id.

Nor, without clear and convincing proof that the defendant harbored serious doubts about the truth of the allegedly libelous statement, would it be enough to "show[ ] ... highly unreasonable conduct constituting an extreme departure from the standards of investigation and reporting ordinarily adhered to by responsible publishers." Harte-Hanks Commc'ns, 491 U.S. at 666, 109 S.Ct. 2678. The failure to investigate a fact or confirm an assertion before publication does not establish reckless disregard -- "even if a prudent person would have investigated before publishing the statement" -- unless the evidence proves that "defendants' 'inaction was a product of a deliberate decision not to acquire knowledge of facts that might confirm the probable falsity' of the published statement." Sweeney v. Prisoners' Legal Servs. of New York, Inc., 84 N.Y.2d 786, 793, 622 N.Y.S.2d 896, 647 N.E.2d 101 (1995) (quoting Harte-Hanks Commc'ns, 491 U.S. at 692, 109 S.Ct. 2678).

B. Legal Standard -- Rule 50

As already noted, the standard for granting a motion under Fed. R. Civ. P. 50 for judgment as a matter of law requires a court to consider all the evidence in the record and draw all reasonable inferences in favor of the non-movant, here Palin. Furthermore, the Court may neither make determinations as to the credibility of witnesses or other evidence nor weigh conflicting evidence, as any such analysis of the evidence is the jury's exclusive province.

Independently, however, in reviewing the evidentiary record of actual malice, "the judge must view the evidence presented through the prism of the substantive evidentiary burden," i.e., clear and convincing evidence. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 254, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). Anderson was a libel case, and it addressed the legal issue before this Court: the appropriate standard to apply to a defendant publisher's motion for summary judgment on the actual malice element of a libel claim brought by a public figure, which it described as identical to the standard applied to motions made under Fed. R. Civ. P. 50. Id. at 245-246, 250, 106 S.Ct. 2505. The Anderson Court held that to determine whether a jury question exists as to the actual malice element, a judge must account for the clear-and-convincing standard of proof and determine. Id. at 255, 106 S.Ct. 2505. Therefore, "there is no genuine issue" of material fact, and so the defendants' motion must be granted, "if the evidence presented [by the plaintiff] is of insufficient caliber or quantity to allow a rational finder of fact to find actual malice by clear and convincing evidence." Id. at 254, 106 S.Ct. 2505.

***19** Anderson also rejected the proposition that a jury question as to actual malice exists where the defendant's "state of mind is at issue and the jury might disbelieve him or his witnesses as to this issue." 477 U.S. at 256, 106 S.Ct. 2505. The Court thus held that a plaintiff cannot reach the jury on her libel claim "without offering any concrete evidence from which a reasonable juror could return a verdict in [her] favor and by merely asserting that the jury might, and legally could, disbelieve the defendant's denial of a conspiracy or of legal malice." Id. A libel plaintiff has a "burden of producing ... evidence that would support a jury verdict." Id. "[D]iscredited testimony" of the libel defendant on its own "does not constitute clear and convincing evidence of actual malice." Bose Corp. v. Consumers Union of U.S., Inc., 466 U.S. 485, 512, 104 S.Ct. 1949, 80 L.Ed.2d 502 (1984). Therefore, as a matter of law, a libel "plaintiff must present affirmative evidence" supporting the inference that the defendant published with knowledge or reckless disregard of the statement's falsity to reach a jury on the question of actual malice, even though such "evidence is likely to be within the possession of the defendant." Anderson, 477 U.S. at 257, 106 S.Ct. 2505. As the Second Circuit has repeatedly explained, this means that a libel plaintiff bears the burden that "[s]ome [affirmative] facts must be asserted to support the claim that the state of mind existed." Contemp. Mission, 842 F.2d at 622.

IV. Bennet's State of Mind

The essential question is whether the record reflects any evidence that could give rise to the conclusion that Bennet knew or consciously disregarded that the Challenged Statements were false at the time the Editorial was published on June 14, 2017. In making this assessment, the Court, construing Palin's claim most favorably to her, assumes, as Palin alleges, that Bennet either intended his edits to Williamson's draft to convey that the crosshairs map played a causal role in spurring Loughner to commit the Arizona shooting or at least that Bennet recklessly disregarded that defamatory meaning. Therefore, the specific inquiry is whether there is any basis from which a reasonable jury could

find by clear and convincing evidence that Bennet knew or strongly suspected, before publication, that no link had been established between the crosshairs map and the Loughner shooting. As explained below, the Court concludes that the record contains no such evidence.

Palin has pointed to two categories of evidence that she argues foreclose judgment as a matter of law on actual malice: the research gathered for the Editorial and Bennet's prior awareness of Loughner's motivations. The Court deals with each in turn and then discusses other evidence in the trial record that is probative of Bennet's pre-publication state of mind.

A. The Research

Viewed in the light most favorable to Palin, the Court assumes that Bennet read and understood three prior New York Times opinion pieces that Lett found and circulated on June 14, 2017: Frank Rich's "No One Listened to Gabrielle Giffords," DX-24, and the two editorials published in January 2011: "Bloodshed and Invective in Arizona," PX-134, and "As We Mourn," PX-135. But even on the assumption that Bennet read and understood these three articles in their entirety, none presents any definitive facts about the Arizona shooting that would have put Bennet on notice (or led him to strongly suspect) that no link had been established between the crosshairs map and Loughner's attack.

Rich's column, "No One Listened to Gabrielle Giffords" was written one week after the Arizona shooting and presented no actual evidence about Loughner's mental state at the time he committed the Tucson attack. DX-24. Rich opened by endorsing President Obama's statement that "no one can know what is in a killer's mind" but nonetheless argued that while a "simple lack of civility didn't cause the Tucson tragedy," the political violence committed by Loughner and others emerged from a context filled with violent, antigovernment political rhetoric from the radical right. Id. at 2-3. Rich contended, therefore, that the fact "[t]hat Loughner was likely insane, with no coherent ideological agenda, does not mean that a climate of antigovernment hysteria has no effect on him or other crazed loners out there." Id. at 3. Assuming that Bennet knew the contents of this column when he revised the Editorial, the Court concludes that "No One Listened to Gabrielle Giffords" provides no facts about Loughner or argument about the attack that contradict the facts asserted in the Challenged Statements. Therefore, the Frank Rich column provides no basis for finding that Bennet knew or suspected that his revision introduced false statements of fact into the Editorial.

***20** The Times' editorial published the day after the Arizona shooting, entitled "Bloodshed and Invective in Arizona," also provides no facts or argument that contradict the Challenged Statements. This editorial describes Loughner as "appear[ing] to be mentally ill" and notes that "[h]is paranoid Internet ravings about government mind control place him well beyond usual ideological categories." PX-134 at 1. But the piece nonetheless argues that violent, antigovernment rhetoric creates a context in which people like Loughner are more likely to commit violent acts.[27] At trial, Bennet described this as "the same point" he was trying to make in "America's Lethal Politics." Tr. 712. The core of the argument presented in "Bloodshed and Invective in Arizona" is also consistent with the argument made in "America's Lethal Politics" that violent political rhetoric can make political violence more likely to occur, even if the perpetrators are deranged:

> It is facile and mistaken to attribute this particular madman's act directly to Republicans or Tea Party members. But it is legitimate to hold Republicans and particularly their most virulent supporters in the media responsible for the gale of anger that has produced the vast majority of these threats, setting the nation on edge. Many on the right have exploited the arguments of division, reaping political power by demonizing immigrants, or welfare recipients, or bureaucrats. They seem to have persuaded many Americans that the government is not just misguided, but the enemy of the people.

PX-134 at 2. Bennet described this passage as "[t]o me, ... the same point" as the one he was trying to make in "America's Lethal Politics." Tr. 713. Granted, a tension emerges when one reads both "Bloodshed and Invective in Arizona" and "America's Lethal Politics" in the light most favorable to Palin's claim: the earlier piece says it is "facile and mistaken to attribute this particular madman's act directly to" specific politicians, but the Editorial can be read as doing just that when it asserts that "the link to political incitement was clear,"

in the context of a discussion of the crosshairs map. But this tension emerges from the arguments made by these two pieces, not contradictions in their presentations of the relevant facts. Of course, "[u]nder the First Amendment there is no such thing as a false idea," so statements of opinion are not actionable in libel. Gertz, 418 U.S. at 340, 94 S.Ct. 2997. "Bloodshed and Invective in Arizona" therefore provides no basis for concluding that Bennet knew or suspected that the Challenged Statements contained materially false statements of fact.

27 See PX-134 at 1 ("But [Loughner] is very much a part of a widespread squall of fear, anger and intolerance that has produced violent threats against scores of politicians and infected the political mainstream with violent imagery. With easy and legal access to semiautomatic weapons like the one used in the parking lot, those already teetering on the edge of sanity can turn a threat into a nightmare.")

The third piece of research Palin emphasizes is the editorial "As We Mourn," which was published four days after the attack and praises then-President Obama's speech at a memorial service for the Tucson victims. PX-135. Palin focuses on its praise of Obama's statement that the Arizona attack should be a turning point "not because a simple lack of civility caused this tragedy -- it did not -- but rather because only a more civil and honest public discourse can help us face up to our challenges as a nation." Id. at 1-2. But neither this line nor any other portion of "As We Mourn" presents any facts that contradict the facts asserted in the Challenged Statements. Accordingly, Bennet's having read "As We Mourn" does not support the conclusion that he knew or recklessly disregarded that it was false to assert that Loughner was "incited" by the crosshairs map.

The Court also rejects Palin's argument that the presence in Williamson's draft (and the final Editorial) of the hyperlink on the word "circulated" to the ABC News article weighs in favor of finding that Bennet published with actual malice. To be sure, had Bennet read the ABC News article -- which states in the tenth paragraph that "[n]o connection has been made between this graphic and the Arizona shooting," DX-10 at 1-2 -- it would be relevant to establishing that Bennet had reason to doubt that the "link to political incitement was clear" with respect to the Arizona shooting.[28] But Bennet testified that he neither clicked on the "circulated" link in Williamson's draft nor read the ABC News article before the Editorial was published. Tr. 609-610. And Palin has adduced no affirmative evidence to undermine Bennet's testimony on this point. Therefore, even viewing the record in the light most favorable to Palin and drawing all reasonable inferences in her favor, the Court concludes that the contents of the ABC News article did not inform Bennet's pre-publication state of mind.

28 Even if, assuming arguendo, Bennet had read the ABC News article, it is not at all clear that it would establish that Bennet knew that there was no connection between the cross hairs map and Loughner's attack. The ABC News article was written only one day after the shooting, and its thrust is that people were drawing a link between the shooting and the cross hairs map in the immediate aftermath of the attack. See DX-10. A reasonable reader in Bennet's position would not necessarily understand the hedge contained in the tenth paragraph -- that within one day of the attack, no firm connection had yet been made been made between Loughner and the map -- as conclusive evidence that no such connection was later established by investigators. Of course, this point is academic, since the record reflects that Bennet never read the ABC News article before publication.

***21** Indeed, Palin effectively conceded as much by adopting the alternate position during oral argument on the Rule 50 motion that it was highly unreasonable for Bennet not to have clicked the hyperlink when revising. See, e.g., Tr. 1274. But this contention fails to establish actual malice for two reasons. First, as a legal matter, assuming arguendo that Bennet was negligent -- or even grossly negligent -- in not clicking the link, that would do nothing to establish that Bennet had the subjective awareness of (probable) falsity that is the sine qua non of actual malice. See Harte-Hanks Commc'ns, 491 U.S. at 666, 109 S.Ct. 2678. And second, as a factual matter, it is not at all clear that Bennet's failure to click on the link was even negligent: the hyperlink was keyed to the word "circulated," thereby implying factual support for the well-known proposition that Palin's PAC had circulated the crosshairs map prior to the Arizona shooting.[29] Palin established no reason why Bennet was negligent not to validate this proposition, which is distinct from the allegedly libelous assertion and was not subject to question at any time. Accordingly, Bennet's failure to click the ABC News link does not support the conclusion that he published with actual malice.

29 The full sentence in Williamson's draft read: "Then, it was the pro-gun right being criticized: in the weeks before the shooting Sarah Palin's political action committee circulated a map of targeted electoral districts that put Ms. Giffords and 19 other Democrats under stylized crosshairs." PX-141.

In sum, drawing all reasonable inferences in Palin's favor regarding Bennet's pre-publication reading, none of the research materials in the record supports the conclusion that Bennet had reason to know, or even to suspect, that his revisions had introduced false statements of fact to the Challenged Statements. [30]

30 Nor was there any other research that could have informed Bennet's state of mind on June 14, 2017, because he testified that he relied on Lett's research and did no independent research himself. Tr. 610, 621.

Accordingly, the Court concludes that none of the evidence related to the Editorial Board's pre-publication research process supports the conclusion that the Times published the Editorial with knowledge or reckless disregard as to the Challenged Statements' falsity.

B. Bennet's Recollection

In addition to research conducted for the Editorial on June 14, 2017, Bennet theoretically could have had prior knowledge regarding the relationship -- or lack thereof -- between the crosshairs map and the Arizona shooting. But the record belies this possibility. Bennet testified that he was not aware of the details of the Loughner case and that he did not recall the controversies surrounding the crosshairs map before the Editorial was written. Palin offered no admissible evidence that would undermine Bennet's testimony on this point. Nor are Bennet's contemporaneous communications inconsistent with his testimony. Accordingly, the Court concludes that Palin has not proved that Bennet had any prior recollection of the Arizona shooting from which a rational jury could infer that he published with actual malice.

Bennet testified that he did not recall seeing the crosshairs map or any press coverage about it when the map was originally released in 2010. Tr. 607. Nor does Bennet recall seeing any posts on Twitter that Palin made in connection with the map. Id. Indeed, Bennet testified that at the time he revised the Editorial, he did not have a mental image of the map and "was relying on [Williamson's] description of it in the piece." [31] Id.; see also Tr. 705.

31 Palin had sought to offer evidence regarding James Bennet's brother, Michael Bennet, who has served during all times relevant to this case as the Democratic Senator representing Colorado. Palin had argued both that James Bennet's relationship to his brother could establish bias and that it would have made James Bennet more likely to have been aware of the cross hairs map at the time it was published. See, e.g., Tr. 501-502; ECF 147. However, the Court ultimately sustained the Times' objections, articulated on the record and in a motion in limine, see ECF 136, and excluded this evidence both on grounds of relevance, since plaintiff's counsel had laid no foundation adequate to support either asserted theory of relevance, and on Rule 403 grounds. Tr. 502-503.
Palin adduced no affirmative evidence that Bennet or others on the Times' Editorial Board were biased, fairly or unfairly, against Palin. Even had Palin been able to elicit such evidence, whether arising from James Bennet's relationship with his brother or from any other source, that would not have established actual malice. See, e.g., Harte-Hanks Commc'ns, 491 U.S. at 666, 109 S.Ct. 2678; Buckley v. Littell, 539 F.2d 882, 889 (2d Cir. 1976). ("Repeatedly the Court has said that ill will toward the plaintiff or bad motive, indeed, hatred, spite or desire to injure, are not the kind of 'malice' that the New York Times Co. v. Sullivan test comprehends.").

***22** Bennet also denied having any recollection of specific articles he read in 2011 or thereafter about the Arizona shooting that discussed Loughner's mental state at the time of his attack. [32] Tr. 620. Bennet did, however, have the general recollection of learning from media reports that Bennet "was deranged." Tr. 621. But Bennet testified that he was unaware on June 14, 2017 "whether or not Jared Loughner had seen the crosshairs map," because, he explained "I hadn't reported that myself and I don't think I read any reporting on that. So I didn't know." Tr. 720. Still, he testified that he had "remember[ed] that there had been a debate ... after the shooting ... about exactly this issue, about, you know, inciting rhetoric, but my memory of that was vague." Tr. 702-703. He did not think to look into this issue, Bennet explained, because he "was functioning as the editor, not the reporter on the piece, so [he]

wouldn't normally do the reporting in a situation like this, particularly when ... on a tight deadline." Tr. 721.

32 Palin had sought to offer several articles written by the commentator Andrew Sullivan who published a blog called The Daily Dish that was associated with website of The Atlantic magazine at the time of the Arizona shooting, when Bennet was the editor of The Atlantic. The Daily Dish articles concerned the investigation into Loughner's attack and the allegation made in its immediate aftermath, but ultimately discredited, that the cross hairs map played a role in causing Loughner to commit the mass shooting. Plaintiff's counsel intended to offer these articles to show that Bennet knew that the allegations of a link between Loughner and the map had been discredited. However, plaintiff's counsel was unable to offer an adequate foundation for these articles' admission. The record reflects that Bennet had no editorial responsibility over The Daily Dish, and plaintiff's counsel never elicited any testimony or proffered any other evidence that Bennet had in fact read the articles in question. Accordingly, the Court excluded the articles under Fed. R. Evid. 401 and 402, subject to reconsideration. Tr. 503-511. Specifically, the Court provided plaintiff's counsel the opportunity to conduct voir dire of Bennet outside the presence of the jury to lay additional foundation for the articles' admission. Tr. 508. However, plaintiff's counsel never availed themselves of this opportunity.

Bennet continued:

> I didn't think then and don't think now that the map caused Jared Loughner to act. I didn't think we were saying that, and therefore I wouldn't have -- the question wouldn't have entered my mind, didn't enter my mind to research that question.

Tr. 721. Palin might argue that the first sentence of this comment indicates that Bennet did not believe that what he was writing was true. But the Court concludes that is not a reasonable reading of Bennet's answer and that such a reading would be inconsistent with Bennet's testimony overall. The answer as a whole explains that Bennet's intention was to convey a message that was consistent with his understanding of the Arizona shooting. As Bennet explained a few answers earlier, "when politicians get shot, I suspect it has something to do with politics, and I think that an atmosphere of highly charged political rhetoric makes such, you now, terrifying events more likely." Tr. 720. Accordingly, Bennet's statement that he "didn't think then ... that the map caused Jared Loughner to act" cannot reasonably be read to mean that he thought the map did not contribute at all to the Tucson attack. Rather, the answer must be read to explain that because Bennet did not intend to convey that the crosshairs map directly caused Loughner to act, he therefore did not consider the need to research the veracity of that assertion. In any event, the statement does not suggest that Bennet knew or suspected that there existed any official or widely accepted conclusion that no link whatsoever existed between Loughner's attack and the map. Therefore, it cannot be reasonably inferred from this answer that Bennet published the Editorial with actual malice.

***23** The evidence reflects that Bennet did not introduce the crosshairs map to the draft Editorial, nor did he direct Williamson or anyone else at the Times to refer to Palin in the Editorial. See Tr. 720. True, Bennet brought up the Giffords shooting in his 12:41 p.m. email, which stated:

> Hey Elizabeth -- As Bob has said there's most likely a gun control point to be made here. The other question is whether there's a point to be made about the rhetoric of demonization and whether it incites people to this kind of violence. Hard for me to imagine that Bernie himself is guilty of anything like that. But if there's evidence of the kind of inciting hate speech on the left that we, or I at least, have tended to associate with the right (e.g., in the run-up to the Gabby Giffords shooting) we should deal with that.

DX-17. Bennet explained that Loughner's shooting of Representative Giffords was "the obvious precedent" for the "violence against politicians" in the Virginia shooting, Tr. 635, and that his "assumption is that when a politician gets

shot, that politics probably had something to do with it," Tr. 704; see also Tr. 720. Bennet also reasonably explained the editorial guidance in his 12:41 email as a proposal for Williamson to research, rather than a directive for her to implement:

> I think "whether" is an important word in this sentence. You know, I've got it there twice. I'm -- I'm putting this to my colleagues as -- I'm raising it as a point to be considered as something we might include, you know, the other question is whether there's a point to be made about this. And then I say the point -- in my mind, the point is whether it incites people to this kind of violence. I didn't write that it incites people to this kind of violence. And I think that's a significant difference. My intention was to raise a question, to make an argument that this was this danger but not to assert it as a matter of fact. Because like the easy availability of guns, you know, I don't have -- I can't prove -- I can't prove that this kind of rhetoric actually, you know, does lead to this sort of violence.

Tr. 700-701. Bennet further testified that when he reviewed Williamson's full draft just after 5:00 p.m., he understood the reference to the crosshairs map to be "the specific example that [Williamson] returned with of incitement or incendiary rhetoric, and I just trusted that it was ... an example of that based on her characterization." Tr. 719. While Bennet then inaccurately strengthened Williamson's language in a manner that led to the factual error, none of Bennet's editorial direction from earlier in the day supports the proposition that Bennet knew or suspected that Loughner's actions were wholly unrelated to the crosshairs map.

If anything, the record as a whole reflects that Bennet had a general, albeit inaccurate, recollection (or, perhaps, assumption) that the Arizona shooting was preceded by "inciting" political rhetoric and that he incorrectly understood Williamson's reference to the crosshairs map as confirmation of that connection. If that account does reflect Bennet's thought process, then it undermines, rather than strengthens, any inference that he knew or suspected that his revision introduced falsity to the Editorial.

In sum, Palin adduced no evidence suggesting that Bennet (and therefore the Times) was aware, at the time "America's Lethal Politics" was published, that the hypothesized link between her crosshairs map and Loughner's attack had been widely rejected.

C. Other Evidence

***24** As discussed above, Palin failed to offer any affirmative evidence supporting the inference that Bennet knew or suspected that his revisions introduced falsity to the Editorial. This alone suffices for the Court to conclude that Palin failed to adduce evidence sufficient for a reasonable jury to find by clear and convincing evidence that Bennet published with actual malice. A public figure cannot rely solely on the chance that the jury declines to credit the defendant's testimony denying that he had the necessary state of mind. See Anderson, 477 U.S. at 256, 106 S.Ct. 2505; Contemp. Mission, 842 F.2d at 621-622; see also § III.B, supra. Nonetheless, the record reflects a wealth of other evidence that is incompatible with the inference that Bennet knew or suspected that his revision introduced falsity to the Editorial, even if that evidence is viewed in the light most favorable to Palin.

First, the context of Bennet's revision in the Times' editing and fact-checking processes belies the inference that he intentionally or recklessly published false information. Far from Palin's allegation that Bennet intentionally defamed her by forcing the Editorial Board to write a piece in accordance with his diktats because he purportedly held a political grudge against her or her positions, the evidence shows that Bennet did not seek out the opportunity to revise Williamson's draft. The uncontroverted testimony is that Cohn brought the draft Editorial to Bennet's attention because she thought that the draft's argument was unclear; Bennet did not direct Cohn, Williamson, or anyone else to involve him in the editing process for "America's Lethal Politics." See Tr. 520, 636. After Bennet completed his revision at 7:21 p.m., DX-30 at 178, he immediately emailed Williamson, asking her to "[p]lease take a look." PX-163. Bennet testified that his request to "[p]lease take a look" was intended to convey to Williamson that she should review the piece for fact-checking issues. Tr. 638. This request is incompatible with the inference that Bennet published with actual malice.

Since Bennet was acting as the editor, and since he had not conducted any of the reporting himself, sending a "playback" of the Editorial to the primary author, Williamson, was consistent with Times practices, as they were consistently explained at trial. See Tr. 639, 577. Bennet also submitted his draft to the other editors who were responsible for ensuring the quality, clarity, and accuracy of Editorial Board publications. Accordingly, after Bennet completed his revision, the draft was reviewed, edited, and (in some cases) corrected by Williamson (fact checking), Cohn (editing), Lepping (fact checking), Semple (editing), and Levine and Rakowski (copy editing). See supra § I.D. The thoroughness of these checks was obviously limited by the fact that the print deadline was less than an hour after Bennet saved his draft to Backfield. But the record reflects that this time pressure is routine in the daily newspaper business and not at all suggestive of actual malice.

The Court therefore concludes that, even taking every inference in Palin's favor, Bennet's compliance with these normal pre-publication procedures is consistent with the behavior of a high-ranking editor who is somewhat removed from the reporting details underlying the piece and so was relying on the established processes to ensure that his revisions did not introduce errors. Those processes may have failed in this case; but, nonetheless, Bennet's submission of the Editorial to several layers of pre-publication review is inconsistent with his intentional or reckless publication of false information.

Second, Bennet's post-publication[33] email exchange with New York Times columnist Ross Douthat about the criticism of the Editorial emerging on Twitter is inconsistent with Bennet having already known or suspected that his revisions introduced falsity. After Douthat explained that the Editorial had the facts of the Loughner case wrong, Bennet responded by stating, in part, that his "understanding was that in the Giffords case there was a gun sight superimposed over her district; so far in this case we don't know of any direct threat against any of the congressmen on the field.... That's not to say ... that the violence in [this] case was caused by the pol[i]tical rhetoric."[34] PX-174. Bennet's response does not specifically insist that he was correct to assert that "the link to political incitement was clear," but he does not state or imply that he believes the Editorial to make a false assertion of fact. Bennet writes instead that the "specific" link between the crosshairs map and Representative Giffords does not mean that the map "caused" Loughner's violence, a message he testified he did not "intend[ ] to send." Tr. 645.

33 See Stern v. Cosby, 645 F.Supp.2d 258, 280 n.14 (S.D.N.Y. 2009) (holding that post-publication statements may be considered as evidence of the defendant's pre-publication state of mind) (Chin, J.).

34 This email's accurate description of the crosshairs map contrasts with the inaccurate description of the map in the published Editorial and, when viewed in the light most favorable to Palin, could support the inference that Bennet knew that the description of the map Williamson had drafted was false. But Palin does not contend that the inaccuracy in the map's description was a defamatory falsehood; Palin instead complains about the asserted link between her PAC's map and Loughner's attack. Accordingly, no reasonable jury could find that this discrepancy establishes that Bennet published with actual malice as to the falsity of the allegedly defamatory aspects of the Challenged Statements.

***25** After checking Twitter to read some of the criticism of the Editorial, Bennet sent a text message to Williamson asking, about "the Giffords comparison." DX-46. Bennet asked Williamson, "Do we have it right?" Id. Even viewing this message and the associated testimony in the light most favorable to Palin, it suggests that at 11:38 p.m. on June 14, 2017, Bennet did not know whether the "link" asserted in the Editorial between the Arizona attack and "political incitement" was accurate. The late-night message, which Bennet said he sent "[b]ecause [he] was really worried," Tr. 747, is inconsistent with Bennet having already known or suspected that the asserted link was false.

Bennet's emails and text messages sent the next morning are also inconsistent with him having already known or suspected that the Challenged Statements were false. At 5:08 a.m. -- an "unusual[ly]" early time for Bennet to be emailing, Tr. 282 -- Bennet told Williamson and Lepping, in part:

> I don't know what the truth is here but we may have relied too heavily on our early editorials and other early coverage of that attack. If so, I'm very sorry for my own failure on this yesterday. In any case I'd like to get to the bottom of this as quickly as possible this morning and correct the

> piece if needed. Can you two please put your heads together on this first thing this morning? Please skip the morning meeting if necessary.

PX-191. There are several aspects of this message that undermine the inference that Bennet had already known or suspected falsity.

First, Bennet states "I don't know what the truth is here." This was an unusual admission: Lepping testified that she had never heard these words from an editor before. Tr. 440. While it may have been negligent for the Times to publish an article that could be read as making a serious accusation without checking if the accusation was true, "there is a critical difference between not knowing whether something is true and being highly aware that it is probably false. Only the latter establishes reckless disregard in a defamation action." [35] Liberman, 80 N.Y.2d at 438, 590 N.Y.S.2d 857, 605 N.E.2d 344.

35 The Court asked during oral argument for the parties to identify any caselaw that concerned whether the standard for reckless disregard is affected where the allegedly libelous statement had levied serious charges, criminal or otherwise, against the plaintiff. Tr. 1260-1262, 1277. There was extensive argument on this point, and the Court was ultimately persuaded that none of the cases identified by plaintiff's counsel stood for any such proposition that would reduce her burden of proof on actual malice. See generally Tr. 1264-1281.

The second significant aspect about the email is that Bennet instructed Williamson and Lepping to "get to the bottom of [the factual question] as quickly as possible ... and correct the piece if needed." PX-191. Later that morning, in a text message to Williamson, Bennet reiterated that he "need[ed] ... a rock-solid version" of the correction, which he did not "want to soften if ... we don't need to -- if there was no link we should say so." DX-46 at 2. The Court concludes that these directives are irreconcilable with the suggestion that Bennet purposefully or recklessly published false information. Had he known or suspected the information was false before publication, he likely would have been defensive, avoided issuing a correction to the Editorial, or tried to minimize the correction's confession of error.

The third significant aspect of Bennet's email is his expression of regret for the mistake, which he describes as his "own failure." Bennet's apologetic tone was repeated elsewhere on June 15, 2017. Williamson testified that Bennet was "crestfallen" about the error, Tr. 183, and Bennet's text messages later that morning also reflect that he "fe[lt] lousy about" the error and that he was "sorry." DX-46 at 2. When working on the Twitter posts that would disseminate the first correction, Bennet edited the language proposed by another New York Times staff member to add an apology for the error and thank readers for "call[ing] us on the mistake." DX-53 at 1; Tr. 1033. Bennet also drafted a statement in response to questions from a CNN media reporter in which he stated that "I, James Bennet, do apologize to [Sarah Palin] for this mistake." DX-60 at 2. However, a member of the New York Times Co. public relations staff did not pass along this statement to CNN, so it was never published. PX-236. But for the purpose of assessing Bennet's state of mind, it is not relevant whether the apology ultimately reached Palin. What matters is that, as Bennet testified, "I tried [to apologize] that day. I did -- I thought I had apologized to her. I went home that night thinking I had made a personal apology to the Governor." Tr. 675. The Court concludes that even applying the Rule 50 presumptions, Bennet's private and (intended to be) public expressions of apology, all made before the prospect of litigation had arisen, are inconsistent with his having intentionally or recklessly introduced the factual error to the Editorial.

***26** Accordingly, the Court's review of the remaining evidence in the record that is relevant to Bennet's pre-publication state of mind weighs heavily and uniformly against finding that he knew or recklessly disregarded that his revisions introduced false statements of fact into the Editorial.

V. Conclusion

For the reasons set forth above, the Court finds that Palin adduced no affirmative evidence that Bennet knew that the Challenged Statements were false or recklessly disregarded their probable falsity. The Court is therefore bound to conclude that no reasonable jury could find that Bennet, and therefore The New York Times Co., published "America's Lethal Politics" with actual malice. Clear and convincing proof of knowledge or reckless disregard for falsity is an essential element of a public figure's libel claim. It is required both by Sullivan's construction of the First Amendment and, independently, by N.Y. Civil Rights L. § 76-a(2). Palin thus failed, as a matter of both state and federal law, to carry the heavy burden necessary to prove her libel claim. So the Court

was obliged to grant Defendants' Rule 50 motion and dismiss the action with prejudice.

Although the Final Judgment ultimately rests on the Court's dismissal of the action under Rule 50, that legal conclusion is reinforced by the jury's verdict that defendants are not-liable. The Court continues to have great confidence in the integrity of the jury's verdict, notwithstanding that a few jurors became aware, involuntarily, of the bare fact that the Court intended to dismiss the case as a matter of law. In a case attracting a high degree of public attention, it is inevitable that at least some jurors will encounter information outside the Court's control, even if they are completely conscientious. Here, of course, it was the timing of the Court's announcement of its Rule 50 determination that increased the risk that some jurors would encounter some snippets of the Court's legal conclusion, and that is unfortunate.[36] But the jurors who saw the media coverage say they did as instructed: they turned away from the reports and set the information aside for the remainder of the deliberation. The jurors, both those who reported awareness of the Rule 50 decision and the others, insisted to the Court's law clerk that the information played no role whatsoever in their deliberations and did not affect the outcome. While some outsiders, totally unfamiliar with the exceptional jury in this case,[37] have been quick to assume otherwise, the Court knows of no reason why the highly conscientious citizens who served as jurors in this case would be so firm that they were unaffected by this information unless it were true. The Court is thus left with the definite conviction that the information did not remotely affect the ultimate verdict.

36 The Court is frank to confess that it was not familiar with the term "push notification" when it was raised by counsel for the Times and did not fully appreciate the potential for jurors to be involuntarily informed about the Court's intended ruling through their smartphones. But it must also be remembered that when defense counsel referred to the term "push notifications," Tr. 1307, the Court responded by doing what defendants' counsel requested, i.e., reminding the jurors of their duty to disregard anything they heard about the case in the media. Defendants' counsel sought no further relief (such as a direction to the jurors to turn off any automated alerts for the duration of the trial) and plaintiff's counsel did not seek any such step or indeed any instruction to the jury whatsoever.

37 As the Court remarked on several occasions during the trial itself, the jury in this case was a model jury, carefully watching the witnesses, taking copious notes, and in general, showing that they intended to decide the case based solely on the evidence. See, e.g., Tr. 689, 878, & 1324.

***27** It also bears repeating that the Final Judgment entered for defendants does not legally depend on the verdict. The verdict could only acquire legal significance if the Court's Rule 50 decision were overturned on appeal and the Court of Appeals then decided to give effect to the verdict rather than remand for retrial.

It remains only to add that the Court's decision to enter judgment as a matter of law also reflected its duty to ensure that public figure libel actions with constitutionally inadequate evidence do not erroneously result in the imposition of liability that might chill protected speech. In libel cases that concern public figures and matters of public concern, the court "must make an independent examination of the whole record so as to assure [itself] that the judgment does not constitute a forbidden intrusion on the field of free expression." Sullivan, 376 U.S. at 285, 84 S.Ct. 710. That principle is no less true in cases where the alleged libel was provably false but neither intentionally nor recklessly so. As the Supreme Court later elaborated:

> [J]udges ... must exercise such review in order to preserve the precious liberties established and ordained by the Constitution. The question whether the evidence in the record in a defamation case is of the convincing clarity required to strip the utterance of First Amendment protection is not merely a question for the trier of fact. Judges, as expositors of the Constitution, must independently decide whether the evidence in the record is sufficient to cross the constitutional threshold that bars the entry of any judgment that is not supported by clear and convincing proof of "actual malice."

Bose Corp., 466 U.S. at 510-511, 104 S.Ct. 1949; see also Harte-Hanks Commc'ns, 491 U.S. at 697, 109 S.Ct. 2678 (reading Bose as requiring "trial judge[s]" to "make their own 'independent' assessment of the facts allegedly establishing actual malice") (Scalia, J., concurring). This independent duty to review the whole record is particularly important where the jury is tasked primarily with "distinguishing actual malice from mere negligence," because this is an area in which "jurors have considerable trouble." Tavoulareas v. Piro, 817 F.2d 762, 807 (D.C. Cir. 1987) (R.B. Ginsburg, J., concurring). And, as this case demonstrates, the stakes of the distinction between negligent error and reckless disregard are significant: the preservation of the "area of breathing space" that "[o]ur profound national commitment to the free exchange of ideas, as enshrined in the First Amendment, demands that the law of libel carve out ... so that protected speech is not discouraged." Harte-Hanks Commc'ns, 491 U.S. at 686, 109 S.Ct. 2678.

For all the reasons set forth above, the Court entered final judgment as a matter of law in favor of The New York Times Co. and James Bennet, because no reasonable jury could find that Sarah Palin proved that the defendants published "America's Lethal Politics" with actual malice.

SO ORDERED.

All Citations

--- F.Supp.3d ----, 2022 WL 599271

Anna Delvey Has Lived Many Lives. After *Inventing Anna*, This Is Where She Is Now.

The fake German heiress was deported, but never boarded her flight to Frankfurt.

By Abigail Covington Mar 16, 2022

The fake German heiress Anna Delvey, whose real name is Anna Sorokin, has lived many lives in her 30 years. She's been a Russian immigrant, a fashion student, a New York socialite, an arts and culture entrepreneur, a Rikers Island inmate, a well-heeled, celebrity defendant, a convicted felon, and the inspiration behind Netflix juggernaut *Inventing Anna*. Next up: a deportee in waiting.

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The Most Anticipated Netflix Series of 2022

The Netflix original series depicts the rapid rise and even steeper descent of Sorokin who spent years galavanting across Manhattan, living in boutique hotels, dining at expensive restaurants, and leaving a trail of suspicious, six-figure IOUs in her wake. She survived off of bounced checks and fake wire transfers until 2017 when she was arrested in a sting operation outside the entrance of an upscale rehab facility in Malibu, California on charges of grand larceny and theft. The jig was up. In May 2019, a jury convicted Sorokin on a handful of grand larceny and theft services charges. She was sentenced to four to 12 years in prison, rebranded as inmate #19G0366, and shipped up to Albion Correctional Facilities in upstate New York.

Read on for the latest on her real life whereabouts.

When was Anna Sorokin released from prison?

Let's cut right to the chase: No, Anna Sorokin is not still in prison. At least, not the same prison she was in when she was first sentenced back in 2019. Sorokin was released from there on parole in February 2021, after serving three years in her four-to-12-year sentence. The reason for her early release? Good behavior.

Immediately after she was released, Sorokin settled her debts. She used a portion of the $320,000 she received from Netflix for the rights to her life story to pay back the $200,000 she owed the banks. She coughed up an additional $25,000 to pay New York state fines. With her debts settled, she checked into the NoMad Hotel in downtown Manhattan and resumed posting glam shots of her post-prison life on Instagram. She gave countless interviews and made a few bold statements about her experience in prison. On *Good Morning America*, she claimed her time in Rikers was "therapeutic." She rented an apartment in Manhattan and began promoting a potential new fashion collaboration with former Hood By Air designer Paul Cupo. She checked in with her parole officer regularly. Obviously, she hired a videographer to document her new life.

Unfortunately, it was short-lived.

Why was Anna Sorokin rearrested?

In March 2021, Sorokin was arrested by immigration authorities for overstaying her visa. She had an immigration detainer attached to her name when she was first released from prison, but clearly, she wasn't in any rush to leave New York. Sorokin was scheduled to be deported back to Germany (Auf Wiedersehen, Anna!) on March 26, but was filing an application for relief, which is essentially legalese for "please don't make me go back to Germany," as as a result stayed in custody stateside. Through her lawyer, Audrey Thomas, Sorokin has asked to be granted asylum.

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According to court documents reviewed by Esquire, Sorokin applied for asylum based on a "fear of returning to Germany." Evidently, Sorokin and her family have received numerous threats "due to the media coverage of her crimes" and she fears she will be "retaliated against for embarrassing her country." Sorokin's application for asylum was denied in June 2021, but she quickly appealed. Despite her lawyer's many attempts to get her released on bond while she awaits a final decision on her appeal, Sorokin remained in custody in Orange County Correctional Facility in upstate New York. She tested positive for COVID-19 in January and spent more than a week in quarantine isolation. "I'm sure I'll live, but I haven't been this sick in years," wrote Sorokin in an article published by Insider.

Did Anna Sorokin Get Deported?

Not yet! Sorokin was supposed to board a flight bound to Frankfurt on Monday night, but the deportation failed at the last minute when, according to the New York Post, she just, like, didn't show up to the airport. Sorokin's lawyer, Manny Arora, has since said that her failure to appear was most likely caused by the motion he filed late on Monday afternoon to stay the deportation. Evidently, a judge needs to make an official decision on that matter before Sorokin can be deported. “Until we get a ruling from the appeal to stay the deportation, there won’t be much else to report," explained Arora.

So consider it one of those rare instances when missing a flight is actually a good thing, because if there's one thing we know for sure, it's that the fake heiress really doesn't want to return to Germany.

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JURIES AND DAMAGES: A COMMENTARY

Introduction

When a jury awarded Stella Liebeck $2.7 million in punitive damages after she had suffered third-degree burns from a spilled cup of McDonald's coffee, [1] many members of the public and press denigrated the result, [2] describing it as "outrageous" [3] and the jury as "runaway." ***428** [4] What was often ignored in these accounts of the case was that the eighty-one-year-old woman's injuries were very serious, [5] that McDonald's had known about the problem of its exceptionally hot coffee [6] but had declined to warn consumers [7] or to change the temperature at which it served its coffee, [8] and that the trial judge subsequently reduced the $2.7 million punitive damage award to $480,000. [9]

Sheila Liebeck's case, though involving punitive damages, illustrates several problems with the way in which civil juries' damage awards in general are covered in the press and perceived by the public. One ***429** problem is that awards that are dramatic are the ones that receive press attention. The more mundane, less sensational damage awards that are decided by juries everyday are often overlooked. One consequence of such coverage is that jury verdicts appear to be more inconsistent than they actually are. Another problem is that the damage awards that are described in the press are not the ones that are necessarily received. A jury's award does not mark the end of the process; the verdict must still be reviewed by the judge. This means that both press and public may be judging damage awards prematurely, before judges have reviewed them.

Neil Vidmar, in a study of pain and suffering awards, [10] and Shari Diamond, in a study of damage awards, [11] provide empirical evidence that challenges the popular view of "runaway" juries reaching "outrageous" verdicts. Vidmar, from his analysis of data found in verdict reporters from three states, [12] concluded that juries are not running wild in their award of damages for pain and suffering in medical malpractice suits; rather, they are reaching consistent awards, which are not as high as the press accounts suggest because they are often reduced by trial judges in the post-verdict period. [13] Diamond, using jury-eligible citizens who engaged in deliberations, found that there is variability in pain and suffering awards, but that the variability is reduced by using juries rather than individual decisionmakers and could be further reduced by giving juries guideposts. [14]

I. Vidmar's Study

A. Background

Vidmar, after reviewing the literature on pain and suffering awards, noted that a common problem for researchers is how to determine how much of a jury's award is attributable to economic losses and how much is attributable to pain and suffering

because the jury is usually not required to specify. In one method, "the subtrahend method," researchers subtract the economic losses from the total verdict; the remainder is attributed to non-economic losses, such as pain and suffering. [15] This method, however, is inexact. To address this problem, ***430** Vidmar looked at jurisdictions that require the jury to specify damages for each element of the award. California, Florida, and New York require the juries to separate economic from non-economic awards. [16] Therefore, Vidmar turned to the commercial verdict reporters for each of these states and examined medical malpractice verdicts during the years 1985-1997.

Among his results, Vidmar found that the awards increased with severity of injury, except when death occurred; [17] that the non-economic component of the award was between 50 to 60% percent of the total award; [18] and that the post-verdict awards that plaintiffs received were lower than the initial jury awards. [19] In New York, approximately 44% of awards were adjusted, mostly downward, by the judge in the post-verdict phase, while in Florida and in California the reductions were less dramatic. [20]

B. Additional Questions

Vidmar has uncovered a useful source of data in the commercial verdict reporters, but they raise additional questions. Although Vidmar recognized that these sources have their limitations and should not be taken at face value, [21] he does not explore as fully as possible some of the questions that data from these reporters raise.

1. Geography

One question, for example, is whether there is a geographical effect of which Vidmar should be aware in limiting his data sets to California, ***431** New York, and Florida. Are these states representative in their litigation patterns and legal cultures? Or are there some special characteristics (They are on the coasts? They are populous states? They have large immigrant populations? [22]) that should limit any conclusions drawn from data from these three states? Do awards from these states tend to be higher or lower than those from other states? It would be useful for Vidmar to explain why he thinks his data, though limited to these three states, can tell us something useful about pain and suffering awards that is applicable beyond these states.

Another question raised by geography is whether there are any county patterns that Vidmar can discern from these reporters. All three verdict reporters identify in which county the case was heard. The reason this information could prove useful is that in criminal cases there has been considerable debate about whether juries in some counties are acquitting criminal defendants at higher rates than the rest of the country. The so-called "Bronx jury," drawn largely from a community of minority jurors, has been characterized as acquitting, whether based on reasonable doubt or nullification, at higher rates than juries in other geographical areas. [23] Are Bronx juries acting differently in medical malpractice cases than juries in other counties? Or, is the Bronx jury effect, to the extent it exists, limited to criminal cases? A county-by-county analysis of damage awards might reveal a Bronx jury effect, not only in the Bronx but in other counties as well. This effect would be important to identify because it might be ***432** that once these outlier counties are excluded the damage award results are even more consistent than Vidmar has found.

2. Selection Criteria

Other questions raised by Vidmar's use of data from the verdict reporters are how are cases selected for inclusion in the reporters and what difference might this make? All of the reporters Vidmar relied on are commercial and may have different selection criteria as to which cases they include. Vidmar acknowledged this problem: "The data sets are not comprehensive of all cases, and there is evidence that the selection may not be random." [24] He described the New York Jury Verdict Reporter, his source for the New York data, as containing "approximately 90% of all personal injury verdicts in Metropolitan New York and surrounding counties," [25] whereas his Florida source, the Florida Jury Verdict Reporter, is neither random nor comprehensive; rather judges and law clerks decide which cases to forward for publication. [26] With respect to the California Jury Verdict Reporter, Vidmar did not say how selection is decided. Vidmar acknowledged a difference in approaches (except for California), but then proceeded to treat all the data the same, selection differences notwithstanding.

From my own experience as a law clerk, [27] I have seen that the decision whether to submit an opinion for publication is made quite carefully. At the district court level, we usually submitted an opinion for publication if we thought it made a contribution to the law. The reasoning was similar at the court of appeals level, much to the consternation of the Supreme Court, which has responded to this growing trend toward unpublished appellate opinions [28] by occasionally deciding to hear such cases. [29] If an opinion simply applied the law of the circuit to the facts of the case, then the opinion became a memorandum ***433** decision, which was unpublished [30] and could not be cited as precedent. [31] Thus, there may be a significant difference in the mix of cases contained in the various reporters when one reporter includes almost all cases that are decided in a jurisdiction, whereas another leaves the decision to the discretion of judges and law clerks, who may be highly selective.

3. Subject Matter

Vidmar also chose to focus on medical malpractice cases and this decision raises the question whether the results would be different in other kinds of cases. In an earlier study, Vidmar had concluded that there is no support for the assertion that jurors treat medical malpractice and auto negligence cases differently. [32] He also intends in the future to extend the scope of cases by conducting additional studies in which he would look at product liability and automobile negligence torts cases. [33] One question then is whether there is anything special about medical malpractice cases that might lead to results that are only applicable to medical malpractice cases. Another question is the role that insurance plays. The verdict reporters indicate whether or not the parties had insurance. [34] It would be interesting to know whether pain and suffering awards increased or decreased based on who had insurance. In federal court, [35] and in some state courts, including California [36] and New York, [37] the jury is not allowed to know ***434** whether the parties have insurance. In other states, such as Florida, [38] the jury is allowed to know about insurance, but not about policy limits. [39] Yet, because this information is reported in the verdict reporter, a researcher could nevertheless determine whether there are any correlations between insurance coverage and pain and suffering awards.

By focusing on medical malpractice cases, Vidmar also has the opportunity to examine the ways that gender might influence pain and suffering awards. The verdict reporters include the names of the parties, which are usually (though not always) sufficient to ascertain gender, and at least one reporter explicitly indicates the gender of the plaintiff. [40] It would be interesting to know if female plaintiffs receive higher or lower damage awards in these medical malpractice cases. Within the medical practice, there have certainly been indications of gender bias, with studies showing that doctors have taken women's complaints of pain less seriously than those of men; [41] that women receive less aggressive medical treatment, particularly with respect to heart attacks, than do men; [42] and that medical research has been limited to all-male studies in the past, with the results simply assumed to ***435** be the same for women. [43] My own hypothesis is that there would be a gender difference, but it must remain a hypothesis until Vidmar or others provide the empirical data to support or refute it. [44]

4. Supplementary Interviews

Although Vidmar points out that his analysis of the data in the verdict reporters will not tell us whether the jury reached a reasonable damage award, [45] supplementary interviews with jurors and judges might begin to answer that question.

It would be possible to do a sampling of follow-up interviews with jurors and judges. Follow-up interviews with jurors would provide some information as to their reasoning: How did they go about determining pain and suffering awards? What were they trying to achieve? Although the verdict reporters do not provide the jurors' names, this information is a matter of public record and would be available at the courthouses where the trials took place.

Similarly, a sampling of follow-up interviews with judges might also yield useful information. The verdict reporters provide the names of the presiding judges, so some of these judges could be interviewed or sent a questionnaire. It would be useful to know the judges' rationales: When do judges adjust damage awards upward or downward and why? Are they consistent in their treatment of pain and suffering awards? There are a variety of procedural mechanisms that allow the ***436** judge to adjust the jury's damage award. The trial judge could decrease or increase the award through judicial remittitur [46] or additur [47] respectively. Or, the trial judge might have to reduce the award because it exceeded a statutory cap established by the state legislature. [48] In addition, the appellate court could reduce the award were the losing party to appeal. Other reasons that an

award might be adjusted after the verdict would be that the parties reached a settlement prior to appeal or the defendant had no collectible assets or insurance with which to satisfy the award.

Of course, this would not be the first time that researchers have looked to judges to try to provide a benchmark for evaluating jury decisions. This was, after all, the approach taken by Professors Harry Kalven and Hans Zeisel in their landmark study of the jury, The American Jury. [49] They compared jury verdicts with judges' assessments of those verdicts, and concluded that judges and juries agreed about 75% of the time; [50] when they disagreed, it was over the evidence or in the grey areas, in which judges believed that juries had more discretion to act in accordance with community values, even if those decisions were sometimes contrary to the law. [51] Although this approach of contrasting judge and jury decisions has a serious methodological flaw, in that there is no reason to use judges as a benchmark and to believe that they have the right answer any more than the jury does, at the very least this information would provide an additional data point. Admittedly, even if the judge agreed with the jury's award, that would not mean that the jury had reached the right number. Rather, all that it would mean is that judge and jury were at least consistent with each other. And since consistency in damage awards is something that Vidmar is interested in examining, judge interviews or questionnaires that supplement the verdict reporters might help in this respect.

*437 C. Possible Reforms

One of Vidmar's conclusions is that a jury's damage award, including the amount it provides for pain and suffering, is often subject to adjustment during the post-verdict period, and this goes unrecognized. [52] One of the challenges, then, is how to educate the press and public as to the interim nature of the jury's damage award. The goal should be to encourage the press to focus its reporting on the damage award ultimately approved by the judge rather than on the initial award reached by the jury.

The reason this shift in focus from damage award to adjusted award is so important is that the press and public will continue to have a skewed vision of juries and their damage awards. They will continue to believe that the awards are too high and that the jury is at fault when, in fact, neither is true. These misperceptions could be corrected if the press and public knew that the awards are often reduced and that the jury is not the only actor in the decisionmaking process. Although Vidmar is cautious about proposing ways to do this, perhaps because he is a social scientist with a healthy respect for the limitations of any one empirical study, I, as a law professor, am less constrained and am willing to speculate on possible reforms.

1. Delay Damages Announcement

One way to shift public focus from the jury's damage award to the judge's adjusted award is to delay the release of the jury's damage award until the judge has made the appropriate adjustments, and then have both awards announced at the same time. The delay would allow the public to learn about the jury's award, not in isolation as it currently does, but as part of the judicial process, in which the judge also has a role to play.

Under the current system, in which the jury award is announced to great fanfare and publicity, by the time the judge adjusts the award, assuming adjustments are required, both press and public have lost interest in the case and the judge's action receives little public notice. After all, it is far more dramatic to hear about a $2.7 million punitive damage award than it is to hear about an award of $480,000 some time later when the facts of the case have already begun to fade. [53]

The delay in the announcement of the jury's damage award might require changes in the judge's instructions and the juror's oath. To ***438** ensure that the jury's damage award is not announced until the judge has made any necessary adjustments might require the jurors to swear to maintain silence and the judge to instruct the jurors that they are not to disclose this information until the judge has acted on the award. [54] Requiring the jurors to keep silent on a matter, if only for a limited period of time, is not unprecedented. Grand jurors must swear to maintain the secrecy of the grand jury proceedings and not reveal what takes place in the proceedings or in the juryroom to those outside. [55] At least federal courts in two states, Connecticut and Louisiana, prohibit petit jurors from revealing to outsiders what occurred during their deliberations [56] and at least one court did the same in a recent high-profile case. [57] In other federal courts, judges instruct jurors at the close of the trial that they are free to talk to others, but they are not required to talk to anybody. [58]

2. Educate Public About Damage Awards

An alternative is for the court to emphasize to the press and public that the jury's damage award is an "interim" award. The judge could make this point in open court at the time when the jury announces its damage award, and it would be reflected in the public record. Every ***439** time the judge refers to the award, he or she could preface it with the word "interim." This would serve to remind those in the courtroom that the jury's damage award is subject to revision by the judge, and should be viewed as only the first step in the process of determining an appropriate figure. The hope would be that when the press reports on the jury's damage award it would note that the award is only an interim figure, and that the final figure would be determined by the judge. It would also be the press's responsibility to report on the damage award after it has been adjusted by the judge.

3. Encourage Early Judicial Involvement

Another approach would be to involve the judge early in the process of determining the damage award rather than waiting until after the jury has reached its determination. This proposal connects Neil Vidmar's research with that of Shari Diamond. [59] Diamond suggested that the judge provide guidelines to the jury in setting damage awards. Diamond's proposal also has support from Vidmar's study. Whatever guidelines the judge uses to adjust a jury's damage award in the post-verdict period, the judge could also share with the jury in the pre-verdict period. The judge could provide the jury with whatever guidelines, range, or past comparable cases the judge would draw from to decide what the appropriate damage award should be and simply share this information with the jury before, rather than after, the jury reaches its damage award.

4. Expand the Judicial Role

An even more radical reform would be to limit the jury to a liability finding and leave the damage award completely in the hands of the judge. Even today, trials are often bifurcated, with the jury determining liability, and if there is a finding of liability, then the trial enters the damages phase and the jury determines damages. Although Vidmar does not suggest allowing the judge to make the damages determination, certainly others have. [60] To advocate such a proposal, however, one would have to have a great deal of faith in judges and a lot of skepticism about juries.

***440 D. Objections**

Objections to the above proposals are likely to come from several different fronts. Judges, attorneys, and members of the press are all likely to want to preserve the status quo.

Judges will resist the suggestion that they become more actively involved in determining damages at an earlier stage in the proceedings. They are likely to explain that decisions about damages are properly left to the jury to decide in the first instance. Similarly, they are unlikely to want to replace the jury in deciding a damage award because it is a difficult determination to make and one for which little guidance exists and for which the judge does not have any particular expertise or training. In general, judges are likely to be wary about intruding upon decisions that they believe are properly within the province of the jury.

Attorneys are also likely to resist greater judicial involvement in determining damage awards. They want the highest possible damage award, and are unlikely to want to give up what they perceive as the potential for a windfall award from the jury. Even if a judge's involvement in determining damages means less risk for the attorney, it also means a reduced chance of a windfall. Attorneys are also likely to disfavor juror silence until the judge has adjusted the jury's verdict because then the attorney's victory will seem less pronounced and the award less likely to attract public attention.

Members of the press would undoubtedly object to the proposal that jury damage awards not be announced until the post-verdict phase when the judge has had the opportunity to make any necessary adjustments. The press could point to the First Amendment [61] and argue that the trial is open to the public, that the damage award that is reached by the jury is public information, and that the jurors need to be held accountable for their decisions. In addition, the press could point to the jurors' First Amendment right to speak to the press, if they so choose. The press's desire to focus on the jury's award rather than the judge-modified award is because the jury's award is likely to be higher and more sensational; it will sell more newspapers. It is not surprising that Stella Liebeck was portrayed in the press as a plaintiff who brought a frivolous lawsuit and was rewarded

with an exorbitant amount of money by a jury system gone awry. Such a story is likely to have popular appeal, whereas a careful examination of the facts and arguments does not have the same appeal.

***441** The press is also unlikely to be persuaded that, because the judge describes the jury's damage award as "interim," it should adopt that convention as well. Again, the press is likely to take refuge in the First Amendment: It will decide how to describe a jury award and will resist deferring to the court's description. Moreover, there are some legal procedures that the press continues to describe incorrectly, and this may be one of those procedures. For example, when the United States Supreme Court denies a petition for a writ of certiorari, it is not upholding a lower court decision; [62] rather, it is simply exercising its discretion [63] and declining to accept the case for review. [64] The press continues to describe the Court's action incorrectly. Just as it may make for a better story to describe the Court as having taken some point of view on the lower court case, so too, it may make for a better story if the jury's damage award is seen as final rather than as an interim award in an extended process.

E. A Recommendation

My recommendation is that the jury's damage award should not be disclosed until the judge's adjustments can also be announced. It seems unlikely that there would be a First Amendment problem because the jury's damage award would only be delayed, not permanently concealed. Courts have said that the First Amendment is not absolute and is subject to time, place, and manner restrictions. [65] This would simply be a time restriction.

***442** I do not have much faith in judges being able to modify the press's descriptions simply by using the word "interim" to describe a jury's damage award. If the Supreme Court cannot persuade the press to describe certiorari accurately, then it seems equally unlikely that courts will be able to persuade the press to describe a jury's damage award as interim.

Although I certainly do not support the proposal that judges take over the role of determining damage awards, I do think there is merit in having judges more involved in the determination at an earlier stage. One reason judges should not be deciding damages is that these are decisions for which there is no right answer, and so it seems appropriate to turn to a jury to obtain a community sense of what an appropriate amount might be. To explore further the guidance that judges might provide to juries without usurping their proper role, I turn to Shari Diamond's research and the role she described for judges and juries in the assessment of damage awards.

II. Diamond's Study

A. Background

Diamond, like Vidmar, investigated damage awards, but used a different method for her inquiry. She showed jury-eligible citizens a videotape of a products liability case. [66] Before the mock jurors viewed one of six versions of the videotape, they completed a questionnaire in which they provided certain demographic and background information. [67] Immediately after the viewing, each juror completed another questionnaire, indicating how he or she would have decided the case. The mock jurors were then assigned to six-person juries, where they deliberated and reached a verdict. [68]

Among her results, Diamond found that while background characteristics showed only a "modest association" [69] with verdict preferences, certain attitudinal variables were associated with verdict ***443** preferences. [70] Nine attitudinal variables enabled the researchers to predict 67% of the individual jurors' liability decisions. [71]

With respect to damages, however, there was less predictability. This was the case for pain and suffering awards in particular, for which jurors receive little guidance, rather than for economic losses, for which jurors hear much testimony. [72] Although there was greater variability in damage awards than there was for liability, Diamond noted that there was slightly less variability for juries' damage awards than there was for individual jurors' damage awards. [73] These results led Diamond to two conclusions: that it may be preferable to return to twelve-person juries rather than the current six- or eight-person juries, and that it may be useful for courts to provide jurors with guideposts for determining damages. [74]

B. Observations on Methodology

Before pursuing Diamond's conclusions, several observations on her method are in order. The first is that by using jury-eligible citizens rather than students, Diamond avoided one of the pitfalls of many jury researchers. Those who use students as mock-jurors must assume that students are representative of the jury population in general, but of course, students differ in significant ways. At the very least, they are from a distinct age group; they may have more education than the general jury population; they are likely to have limited or no work experience; and their marital status is likely to be single with no dependents. Even in federal court, where the trial judge typically conducts a very limited voir dire, [75] the types of questions that are asked ***444** of prospective jurors (How long have you lived in the jurisdiction? What kind of work do you do? What is your marital status? What kind of work does your spouse do? Do you have any children, and if so, what kind of work do they do? Have you served on a jury before, and if so, was it criminal or civil, and did it reach a verdict?) [76] are likely to receive very different answers from students than from a jury-eligible population. Diamond avoided this methodological weakness, prevalent in many mock-jury studies, by using jury-eligible citizens.

The second observation is that Diamond avoided another pitfall by using deliberating juries rather than simply relying on individual jurors in her study of damage awards. Researchers often treat an individual's verdict preference or assessment of damages as equivalent to that reached by a jury, [77] but of course when they do so, they fail to take into account the effects of the deliberation process. A jury verdict or award is not just the sum of the individual preferences. [78] If it were, there would be no need to have deliberations. The jurors could simply submit their ballots at the end of the trial, as they do in Brazil. [79] But in this country, jurors are asked to deliberate. One reason is that we assume that there is a give-and-take that occurs so that jurors who might have entered the juryroom with one point of view might leave the juryroom persuaded of the correctness of a contrary point of view. [80]

***445** Perhaps the best-known example of the transformative power of deliberations is the movie 12 Angry Men, [81] which depicts a fictional jury deliberation. Each of the jurors, with the exception of Henry Fonda's character, entered the juryroom convinced of the defendant's guilt. After hours of heated debate, sparked by Fonda's questions, doubts, and arguments, the jury, however, emerged with a unanimous verdict of not guilty. Although studies have shown that it is difficult, if not extremely unlikely, for one or two people to change the opinions of the entire group, as Fonda did, it is possible for three or four people, or a sizable minority, to produce such a change. [82] Diamond, by focusing her study on the result reached by the jury, rather than just the individual juror, acknowledged the critical role that deliberations play.

Another point acknowledged by Diamond is the difficulty in defining what is meant by “pain and suffering.” It is a nebulous phrase, for which there is no one understanding. It is precisely in situations such as this, when there is no right answer, that we turn to the jury to provide at least an answer. The expectation is that jurors, drawn from a fair cross section of the community, will be representative of the community and will engage in a deliberative process through which consensus is reached, and that the judgment arrived at will reflect the values of the community. [83] What is required of the jury is an interpretation of the phrase “pain and suffering” and how it applies to the facts of the case. [84] The jurors cannot help but bring their values to the task. Diamond acknowledged as much when she asked jurors about attitudes that she thought likely to inform their decisionmaking in her test products liability case: from current smoking behavior to opinions ***446** about big business to their views on how much money is required for a person to be wealthy to how much money it would take to compensate an injured person for various types of injuries. [85] She described these as “internal guideposts” that a juror might use in reaching a determination about pain and suffering awards. [86]

C. Possible Reforms

1. Increase Jury Size

One reform that Diamond proposed is a return to the twelve-person civil jury. [87] Diamond suggested this change because it would reduce variability in jury damage awards. Diamond had noted greater variability among individual jurors' awards, but reduced variability among jury awards, particularly for economic damages. [88] By increasing the number of participants on the jury, any idiosyncracies of individual jurors would be minimized. [89]

Diamond's proposal to increase jury size would help not only to make jury damage awards more consistent but also to make the jury more representative of the community. Although this is not a benefit Diamond explicitly sought, it would be another benefit. If civil juries consisted of twelve jurors, rather than six or eight, then the chances that they would include members with different backgrounds, perspectives, and life experiences, assuming the venire was broadly drawn, [90] would be increased.

***447** The debate over the size of the civil jury is hardly new. In the 1970s, academics, judges, and lawyers debated the issue, with courts taking steps to reduce the size of the civil jury, [91] and academics urging preservation of the twelve-person civil jury. [92] Courts were struggling to save time and money, and reducing jury size allowed them to achieve both those objectives. Meanwhile, academics were worried that smaller juries would be less representative of the community at large and there would be less consistency from verdict to verdict. [93] Although many judges today continue to support the smaller civil juries, especially now that they have had a fair amount of experience with them, [94] Diamond's research points to why the twelve-person civil jury still remains the ideal.

2. Provide Guideposts

Diamond's research also led her to take up Peter Schuck's suggestion that courts provide juries with "schedules," [95] or in Diamond's language, "guideposts" [96] so that they have some guidance as they struggle to determine damage awards. Diamond is a little vague about what form these guideposts might take. One possibility is for courts to give juries a distribution of awards in comparable cases. Of course, the difficulty is in deciding which cases are comparable. But, as Diamond pointed out, the task is similar to the one faced by the drafters of the United States Sentencing Guidelines [97] as they tried to figure out past practices in an effort to determine an appropriate range of sentences for particular crimes. [98] There are other forms the guidepost could take, from a list of factors that a jury could consider ***448** but would not be bound to follow, to the judge's view of an appropriate award. In each instance, the goal would be to give the jury some indication of a range or ballpark figure.

a. Advantages

Giving the jury some form of guidepost seems quite sensible in many ways. If jurors had more information about pain and suffering awards to guide them, in the same way that they have information about economic losses, then they would find their job as jurors less frustrating. They would not feel that they were simply inventing a figure, but rather, that the figure they reached had some foundation.

Providing jurors with the tools they need to do their job, in this case guideposts with information about awards in comparable injury cases, is consistent with a modern movement to equip juries properly so that they can perform their tasks well. For example, some courts are now giving jurors notebooks and allowing them to take notes during the trial, on the theory that it helps jurors to pay attention during the trial and helps them to recall evidence and testimony during deliberations. [99] Courts have also begun to provide jurors with written copies of the judge's instructions so that they can refer to them in the juryroom. [100] State courts in Arizona have gone even further, allowing jurors to ask questions by submitting them in writing to the judge during the trial. [101] Judge Michael Dann, a state court judge in Arizona who has spearheaded many of these efforts, [102] has abandoned the ***449** traditional Allen charge, [103] delivered to a jury that has reached an impasse, and has replaced it with a judge-jury conversation in which he tries to figure out if he or the lawyers can provide the jury with additional information that will enable it to overcome the impasse. [104] Giving juries guideposts about past damage awards would be consistent with all of these current efforts to ensure that the jury has the tools it needs to perform its job properly.

Another advantage to giving juries a guidepost for damage awards is that it would help them to avoid vastly inconsistent awards. Diamond drew upon the work of Michael Saks and colleagues, [105] who noted that when mock jurors were given information about the distribution of awards in comparable cases, the variability of pain and suffering awards was substantially reduced. Even if jury awards are not as inconsistent as the press and public might think, any reduction in inconsistency of jury awards could only be beneficial for the institution of the jury.

b. Disadvantages

Providing a jury with a guidepost, however, is not without its disadvantages, and these would depend, to some extent, on what form the guidepost took. Any guidepost might signal to jurors a loss of faith in the jury, or at least a questioning of its capacity to determine damages on its own. Moreover, a guidepost would wrest some power from the jury, particularly if jurors felt bound to adhere to it. Even if jurors did not feel bound by the guidepost, whoever fashions the guidepost would wield much power. Furthermore, jurors may be influenced by the guidepost even if they do not rigidly adhere to it.

c. Caveats

Thus, there are several caveats that accompany the design and use of any guidepost. The first is that whoever is given responsibility for ***450** compiling the guidepost will have a certain amount of influence. If this task falls to the judge, then the judge will have added power.

Second, there are lessons to be learned from the Sentencing Guidelines experience. [106] The guidepost should remain merely a guidepost and should not become a mandatory schedule to which jurors must adhere. The Sentencing Guidelines allow federal judges little discretion in terms of sentencing. [107] They were implemented largely because Congress decided that sentences meted out for the same crime varied too greatly from judge to judge. [108] The Sentencing Guidelines were an effort to bring uniformity to federal sentencing. [109] One effect of the Sentencing Guidelines has been to shift the sentencing discretion that once belonged to the judge, to the prosecutor. [110] The prosecutor, in deciding how to charge a defendant, is in effect deciding how that defendant will be sentenced if he or she is found guilty, now that the judge no longer has discretion to alter that sentence in any significant way. A guidepost that functions as the Sentencing Guidelines currently do would shift power that now resides with the jury and would place it in the hands of the judge, or whoever was given responsibility for creating the guidepost.

Third, much care has to be taken with the way any guidepost is framed. Empirical studies have shown that the same information ***451** worded in different ways can produce different responses from jurors. [111]

3. Special Verdicts/Interrogatories

An alternative that Diamond did not consider is the special verdict or the general verdict and interrogatories. These are procedural devices that are already available in federal [112] and state [113] courts and provide a means by which trial judges can give some structure to a jury's reasoning process. Under the Federal Rules of Civil Procedure, the trial judge can submit written questions to the jury and the jury returns a special verdict in the form of written findings of fact. [114] Or, the judge can have the jury return a general verdict, but answer interrogatories that have been posed to it by the judge. [115] With either method, the judge is outlining the way the jury should approach the issue, step by step. Although these methods are typically used to assist the jury in rendering a verdict, they could also be used for a damage award.

This alternative is not without its drawbacks. Many of the criticisms that can be made about guideposts are equally applicable to these procedural mechanisms. Once again, the power of the jury is being somewhat redistributed to the judge. The judge designs the questions that are to be answered by the jury, and thus, the judge plays a more intrusive role in structuring the jury's deliberations, a task that is typically left in the jury's hands. Academics are likely to be wary of this reform because it enhances the judge's power. Judges are likely to resist because they worry about intruding on the jury's deliberations. Attorneys are likely to object because they remain ever hopeful that their client will receive the wildcard damage award, which is less apt to occur if the judge is involved in shaping the jury's determination.

***452 4. Recommendations**

With the recommendations Diamond suggested, there is no need to choose one over the other; they are not mutually exclusive. Jury size could be increased and a guidepost could be provided. If a guidepost is unsuitable in a particular case, then the alternative of using the special verdict or the general verdict plus interrogatories may be appropriate. In the case of guideposts

or special verdicts/interrogatories, care must be taken that the jury still retains its discretion and that neither approach becomes rigid and binding. Both methods must be viewed with caution because in either case the drafter, who is likely to be the judge, will have increased power to shape and influence the damage award.

Conclusion

Both Neil Vidmar's and Shari Diamond's empirical studies of damage awards provide useful insights about jury behavior. Vidmar's research establishes that juries' pain and suffering awards are consistent and that they are not as munificent as they seem in press accounts once post-verdict adjustments have been made by judges. Diamond's work shows that while there is greater volatility in pain and suffering awards than in liability verdicts, there is less volatility when juries' awards are compared to individual jurors' awards. Both studies provide useful rejoinders to members of the press and public who would characterize jury verdicts as "outrageous" and who would describe juries as "runaway."

Vidmar and Diamond do not claim to know what is the "right" amount for pain and suffering awards. At most, they look to variation and consistency in jury awards and make careful comparisons between judge and jury awards, avoiding the trap of using a judge's assessment as a benchmark for what is a "correct" damage award. [116] As Vidmar and Diamond have acknowledged, there is no right answer when it comes to damage awards, which is precisely why we rely on juries to make these determinations in the first place.

Footnotes

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1 See Liebeck v. McDonald's Restaurants, P.T.S., Inc., No. CV 93-02419, 1995 WL 360309, at *1 (D.N.M. Aug. 18, 1994).

2 See, e.g., A Case for Iced Coffee, Wall St. J., Aug. 26, 1994, at A10 ("Iced coffee may not be just for summer anymore, thanks to a jury in Albuquerque, N.M. Last week it awarded Stella Liebeck, 81, $2.9 million in damages for burns she suffered after spilling a cup of McDonald's coffee on herself."); Robert A. Clifford, Justice System Corrects Its Outrages, Chi. Trib., Sept. 29, 1994, § 1, at 24 (describing the McDonald's case as "an example of the system gone berserk," but correcting itself with the judge's reduction of the punitive damages award); Maura Dolan, Huge Jury Awards Seldom Live Up to Their Billing; Lawsuits: Plaintiffs Often Pocket Far Less, Study Finds, L.A. Times, Nov. 26, 1996, at A1 ("The scrutiny from appellate courts is often mild compared to the disdain that huge awards generate among the public. The $2.9 million awarded to an elderly woman who received severe burns after spilling McDonald's coffee in her lap became fodder for tort reformers and talk show hosts."); Randy Harris, Letter to Editor, Litigation Explosion, L.A. Times, Apr. 4, 1995, at B6 (describing McDonald's case as "infamous"); Has the "Litigation Explosion" Blasted Away Common Sense?, L.A. Times, Mar. 22, 1995, at B6 [hereinafter Litigation Explosion] ("There indeed are some excessive verdicts; the $2.7 million a New Mexico jury awarded a woman who was scalded when she spilled a cup of McDonald's coffee on her legs is the most recent egregious example."); Thomas Olson, Spilled Coffee and Leaky Valves Spur Reform of Lawsuit Awards, Pittsburgh Bus. Times & J., Apr. 10, 1995, available in 1995 WL 7907075 ("Probably the most celebrated--and ridiculed--punitive damage award in recent years was the case involving the now infamous McDonald's coffee.").

3 See, e.g., Andrea Gerlin, A Matter of Degree: How a Jury Decided That a Coffee Spill Is Worth $2.9 Million, Wall St. J., Sept. 1, 1994, at A1 ("Public opinion is squarely on the side of McDonald's. Polls have shown a large majority of Americans--including many who typically support the little guy--to be outraged at the verdict."); Andrea Gerlin, How Jury Gave $2.9 Million for Coffee Spill McDonald's Callousness Was Real Issue, Jurors Say, in Case of Burned Woman, Pittsburgh Post-Gazette, Sept. 4, 1994, at B2, available in 1994 WL 8232627 (same); Olson, supra note 2, at 1995 WL 7907075 ("'Even if it was a truly outrageous result, our judicial system can throw out outrageous results, as they did in the McDonald's case.'" (quoting John Gismondi, a plaintiffs' litigator with Gismondi & Margolis)); Aric Press, Are

Lawyers Burning America?, Newsweek, Mar. 20, 1995, at 32, 35 (“The American Tort Reform Association bought radio ads in the Washington area using the Liebeck case as its key example of an ‘outrageous' lawsuit.”); John Taylor, Coffee Ruling Spurs Popeye's To Halt Sales, Omaha World-Herald, Sept. 8, 1994, available in 1994 WL 8593317 (“‘I thought [the award] was outrageous.”’ (quoting Pat Kelley, treasurer for Rigel Corp., which holds the franchise for 14 Kentucky Fried Chicken restaurants and 66 Godfather's pizza restaurants)). See generally Olson, supra note 2, at 1995 WL 7907075 (“‘There are runaway damages and outrageous awards.”’ (quoting Chris Hague, a partner at Meyer, Unkovic & Schott, who represents both plaintiffs and defendants in civil cases)).

4 See, e.g., Chi Chi Sileo & David Cogan, Does Legal Debate Rely on Rhetoric Over Reason?, Insight on the News, May 29, 1995, at 15 (“Advocates of legal reform immediately pointed to the [Liebeck] award as yet another instance of runaway litigation, ‘frivolous' lawsuits and vindictive juries.”). But see id. (“Far from being a symbol of runaway litigation, say opponents of legal reform, the [Liebeck] case is an example of the civil-justice system working to protect ordinary citizens.”). See generally Stephen Budiansky, How Lawyers Abuse the Law, U.S. News & World Rep., Jan. 30, 1995, at 50, 52 (“Insurers and manufacturers have spent millions publicizing tales of runaway litigation, of outrageous multimillion-dollar punitive-damage awards .... Much of it is exaggerated.”); Alex Kozinski, The Case of Punitive Damages v. Democracy, Wall St. J., Jan. 19, 1995, at A18 (“While most juries will resist the pressure, it only takes a single runaway jury to send shock waves through an entire industry.”).

5 See S. Reed Morgan, A Slow Burn Over Fast Food; Don't Blame a Runaway Jury for a Recent Verdict Against McDonald's, Recorder, Sept. 30, 1994, at 8 (“To critics of the original jury awards, the case is an example of runaway juries .... The facts, of course, point in an entirely different direction.... Third-degree burns do not heal without skin grafting, debridement and whirlpool treatments ....”).

6 See id. (“McDonald's admitted that it has known about the risk of serious burns from its scalding hot coffee for more than 10 years.”); see also Nicolle Bratkovics, Restaurant Adviser Assists in Coffee Spill Verdict, Legal Intelligencer, Aug. 22, 1994, at 1 (“Evidence at trial indicated that McDonald's coffee is served at 180-190 degrees, and was at least 165-170 degrees when it was spilled. In contrast, ... coffee brewed at home is generally 135-140 degrees.”); Richard Grossman, Editorial, As a Matter of Law: Punitive Damages Serve a Purpose, Post-Standard (Syracuse, N.Y.), Sept. 12, 1994, available in 1994 WL 5600240 (“Post-verdict reports in the McDonald's case indicate that they deliberately make their coffee unreasonably hot.”).

7 See Morgan, supra note 5, at 8 (“McDonald's admitted that it did not warn customers of the nature and extent of this risk and could offer no explanation as to why it did not.”).

8 See id. (“McDonald's witnesses testified that it did not inten[d] to turn down the heat. As one witness put it: ‘No, there is no current plan to change the procedure that we're using in that regard right now.”’).

9 See, e.g., Clifford, supra note 2, § 1, at 24 (noting that “studies support the conclusion that the judicial system inevitably corrects what the public deems to be outrageous .... [G]enerally only 11.2% of the punitive damages awards are collected after appeal.”); Dolan, supra note 2, at A1 (“Unbeknown to most, the award was reduced by a court and settled for less than $640,000 [including compensatory damages].”); Litigation Explosion, supra note 2, at B6 (“In the McDonald's case, the judge cut the punitive award to $480,000; jury awards in other cases are quite often reduced significantly after trial as a result of appellate court action or settlement.”).

10 Neil Vidmar et al., Jury Awards for Medical Malpractice and Post-Verdict Adjustments of Those Awards, 48 DePaul L. Rev. 265 (1999).

11 Shari Seidman Diamond et al., Juror Judgments About Liability and Damages: Sources of Variability and Ways to Increase Consistency, 48 DePaul L. Rev. 301 (1999).

12 Vidmar looked at commercial verdict reporters from California, Florida, and New York.

13 See infra note 19 and accompanying text.

14 Diamond et al., supra note 11, at 318.

15 Vidmar et al., supra note 10, at 270-72.

16 See Cal. Civ. Pro. Code § 625 (West Supp. 1998); Fla. Stat. Ann. § 768.042 (West 1997); N.Y. C.P.L.R. 4111(d) (McKinney Supp. 1998).

17 Vidmar et al., supra note 10, at 294 (California); id. at 291 (Florida); id. at 284 (New York); id. at 296 ("Awards increased with injury severity, except that there was a sharp decrease when death occurred.").

18 Id. at 296 ("In all three states, the percentage of the total, unadjusted damage awards exceeded 50%, on average, for all cases ...."); id. (finding that the percentage of the award for non-economic damages was 60% in California); id. at 292 (finding that the proportion of the award for non-economic damages was 54% in Florida); id. at 285 (finding that the percentage of the award for non-economic damages was 58% in New York).

19 Id. at 295 (noting that in California, the median and mean verdict awards were reduced by about 10% through post-verdict adjustment); id. at 292 (observing that in Florida, post-verdict awards were lower than jury awards, but noting that the adjustments were "substantially smaller" in Florida than in New York); id. at 286 ("[T]he mean payment to the plaintiff was approximately 62% of the jury verdict[ ]" based on the New York data.).

20 Id. at 298 (providing summary).

21 See id. at 267 ("[T]hese data sets present a number of methodological problems ...."); id. at 281 (noting that the data sets are not comprehensive and selection may not have been random); id. at 295 (recognizing there may be differences in the litigation patterns of the three states and the way in which the data in the reporters were compiled).

22 See, e.g., Deborah Sontag & Celia W. Dugger, The New Immigrant Tide: A Shuttle Between Worlds, N.Y. Times, July 19, 1998, at A1 (describing New York as "the American city with the largest and most diverse population of immigrants, living side by side in neighborhoods where the very fact of their double identity [with their new home and their homeland] is a bond"); id. at A12 ("So fluid is the exchange between the homeland and New York that it alters both places. People move back and forth, money moves back and forth, ideas move back and forth.").

23 There is debate about whether Bronx juries, and juries in other largely urban, minority areas, are acquitting at an unusually high rate. According to one writer, Bronx juries are not acquitting at unusually high rates, but are acquitting merely at the high end of the norm. See Roger Parloff, Race and Juries: If It Ain't Broke, A.B.A. J., June 1997, at 5, 6 (concluding that the acquittal rate for jury trials in the Bronx of black defendants charged with felonies was 43.6% in 1995 and 39.1% in 1996). But see Bejamin A. Holden et al., Racism on Trial, Montreal Gazette, Oct. 7, 1995, Weekly Review, at B1 (claiming that in the Bronx, "black defendants are acquitted in felony cases 47.6% of the time--nearly three times the national acquittal rate of 17% for all races"). Parloff, while challenging others' figures of Bronx acquittal rates as "nearly triple" those of the national average, acknowledged that the figures he offered indicate that the rates of acquittals in the Bronx "are high for state courts in New York, and probably for state courts nationwide." Parloff, supra, at 6. From the interviews he conducted with Bronx judges, prosecutors, and defense attorneys, however, he concluded that these juries are likely to be acquitting, not because of nullification, but because of greater juror skepticism of police testimony. See id. at 7.

24 Vidmar et al., supra note 10, at 281.

25 Id. at 282.

26 Id. at 290.

27 I had the good fortune to clerk for Judge Leonard B. Sand in the Southern District of New York in 1988-89, for Judge William A. Norris on the Court of Appeals for the Ninth Circuit in 1989-90, and for Justice John Paul Stevens at the United States Supreme Court in 1990-92.

28 See, e.g., William M. Richman & William L. Reynolds, Elitism, Expediency, and the New Certiorari: Requiem for the Learned Hand Tradition, 81 Cornell L. Rev. 273, 282 (1996) ("[I]t is hardly surprising that published opinions today account for less than a third of federal circuit terminations. The decline in publication is unfortunate because the traditional, fully reasoned written opinion serves a number of vital functions.") (footnotes omitted).

29 See, e.g., United States v. Edge Broadcasting Co., 509 U.S. 418, 425 n.3 (1993) ("We deem it remarkable and unusual that although the Court of Appeals affirmed a judgment that an Act of Congress was unconstitutional as applied, the court found it appropriate to announce its judgment in an unpublished per curiam opinion.").

30 See 21 Moore's Federal Practice 359-78, Rule 36-1 (1998) (Opinions, Memoranda, Orders; Publication).

31 See id. at 359-79, Rule 36-3 ("Any disposition that is not an opinion or an order designated for publication under Circuit Rule 36-5 shall not be regarded as precedent ....").

32 Neil Vidmar et al., Damage Awards and Jurors' Responsibility Ascriptions in Medical Versus Automobile Negligence Cases, 12 Behav. Sci. & L. 149, 157-59 (1994).

33 Vidmar et al., supra note 10, at 267.

34 See, e.g., Anguiano-Delpino v. Sanchez, 3 Trials Digest 3d 154, available in 1997 WL 852659, at *5-6 ("The insurance carrier was Norcal Mutual Insurance Company for defendant John Sanchez and The Doctors Company for defendant John Petraglia.").

35 See Fed. R. Evid. 411 ("Evidence that a person was or was not insured against liability is not admissible upon the issue whether the person acted negligently or otherwise wrongfully.").

36 See Cal. Evid. Code § 1155 (West 1997) ("Evidence that a person was, at the time a harm was suffered by another, insured wholly or partially against loss arising from liability for that harm is inadmissible to prove negligence or other wrongdoing."). In civil trials in California, the court may instruct the jurors as follows: "There is no evidence before you that the defendant has or does not have insurance for the plaintiff's claim. Whether such insurance exists has no bearing upon any issue in this case. You must not discuss or consider it for any purpose." California Book of Approved Jury Instructions (BAJI) § 1.04 (8th ed. 1986).

37 See, e.g., Constable v. Matie, 608 N.Y.S.2d 10, 11 (App. Div. 1993) (holding that a new trial was required because evidence of insurance should not have been admitted); Griffen v. Corporation of the Church of the Assumption of Mechanicville, 218 N.Y.S.2d 141, 142 (App. Div. 1961) (holding that "the persistent insinuation by plaintiff's counsel before the jury of the liability insurance coverage of the appellant church was prejudicial" and therefore reversing the

judgment and ordering a new trial); Note, Admissibility in New York of Evidence Alluding to the Fact that the Defendant is Insured, 14 St. John's L. Rev. 319, 319 (1940) ("As a general rule, evidence in a negligence action that the defendant is insured against liability is inadmissible.").

38 Florida's rule, Fla. R. Civ. P. 1.450(e), which required that medical malpractice actions be conducted without any reference to insurance or the joinder of an insurer as a co-defendant, was deleted in 1984.

39 See Stecher v. Pomeroy, 244 So. 2d 488, 490 (Fla. Dist. Ct. App. 1971) (holding that "while it was error for the trial court to permit evidence as to the amount of insurance coverage, such error was harmless").

40 The verdict reporter in Florida provided plaintiff's sex as part of plaintiff's information. See, e.g., 98 Florida Jury Verdict Reporter 2-19, available in 1997 WL 862879.

41 See, e.g., Lee A. Green & Mack T. Ruffin, Differences in Management of Suspected Myocardial Infarction in Men and Women, 36 J. Fam. Prac. 389, 392 (1993) ("'If men are more likely to have [myocardial infarctions], then men with chest pain are more likely to have heart disease than women with chest pain' is not a valid inference, although it would appear to be one that physicians in this study group made, whether consciously or not.").

42 See, e.g., Chelmer L. Barrow, Jr. & Kirk A. Easley, The Role of Gender and Race on the Time Delay for Emergency Department Patients Complaining of Chest Pain to be Evaluated by a Physician, 15 St. Louis U. Pub. L. Rev. 267, 276 (1996) ("[F]emales have been determined to receive less aggressive treatment of coronary artery disease than their male counterparts, despite the fact that women may experience a higher mortality rate from heart disease.") (footnote omitted); Green & Ruffin, supra note 41, at 389 ("Women appear to receive not only less intensive invasive treatment for ischemic heart disease than men, as previous studies have shown, but also less aggressive noninvasive treatment."); Leslee J. Shaw et al., Gender Differences in the Noninvasive Evaluation and Management of Patients with Suspected Coronary Artery Disease, 120 Annals Internal Med. 559, 564 (1994) ("Our study of 840 patients showed a relative likelihood for further diagnostic testing in men that was approximately two times greater than that observed in women."); Lawrence K. Altman, Study Finds Heart Treatment Differs for Men and Women, N.Y. Times, Nov. 13, 1991, at A18 ("Men are twice as likely as women to receive newer life-saving treatments for heart attacks, a study ... has found.").

43 See, e.g., Mary Anne Bobinski, Women and HIV: A Gender-Based Analysis of a Disease and Its Legal Regulation, 3 Tex. J. Women & L. 7, 15 (1994) (providing reasons often given to justify the exclusion of women from medical research trials, including the effects of their hormonal cycles and the possibility of pregnancy); id. at 16 (describing how the medical definition of AIDS was based on studies of gay men, with the assumption that women would be affected in the same way, but women did not suffer Kaposi's Sarcoma as did gay men, and they did experience a range of reproductive system effects, which the men did not); Denise Grady, Study Says H.I.V. Tests Misstate Women's Risk, N.Y. Times, Nov. 6, 1998, at A18 ("Women infected with H.I.V. may be at a more advanced stage of infection and at a higher risk of developing AIDS than men with identical results on certain blood tests ...."); id. ("The researchers suggest that official treatment guidelines, used for both sexes even though they are based on research only in men, should be changed to recommend earlier treatment for women."); Altman, supra note 42, at A18 ("One possible explanation [for men being twice as likely as women to receive more life-saving treatments for heart attacks] is that the initial studies proving the value of the treatments were carried out chiefly in men.").

44 See, e.g., Thomas Koenig & Michael Rustad, His and Her Tort Reform: Gender Injustice in Disguise, 70 Wash. L. Rev. 1, 82 (1995) ("Medical malpractice awards to the women in our sample were almost three times more likely to include a pain and suffering component as those given to men. This finding is consistent with past research showing the male victims receive less in non-economic damages than female victims.").

45 See Vidmar et al., supra note 10, at 281 ("Additionally, we cannot stress too strongly the fact that our data do not provide any criteria for assessing whether the jury decisions were right or wrong.").

46 Remittitur, "[t]he power to reduce damages," is recognized "by virtually all judicial systems." Jack H. Friedenthal et al., Civil Procedure § 12.4, at 560 (2d ed. 1993).

47 Additur, which is "the power to increase damages ... has not been accepted in all courts," id., largely because it did not exist under common law, leading the Supreme Court to hold in Dimick v. Schiedt, 293 U.S. 474 (1935), that additur violated the Seventh Amendment. Id. However, some state courts have upheld its constitutionality under state law. See Friedenthal et al., supra note 46, at 561.

48 See Koenig & Rustad, supra note 44, at 79 ("Twenty-one states have enacted some reform measure limiting non-economic damages in health care litigation.... [T]ort reformers have succeeded in capping non-economic damages in medical malpractice cases in several states.") (footnote omitted). Among states that have passed statutes limiting pain and suffering awards in medical malpractice suits are Michigan, Wisconsin, and Utah. See id. n.331.

49 Harry Kalven Jr. & Hans Zeisel, The American Jury (1966).

50 Id. at 56.

51 Id. at 115-16.

52 Vidmar et al., supra note 10, at 298-99.

53 See Liebeck v. McDonald's Restaurants, P.T.S., Inc., No. CV 93-02419, 1995 WL 360309, at *1 (D.N.M. Aug. 18, 1994).

54 See generally Nancy S. Marder, Deliberations and Disclosures: A Study of Post-Verdict Interviews of Jurors, 82 Iowa L. Rev. 465, 541-44, 546 (1997) (suggesting that courts, using the juror's oath and the judge's instruction, impose some limitations on a juror's disclosures of jury deliberations, if only for a limited amount of time, to preserve the integrity of the jury's verdict).

55 See Fed. R. Crim. P. 6(e)(2) ("A grand juror ... shall not disclose matters occurring before the grand jury, except as otherwise provided for in these rules.... A knowing violation of Rule 6 may be punished as a contempt of court.").

56 See Conn. Fed. Loc. Ct. R. 12(e)(1) ("No juror shall respond to any inquiry as to the deliberations or vote of the jury or of any other individual juror, except on leave of Court ....") (emphasis added); La. Fed. Loc. Ct. R. 47.5E(c)(2) and 47.5M & W(c)(2) ("No juror who may consent to be interviewed shall disclose any information with respect to ... the deliberations of the jury."). See generally Abraham S. Goldstein, Jury Secrecy and the Media: The Problem of Postverdict Interviews, 1993 U. Ill. L. Rev. 295, 310 (recommending a statute "making it a crime for anyone without court permission to seek information from jurors about their deliberations, or for jurors to provide such information").

57 See United States v. Cleveland, No. 96-207 Section "R," 1997 U.S. Dist. LEXIS 10718, at *1, *4 (E.D. La. July 22, 1997) (instructing jurors in a high-profile criminal case that "absent a special order by [the judge], no juror may be interviewed by anyone concerning the deliberations of the jury"), aff'd, 128 F.3d 267, 270 (5th Cir. 1997) ("A juror in this case ... is only prevented from being interviewed about the private debates and discussions which took place in the jury room during the time leading up to the jury's rendering of its verdict.").

58 See, e.g., Kan. Fed. Loc. Ct. R. 123 (a)(9) ("No juror has any obligation to speak to any person about any case and may refuse all interviews or comments."); Okla. Fed. Loc. Ct. R. 47.2 ("Upon discharge from service, each juror is free to

discuss, or refuse to discuss, said juror's service with any person if the juror so desires."); Wyo. Fed. Loc. Ct. R. 309(b) ("No juror has any obligation to speak to any person about any case and may refuse all interviews and comments.").

59 See infra Part II.

60 See generally Development in the Law-The Jury's Capacity to Decide Complex Civil Cases, 110 Harv. L. Rev. 1489, 1498 (1997) ("[J]udges can bifurcate tort trials so that jurors can consider liability issues without being burdened by the calculation of damages.").

61 U.S. Const. amend. I ("Congress shall make no law ... abridging the freedom of speech, or of the press ....").

62 See, e.g., Affirmative Action; Ban may be Legal but Isn't Wise, Star Trib. (Minneapolis), Nov. 5, 1997, at 22A (describing the Supreme Court's denial of certiorari as "uph[olding] one state's ban on affirmative action"); Stuart J. Davis, Letter to Editor, High Court Has Upheld 2d Amendment Limit, N.Y. Times, Dec. 19, 1993 (describing the Supreme Court's denial of certiorari in Quilici v. Village of Morton Grove, 464 U.S. 863 (1983), as "uph[olding] without comment a United States Court of Appeals decision").

63 See Sup. Ct. R. 10 ("Review on a writ of certiorari is not a matter of right, but of judicial discretion.").

64 "Inasmuch, therefore, as all that a denial of a petition for a writ of certiorari means is that fewer than four members of the Court thought it should be granted, this Court has rigorously insisted that such a denial carries with it no implication whatever regarding the Court's views on the merits of a case which it has declined to review." Maryland v. Baltimore Radio Show, Inc., 338 U.S. 912, 919 (1950) (Frankfurter, J., opinion respecting the denial of the petition for writ of certiorari).

65 See, e.g., Adderley v. Florida, 385 U.S. 39, 47-48 (1966) (upholding as constitutional the trespass conviction of demonstrators who gathered in front of a jail to protest its segregation of inmates and who refused to disperse after warnings by the sheriff); Poulos v. New Hampshire, 345 U.S. 395, 414 (1953) (upholding as constitutional a state law requiring a license to hold religious services in a public park); John E. Nowak & Ronald D. Rotunda, Constitutional Law § 16.46, at 1139-40 (5th ed. 1995).

66 The case involved plaintiff Boyd suing American Beryllium Corporation ("ABC") for damages based on Boyd's claim that he had suffered lung damage after exposure to a product manufactured by ABC during his work as a plasterer for ABC. See Diamond et al., supra note 11, at 303.

67 Id. at 304-05.

68 Id. at 305.

69 Id. at 306-07.

70 Id. at 309-11 (listing the attitudinal variables associated with a verdict preference for the defendant, including whether jurors thought plaintiffs receive more than they ought to, whether they favor business, oppose regulation, believe smokers have themselves to blame for smoking-related illnesses, and believe witnesses tend to give testimony favoring the side that hired them).

71 Id. at 313.

72 Diamond, supra note 11, at 313-14.

73 Id. at 315-16.

74 Id. at 317-18.

75 The federal rules of civil and criminal procedure give federal judges the discretion to decide whether to allow attorneys to conduct the entire voir dire or merely to supplement questions asked by the court. See Fed. R. Civ. P. 47(a); Fed. R. Crim. P. 24(a). According to one survey, based on 420 completed questionnaires, approximately three-fourths of federal district judges conduct the voir dire without oral participation of the attorneys. See Gordon Bermant, Conduct of the Voir Dire Examination: Practices and Opinions of Federal District Judges 5-20 (1977). The trend is toward judge-conducted voir dire. See John B. Ashby, Juror Selection and the Sixth Amendment Right to an Impartial Jury, 11 Creighton L. Rev. 1137, 1158 (1978). Barbara Babcock has suggested that when judges conduct voir dire they do not do so with the same thoroughness as attorneys. Barbara Allen Babcock, Voir Dire: Preserving "Its Wonderful Power," 27 Stan. L. Rev. 545, 546 (1975).

76 See, e.g., United States v. Torres, No. 77 Cr. 680 (S.D.N.Y. May 19, 1980) (transcript of jury selection).

77 See, e.g., Michael J. Efran, The Effect of Physical Appearance on the Judgment of Guilt, Interpersonal Attraction, and Severity of Recommended Punishment in a Simulated Jury Task, 8 J. Res. Personality 45 (1974); Harold Sigall & Nancy Ostrove, Beautiful but Dangerous: Effects of Offender Attractiveness and Nature of the Crime on Juridic Judgment, 31 J. Personality & Soc. Psychol. 410 (1975).

78 One writer suggested that such studies should not even be called simulated juror studies: "It is not clear whether we can even meaningfully speak of simulated jurors without employing a group deliberation. Investigations of these individual phenomena would be more appropriately referred to as studies of individual judgment rather than of simulated jurors." Robert D. Foss, Group Decision Processes in the Simulated Trial Jury, 39 Sociometry 305, 305 n.1 (1976).

79 Jeffrey Abramson, We, the Jury 205 (1994) ("In Brazil, federal juries do not deliberate. At the close of evidence, jurors are individually polled in writing, a secret ballot is taken, and the majority prevails. Such a procedure stands in stark contrast to our own, where deliberation is the essence of a juror's duty.") (citing Herman G. James, The Constitutional System of Brazil 122 (1923)).

80 Jurors could also change their views because they feel pressured to conform. See, e.g., Saul M. Kassin & Lawrence S. Wrightsman, The American Jury on Trial 185 (1988) (describing two possibilities, one in which jurors change their vote because they are persuaded that another position is correct and the other in which jurors succumb to the majority view simply because they feel pressured to do so). This undoubtedly occurs, see, e.g., William Finnegan, Doubt, New Yorker, Jan. 31, 1994, at 48 (offering a personal account of the author's capitulation to the other jurors, despite his reservations), but it is certainly not the ideal form of deliberation.

81 12 Angry Men (Metro-Goldwyn-Mayer/United Artists 1957).

82 Despite Henry Fonda's ability to convince 11 other jurors to change their votes in the movie, see id., "outcomes like this one almost never occur in real life." Valerie P. Hans & Neil Vidmar, Judging the Jury 110 (1986). Research has shown that the "[p]ressures to conform to the group are strong," and "[i]t is only when a minority juror has initial support, in the form of other jurors with similar views, that the probability that a juror will sway the majority or hang the jury improves." Id. Otherwise, the lone dissenters typically capitulate, and "[t]he majority almost always wins." Kassin & Wrightsman, supra note 80, at 182; see Kalven & Zeisel, supra note 49, at 488 ("[I]n the instances where there is an initial majority either for conviction or for acquittal, the jury in roughly nine out of ten cases decides in the direction

of the initial majority. Only with extreme infrequency does the minority succeed in persuading the majority to change its mind during the deliberation.").

83 See Marder, supra note 54, at 470-74 (describing how the jury should ideally function).

84 Jurors must often engage in interpretation. See Nancy S. Marder, The Myth of the Nullifying Jury, 93 Nw. U. L. Rev. (forthcoming July 1999). For example, jurors are called upon to decide whether the government has proven its case "beyond a reasonable doubt" in a criminal case or whether a defendant has taken "reasonable care" in a negligence case. Id.

85 Diamond et al., supra note 11, at 309-11.

86 Id. at 305

87 Id. at 317.

88 Id. at 318.

89 Id. ("By pooling contributions from twelve rather than six sources, the larger jury would be likely to arrive at a more reliable estimate of an appropriate damage award. Whether the jury is assessing economic or general damages, the effect of pooling should be to reduce the influence of idiosyncratic estimates.") (footnote omitted).

90 Some commentators have noted that venire lists are often limited to voter registration lists, and when jurors are drawn from only one type of list, the representativeness of the venire is compromised. See, e.g., David Kairys et al., Jury Representativeness: A Mandate for Multiple Source Lists, 65 Cal. L. Rev. 776, 803-11 (1977). To overcome this problem, some recommend supplementing the voter registration list with multiple lists, such as lists of those who have driver's licenses, pay utilities, or receive welfare benefits or unemployment compensation. See id. at 826; see also Dennis Bilecki, Program Improves Minority Group Representation on Federal Juries, 77 Judicature 221, 222 (1994) (recommending the use of driver's license and identification card registration records as a supplement to voter registration records to expand jury pools to include minority groups that have been underrepresented in the past). Other commentators have recommended "stratefied selection" in which prospective jurors for the venire are summoned proportionally "to obtain a qualified list with racial demographics identical to that of the population." Nancy J. King & G. Thomas Munsterman, Stratefied Juror Selection: Cross-Section by Design, 79 Judicature 273, 276 (1996). But see United States v. Ovalle, 136 F.3d 1022 (6th Cir. 1998) (holding the practice violative of 28 U.S.C. § 1862 and the equal protection component of the Fifth Amendment).

91 In civil cases in federal court, the number of jurors is not fixed, but cannot go below six. See Fed. R. Civ. P. 48. In Colgrove v. Battin, 413 U.S. 149, 160 (1973), the court held that a jury of six members did not violate the Seventh Amendment right to a jury trial in a civil case.

92 See, e.g., Richard Lempert, Uncovering Nondiscernible Differences: Empirical Research and the Jury-Size Cases, 73 Mich. L. Rev. 643 (1975); Hans Zeisel, ... And Then There Were None: The Diminution of the Federal Jury, 38 U. Chi. L. Rev. 710, 715-24 (1971); Hans Zeisel & Shari Diamond, "Convincing Empirical Evidence" on the Six Member Jury, 41 U. Chi. L. Rev. 281 (1974).

93 Zeisel, supra note 92, at 715-20.

94 "Improving Jury Selection and Juror Comprehension," Workshop cosponsored by the Federal Judicial Center and the Institute of Judicial Administration at New York University School of Law (Dec. 13, 1996).

95 Peter H. Schuck, Mapping the Debate on Jury Reform, in Verdict: Assessing the Civil Jury System 306, 325-26 (Robert E. Litan ed., 1993).

96 Diamond et al., supra note 11, at 318.

97 U.S. Sentencing Guidelines Manual (1998) [hereinafter Sentencing Guidelines].

98 See Diamond et al., supra note 11, at 320.

99 See, e.g., ABA/Brookings Institute, Charting a Future for the Civil Jury System 18-19 (1992) (recommending notetaking); Kassin & Wrightsman, supra note 80, at 128-29 (considering why there is so much resistance to allowing jurors to take notes); David Margolick, A Call for the Jurors to Take Bigger Roles in Trials, N.Y. Times, Jan. 1, 1993, at A19 (reporting on notetaking recommendation).

100 See, e.g., ABA/Brookings Institute, supra note 99, at 24-25.

101 See Laura Mansnerus, Under Fire, Jury System Faces Overhaul, N.Y. Times, Nov. 4, 1995, at A9 (summarizing Arizona's reforms which "will permit jurors to take notes, question witnesses through the judge and, in some cases, discuss evidence while a trial is in progress").

102 See The Arizona Supreme Court Comm. on More Effective Use of Juries, Jurors: The Power of 12 (1994) (including a list of recommendations and a proposed bill of rights for jurors); B. Michael Dann & George Logan III, Jury Reform: The Arizona Experience, 79 Judicature 280, 280-83 (1994) (describing some of Arizona's more controversial reforms to its jury system, including giving jurors preliminary jury instructions, allowing them to ask questions in writing, telling jurors that they can discuss the evidence before the close of trial in a civil case, giving judges discretion about the timing of instructions, and having the judge and jury engage in a dialogue if the jury has reached an impasse); William H. Carlile, Arizona Jury Reforms Buck Legal Traditions, Christian Sci. Monitor, Feb. 22, 1996, at 1 (reporting that Arizona has adopted 18 of the jury reform panel's 55 recommendations); Junda Woo, Arizona Panel Suggests Package of Reforms to Empower Juries, Wall St. J., Oct. 25, 1994, at B12 (describing the proposals of a reform panel, headed by Judge B. Michael Dann, which include: allowing jurors to take notes and ask questions, providing glossaries to jurors, having lawyers do mini-summations, passing out written summaries of lengthy depositions, urging lawyers and judges to simplify their language, providing counseling sessions after stressful trials, instructing jurors that they can discuss the evidence before the end of trial, and increasing the jurors' pay and the diversity of the venire).

103 If a jury has decided that it has reached a deadlock, then the judge can deliver an "Allen charge," approved in Allen v. United States, 164 U.S. 492, 501-02 (1896), which is "a sharp punch to the jury, reminding [the jurors] of the nature of their duty and the time and expense of a trial, and urging them to try again to reach a verdict. We specifically have approved the use of such a charge." United States v. Anderton, 679 F.2d 1199, 1203 (5th Cir. 1982) (citations omitted).

104 See Dann & Logan, supra note 102, at 283.

105 Diamond et al., supra note 11, at 320.

106 See Sentencing Guidelines, supra note 97.

107 Id.

108 See, e.g., Donald A. Dripps, Judicial Sentencing: The Soul of Justice or a Ghost in the Machine?, Trial, Apr. 1996, at 60, 61 ("Of course, Congress intended the commission's guidelines to greatly restrict the discretion of sentencing judges, who hitherto exercised vast and practically unreviewable authority over sentencing."); William W. Wilkins, Jr., The Federal Sentencing Guidelines: Striking an Appropriate Balance, 25 U.C. Davis L. Rev. 571, 571 (1992) ("Prior to the new federal sentencing guidelines, federal judges exercised virtually unreviewable discretion when sentencing. Too often, Congress decided, this discretion resulted in unwarranted disparities in sentences imposed on similar defendants convicted of similar crimes.").

109 See Dripps, supra note 108, at 61; Wilkins, supra note 108, at 572 (describing Congress as having the following three goals in passing the Sentencing Reform Act of 1984: honesty in sentencing, reasonable uniformity in sentencing, and proportionality in sentencing); Ronald F. Wright, Complexity and Distrust in Sentencing Guidelines, 25 U.C. Davis L. Rev. 617, 633 (1992) (explaining that "the Commission emphasized the theme of uniform sentences in the statute"); see also Sheila Balkan, Sentencing Matters, Trial, Oct. 1996, at 74 (reviewing Michael Tonry, Sentencing Matters (1996)) ("Based on promises of making sentencing fair by making punishments proportionate to crime and ending racial and class disparities in sentencing for similar crimes, imposing a scaled approach to sentencing became the justification for the current system.").

110 See, e.g., Balkan, supra note 109, at 74 ("Certainly one reason for the disparity [still present in sentencing] is the power given to prosecutors to influence the sentences of cooperative defendants so they receive more lenient sentences than those under the guidelines. This is a power not given to judges.").

111 See Edward J. McCaffery et al., Framing the Jury: Cognitive Perspectives on Pain and Suffering Awards, 81 Va. L. Rev. 1341 (1995).

112 See Fed. R. Civ. P. 49(a) (Special Verdicts) and 49(b) (General Verdict Accompanied by Answer to Interrogatories).

113 See, e.g., Conn. Gen. Stat. Ann. § 52-224(a) (West 1997) ("In a special verdict the jury shall find the facts ...."); Md. R. Civ. P. 2-522(c) (Michie 1998) ("The court may require a jury to return a special verdict in the form of written findings upon specific issues."); N.Y. C.P.L.R. 4111(b) (Consol. 1997) ("When the court requires a jury to return a special verdict, the court shall submit to the jury written questions susceptible of brief answer or written forms of the several findings which might properly be made ...."); id. at 4111(c) ("When the court requires the jury to return a general verdict, it may also require written answers to written interrogatories submitted to the jury upon one or more issues of fact.").

114 See Fed. R. Civ. P. 49(a) (Special Verdicts).

115 See Fed. R. Civ. P. 49(b) (General Verdict Accompanied by Answer to Interrogatories).

116 Although Kalven and Zeisel anticipate some of the objections that may be raised to using a judge's assessment of a case as a benchmark for evaluating a jury's assessment, see Kalven & Zeisel, supra note 49, at 50-52, they also offer reasons for relying on judges' assessments, see id. at 94-95, which is the approach they ultimately choose to take.

48 DPLLR 427

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United States District Court, S.D. New York.

UNITED STATES of America
v.
Michael AVENATTI, Defendant.

19-CR-374 (JMF)
|
Signed 02/15/2022

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OPINION AND ORDER

JESSE M. FURMAN, United States District Judge:

***1** On February 4, 2022, after an eight-day trial, a jury found Defendant Michael Avenatti guilty of wire fraud and aggravated identify theft in connection with a scheme to defraud his former client, Stephanie Clifford (also known as Stormy Daniels), of money that she was supposed to receive in connection with a book contract. In advance of and during the trial, Avenatti made at least three motions to compel the Government to acquire or disclose information on servers containing data and files from his former law firm (the "Servers"), servers that had been seized by prosecutors in the United States Attorney's Office for the Central District of California in connection with a different case. During trial, the Court denied Avenatti's motions to compel, providing a brief summary of its reasoning and promising that a more detailed opinion would follow. *See* Tr. 71, 1035-36. [1] This is that opinion.

1 "Tr." refers to the trial transcript; "GX ___" refers to a Government exhibit admitted at trial (except for GXs in the 35 series, which are Jencks Act materials merely marked for identification); and ECF docket number references are to documents filed in this case, unless otherwise noted.

As the Court will explain, Avenatti's motions were and are without merit for several reasons. First, at least one, if not all, of the motions were patently untimely, as Avenatti knew or should have known the facts underlying his motions for months, if not years, and yet he waited until the eve of trial (or during trial) to raise them. Second, there was and is no basis to compel the Government to disclose the Servers because Avenatti himself has had them since September 2021 — more than four months before trial — when he obtained a complete forensic copy of the Servers from the prosecutors in California. Third, the Government's disclosure obligations extend only to evidence or information in the possession of the "prosecution team" — those involved in the prosecution at issue — and the Servers are not, and have never been, in the possession of the prosecution team for purposes of *this* case. And finally, Avenatti has not shown, and almost certainly cannot show, that anything on the Servers was favorable to his defense and would have altered the outcome of the trial. That is because the evidence that he engaged in a scheme to defraud was overwhelming and largely undisputed; his sole "defense" was no valid defense at all. In short, Avenatti's motions to compel were and are without merit.

BACKGROUND

These motions arise from the fact that Avenatti has, for almost three years, been facing three (or arguably four) sets of charges in two different districts: an indictment for extortion and other crimes in 19-CR-373 (PGG) (S.D.N.Y.) (the "Nike Extortion Case"); an indictment for tax offenses and other crimes (since severed into two sets of charges to be tried separately) in 8:19-CR-061 (JVS) (C.D. Cal.) (the "California Case"); and the indictment in this case for wire fraud and aggravated identity theft. More specifically, the motions arise primarily from the seizure by prosecutors and agents in the California Case of servers containing data from Eagan Avenatti, LLP, Avenatti's former law firm.

A. The Relationship Between the USAO-CDC and USAO-SDNY

***2** Avenatti's motions are premised in part on the relationship between the two U.S. Attorney's Offices involved in his three cases, so a detailed summary of that relationship is warranted. On March 25, 2019, Avenatti was arrested pursuant to a criminal complaint filed in the Central District

of California and a criminal complaint filed in this District in connection with the Nike Extortion Case. *See* ECF No. 190 ("Def.'s Mot. for Adjournment"), at 2. The United States Attorney's Office in this District ("USAO-SDNY") learned of the nature and scope of the investigation being conducted by the United States Attorney's Office for the Central District of California ("USAO-CDC") "only a few days before" Avenatti was arrested "in the context of deconfliction discussions concerning the place and timing of [his] arrest." ECF No. 287 ("Gov't Opp'n"), at 1. Beyond deconfliction efforts, the interactions between the two offices were limited to "discrete requests for certain materials" and a small number of joint witness interviews discussed in more detail below. *Id.* at 1-2, 7.

Aside from these interactions, the USAO-SDNY and USAO-CDC investigated and prosecuted their respective cases largely independently. The two offices conducted their investigations with different agency partners — the USAO-SDNY partnering with the Federal Bureau of Investigation's New York Field Office ("FBI-NY") in this case and the Nike Extortion Case, and the USAO-CDC partnering with the Internal Revenue Service-Criminal Investigations ("IRS-CI") in the California Case. *Id.* at 1, 6; No. 19-CR-373, ECF No. 360, at 3. Additionally, the USAO-CDC was not involved in the USAO-SDNY's grand jury presentation for this case (or the Nike Extortion Case). Gov't Opp'n 7. Nor did it accompany the USAO-SDNY to any court proceedings in this case (or the Nike Extortion Case). *Id.* [2] Likewise, the USAO-CDC played no role in the development of the USAO-SDNY's prosecutorial strategy or trial plans. *Id.* For instance, when the USAO-CDC moved to remand Avenatti just days before the trial in the Nike Extortion Case, it gave no prior notice to the USAO-SDNY team. *Id.*

2 Members of the USAO-CDC team did observe parts of the Nike Extortion Case trial from the public gallery. *See* No. 19-CR-373, ECF No. 360, at 8; No. 19-CR-373, ECF No. 363, at 7.

With respect to witness interviews, the USAO-SDNY conducted more than 120 interviews with approximately 45 witnesses over the course of its investigation both for this case and the Nike Extortion Case without "any involvement whatsoever" on the part of the USAO-CDC. *Id.* The USAO-SDNY and USAO-CDC met jointly, "for mutual convenience," with only two witnesses of mutual interest on five total occasions — four times with Avenatti's former assistant, Judy Regnier, [3] and one time with Sean Macias. [4] *Id.* at 2, 6-7. But the two USAOs met with Regnier and Macias more times alone than they did together. The USAO-SDNY met with Regnier approximately nine times without a representative of the USAO-CDC present, [5] and the USAO-CDC met with Regnier approximately twelve times without a representative of the USAO-SDNY present. [6] *Id.* Likewise, the USAO-SDNY met with Macias approximately three times without a representative of the USAO-CDC present, [7] and the USAO-CDC met with Macias approximately once without a representative of the USAO-SDNY present. [8] *Id.* The USAO-SDNY produced to Avenatti documentation of the USAO-CDC's meetings with Regnier and Macias that were not attended by the USAO-SDNY, in addition to documentation of the USAO-SDNY's meetings with both witnesses. *Id.* [9]

3 *See* GX 3514-003 & GX 3514-004 (Nov. 20, 2019); GX 3514-005 (Jan. 9, 2020); GX 3514-024 (Feb. 4, 2020); GX 3514-025 (Feb. 5, 2020). GX 3514-003 (an interview memorandum) states that it memorializes an interview conducted on November 26, 2019, but this appears to be a scrivener's error, as the interview memorandum contains nearly identical information to handwritten notes from the November 20, 2019 interview in GX 3514-004.

4 *See* GX 3565-005 (Nov. 20, 2019). This interview memorandum also appears to contain a scrivener's error: The body of the memorandum indicates the interview took place on November 26, 2019, but the header of the memorandum states that the interview took place on November 20, 2019. The USAO-SDNY also indicated that this took place on November 20, 2019. *See* Gov't Opp'n 2 n.2.

5 *See* GX 3514-010 (Jan. 16, 2020); GX 3514-011 (Jan. 17, 2020); GX 3514-034 (Dec. 10, 2021); GX 3514-038 (Jan. 4, 2022); GX 3514-041 (Jan. 12, 2022); GX 3514-042 (Jan. 13, 2022); GX 3514-043 (Jan. 16, 2022); GX 3514-044 (Jan. 17, 2022); GX 3514-065 (Jan. 19, 2022).

6 *See* GX 3514-001 (Mar. 25, 2019); GX 3514-014 (Mar. 26, 2019); GX 3514-017 (June 14, 2019); GX 3514-019 (July 25, 2019); GX 3514-020 (Oct. 24, 2019); GX 3514-012 (Nov. 19, 2019); GX 3514-021 (Dec. 5, 2019); GX 3514-056 (June 14, 2021); GX 3514-057 (July 6, 2021); GX 3514-058

(July 8, 2021); GX 3514-059 (July 19, 2021); GX 3514-060 (July 22, 2021).

7 *See* GX 3565-004 (June 5, 2019); GX 3565-009 (Dec. 17, 2021); GX 3565-010 (Jan. 12, 2022).

8 *See* GX 3565-008 (July 24, 2019).

9 Avenatti also contends that Joseph Varani — a Senior Digital Investigative Analyst with "Main Justice," who assisted USAO-CDC in the California Case — "engage[d] in joint fact-gathering with the prosecutors in this case" related to forensic processing of Avenatti's laptop. ECF No. 279 ("Def. First Mot."), at 5-6. But the Government's opposition makes plain that there was no collaboration between the USAO-SDNY and Varani (or any member of the USAO-CDC prosecution team) regarding forensic processing of Avenatti's laptop. *See* Gov't Opp'n 2-3. The USAO-SDNY and USAO-CDC teams obtained separate court-authorized warrants to search Avenatti's laptop, and the laptop was processed by a separate analyst in a separate agency — Jessica Volchko, an FBI-NY IT Specialist/Forensic Examiner — for the USAO-SDNY prosecution team. *Id.* at 3. The USAO-SDNY team never communicated with, nor utilized the services of, Varani in relation to its investigations and prosecutions of Avenatti. *Id.* As such, any argument based on the alleged collaboration between the USAO-SDNY and the Main Justice forensic analyst identified by Avenatti is meritless.

B. Seizure of, and Avenatti's Initial Requests for, the Servers

***3** As noted, Avenatti was arrested on March 25, 2019, pursuant to warrants issued in connection with both the Nike Extortion Case and the California Case. *See* Def.'s Mot. for Adjournment 2. A few weeks later, pursuant to a search warrant obtained in the Central District of California, agents involved in the California Case obtained the Servers — containing approximately twenty terabytes of client and other firm data — from a receiver (the "Receiver") who had been appointed to manage Eagan Avenatti and made a complete forensic copy of the Servers. *See id.*; ECF No. 196 ("Gov't Adjournment Ltr."), at 1-2. In May 2019, the agents in the California Case obtained another search warrant authorizing a search of the Servers. *See* Def.'s Mot. for Adjournment 4.

Beginning as early as April 2019, Avenatti repeatedly sought access to data on the Servers in the California Case. *See id.* at 2-4. By contrast, until shortly before trial in this case, Avenatti appears to have raised the issue only once in this District — and not at all in this case. *See* Gov't Adjournment Ltr. 2. Specifically, in a June 18, 2019 status conference before Judge Gardephe — the District Judge in the Nike Extortion Case — Avenatti's counsel noted that he had "made a request of the government in" the Nike Extortion Case "for a copy and image of the server" and that "their response is they don't have it in their possession. I believe it ... is in the possession of the U.S. Attorney in the Central District of California." 19-CR-373, ECF No. 25, at 7. The Assistant United States Attorney (who represents the Government in this case as well) responded: "We don't have possession of the server. We haven't reviewed the contents." *Id.* at 9. At that time, Avenatti did not seek relief from Judge Gardephe, and he did not raise the issue at all in this case.

Fast forward to 2020 and 2021. In February 2020, a jury convicted Avenatti of all charges in the Nike Extortion Case; later, Judge Gardephe sentenced him principally to thirty months' imprisonment. *See United States v. Avenatti*, No. 19-CR-374-1 (JMF), 2021 WL 4120539, at *2 (S.D.N.Y. Sept. 9, 2021). The California case, meanwhile, was severed into two sets of charges, and trial on the first set began in July 2021. *See id.* A few weeks into trial, Judge Selna — the District Judge in the California Case — granted a mistrial after finding that the Government had failed to produce certain *Brady* information contained on the Servers. *See* Def.'s Mot. for Adjournment 5-6. Even then, Avenatti made no mention of the Servers in this case.

On September 16, 2021, more than four months before trial in this case was scheduled to begin, Avenatti was provided (apparently by the USAO-CDC) a complete forensic copy of the Servers. *See id.* at 7. By contrast, when trial started in this case, the USAO-SDNY did not have a copy of the Servers, although it had issued three subpoenas to the person appointed by the Bankruptcy Court for the Central District of California to serve as the trustee for Eagan Avenatti (the "Bankruptcy Trustee") seeking to obtain any data on the Servers relating to Ms. Clifford, and, on January 10, 2022, a similar subpoena to Avenatti himself. *See* Gov't Adjournment Ltr. 3 & n.5; ECF No. 313, at 1; Tr. 1034-35. For reasons that are unclear, Avenatti served a subpoena of his own on the Bankruptcy Trustee on January 10, 2022. *See* ECF No. 344, at 4.

C. Avenatti's First Mentions of the Servers in This Case

Avenatti did not mention the Servers in the context of *this* case until December 23, 2021 — less than one month before trial — but he has since made up for lost time, raising them on no fewer than six occasions in writing (and at least twice orally). The first mention came in Avenatti's opposition to the Government's motion *in limine* seeking an order admitting evidence of Avenatti's and his law firm's financial condition. *See* ECF No. 187 ("Def. Opp'n to Motion *in Limine*") at 18-20. That was swiftly followed by a letter motion seeking an adjournment of trial based in part on the need to review the data on the Servers, in which Avenatti noted that he had "retained a highly qualified computer expert to assist with" his review of the Servers and that "a preliminary review" revealed that they contained "information highly relevant to" this case, including communications with and about Ms. Clifford and financial information relating to Avenatti's representation of Ms. Clifford. *See* Def.'s Mot. for Adjournment 1-7. Just under two weeks later, on January 6, 2022, Avenatti raised the issue again, opposing the Government's motion for reciprocal discovery under Rule 16(b) of the Federal Rules of Criminal Procedure on the ground that the Government had failed to comply with its Rule 16(a) obligations by not producing the Servers (and other information in the possession of the USAO-CDC less relevant here). *See* ECF No. 211. In its responses to these submissions, the Government stressed that Avenatti had had the Servers since September 16, 2021; that the Servers had "never been in the possession of or reviewed by the Government" in this case; and that Avenatti had never sought the Servers from the Government in this case. Gov't Adjournment Ltr. 1-4.

***4** In each of these first instances, the Court sided with the Government. *See* ECF Nos. 203, 213, 239; *see also* ECF No. 288 ("Jan. 11, 2022 Tr."), at 47-48. The Court indicated that it was "inclined to agree" that the Government had no obligation to disclose materials in the exclusive possession of the USAO-CDC, but rested on the fact that the Servers had been in Avenatti's possession since September 16, 2021. *Id.* As the Court put it in granting the Government's letter motion for reciprocal discovery, Avenatti's "arguments about the Government's compliance with Rule 16(a) are a red herring. Putting aside the question of whether the servers at issue were subject to disclosure under Rule 16(a), the fact of the matter is that Defendant has had the servers since September 2021." ECF No. 213 (citation omitted). The Court acknowledged that "the volume of materials on the servers may be large," but noted that "four months is ample time to prepare for trial and comply with Rule 16(b) given, among other things, Defendant's own knowledge of what is on the servers and the tools available to search and review electronic data." *Id.*

D. The First and Second Motions to Compel

Alas, that did not put the issue to rest. First, on January 18, 2022 — the morning of the final pretrial conference and five days after jury selection had commenced — Avenatti filed another letter with respect to the Servers. *See* ECF No. 272 ("Def. Pretrial Ltr."). In this letter, Avenatti raised for the first time that he had "been unable to access critical information on the servers relating to [the] representation of Ms. Clifford, including financial information and cost data." *Id.* at 2. Avenatti noted that this unspecified technical problem had "trigger[ed] a pending motion before Judge James V. Selna in California." *Id.* The letter did not explain the nature of the motion filed with Judge Selna. Nor did it seek any related relief from this Court.

Two days later, on the first day of oral *voir dire*, Avenatti filed his First Motion to Compel — one of the three motions at issue here — seeking "all *Brady, Giglio*, and 3500 materials in the possession of" Main Justice and the USAO-CDC, including any data stored on the Servers. ECF No. 279 ("Def. First Mot."), at 1. The next day, immediately following selection of the jury, Avenatti's counsel renewed the issue orally, prompted by the fact that Judge Selna had denied his motion in the California Case without prejudice to seeking relief in this case. Tr. 41. Counsel indicated that, on Monday, January 24, 2022, some third party was supposed to assist Avenatti and a privilege review team from the USAO-CDC in retrieving certain files from the Servers, but that — consistent with orders entered by Judge Selna — the relevant files were limited to the clients at issue in the California Case. *Id.* at 37. For the first time, Avenatti asked this Court for relief, namely an order directing the USAO-CDC privilege review team to also retrieve files relevant to Ms. Clifford. *Id.* at 38. In response to the Court's inquiries about the nature of the technical issue and the relevant chronology, defense counsel indicated that he would elaborate and seek appropriate relief in writing. *Id.* at 41-42.

The next day — namely, Saturday, two days before the parties' opening statements were to take place — Avenatti filed his Second Motion to Compel. *See* ECF No. 290 ("Def. Second Mot."). In it, Avenatti recounts the following chronology:

- September 16, 2021: Avenatti receives a forensic copy of the Servers;

- September 16, 2021, through the date of filing: Avenatti, aided by his retained computer expert, has "worked diligently" to "extract the data from the servers in a form where at least some of it is searchable" and to "access the data relevant to Mr. Avenatti's representation of Ms. [Clifford]";

- October 13, 2021: the USAO-CDC filed "an emergent application" for an order "Requiring Software Technology, LLC," the maker of software called "Tabs" that Eagan Avenatti used to maintain financial information, "to facilitate the Government's Restoration of Tabs Software Files" on the Servers. The USAO-CDC filed the motion "after Government agents ..., like Mr. Avenatti and his expert[,] were unable to access the Tabs data on their own";

***5** • October 15, 2021: a status conference was held before Judge Selna after Software Technology indicated that, due to confidentiality concerns, it would not comply with the Government's request absent a stipulation;

- October 27, 2021: the USAO-CDC filed "an emergent application" after the parties failed to reach agreement on the language of a stipulation;

- November 1, 2021: Judge Selna granted the USAO-CDC's application, ruling that Software Technology "was permitted to provide technical assistance to both parties";

- November 24, 2021: after several weeks of negotiations involving Avenatti, the privilege review team, and Software Technology, the parties memorialized the terms of a stipulation regarding a protocol that would allow for the production of data to both Avenatti and the privilege review team "relating to the five clients" at issue in the California Case;

- December 6, 2021: the privilege review team proposed at least one date for the search on which Software Technology was available (December 8, 2021), but Avenatti's expert was not available on that date;

- January 11, 2022: a conference call with Avenatti, the privilege review team, and Software Technology occurred during which the parties discussed "the logistics of segregating the data and scheduled the in-person segregation to take place on January 18, 2022, which was ultimately rescheduled" — for unspecified reasons — "to January 24, 2022";

- January 12, 2022: the Government in this case produced notes that it had taken from an interview earlier the same day with Regnier, Avenatti's former business manager who had been responsible for inputting entries in QuickBooks and Tabs, in which Regnier stated "that information relating to ... Mr. Avenatti's firm's representation of Ms. Clifford was kept in QuickBooks and Tabs";

- On an unspecified date, but clearly between January 12 and 14, 2022: Avenatti "raised with the [privilege review team] the need to also acquire the Tabs data related to Ms. Clifford"; the privilege review team responded that, "in order to facilitate the segregation of the Tabs data related to Ms. Clifford, it would need to be directed to do so by the court and took no other position on the matter";

- January 14, 2022: Avenatti filed his "emergent application" with Judge Selna seeking an order "permitting the Privilege Review Team to assist in segregating the data relating to Ms. Clifford";

- January 20, 2022: Judge Selna denied the request "without prejudice to any relief which defendant may be entitled to in the Southern District of New York."

Def. Second Mot. 2-5; No. 8:19-CR-061 (JVS), ECF Nos. 903, 909. At the conclusion of the Second Motion to Compel, Avenatti tacitly acknowledged that he could have sought access to the data relating to Ms. Clifford earlier, but argued that the delay was immaterial because, "[t]hrough no fault of his own, the data has been inaccessible for months and the company responsible for the Tabs program has required multiple court orders to even assist the parties in obtaining the data. Thus, even if Mr. Avenatti had specifically requested the Tabs data for Ms. Clifford on September 16, 2021, the day the servers were first produced, he would still be in the exact same position he is in now." Def. Second Mot. 5. Reiterating his position that the USAO-CDC is "part of the ... prosecution team" for purposes of this case, and noting that "the data segregation will occur on the copy of the servers in the possession" of the USAO-CDC, Avenatti argued that the Court "should compel the Government's production of the Tabs data for Ms. Clifford." *Id.*

E. The Third Motion to Compel and Other Developments During Trial

***6** On Monday, January 24, 2022, shortly before opening statements, the Court denied Avenatti's First and Second Motions to Compel "[f]or reasons to be summarized in Court ... and to be spelled out in a forthcoming opinion." ECF No. 300. Shortly thereafter, the Court explained from the bench that one or both motions were untimely; that both motions failed because Avenatti already had the data he was seeking; and that both motions also failed because the USAO-CDC was not part of the prosecution team for purposes of this case. Tr. 71-72. The Court reiterated that it would, in due course, "issu[e] an opinion addressing these points in further detail and making a more fulsome record on these issues." *Id.* at 72.

Several other developments during trial warrant brief discussion. First, as noted, both Avenatti and the USAO-SDNY had served subpoenas on the Bankruptcy Trustee for Eagan Avenatti. On January 26, 2022 — in the middle of trial here — the Bankruptcy Court for the Central District of California held a hearing to decide whether the Bankruptcy Trustee could comply with the subpoenas. *See* ECF No. 315 ("Def. Third Mot."), at 1; No. 8:19-BK-13560 (SC), ECF No. 360. As recounted by the Government during trial, the Bankruptcy Court denied the Bankruptcy Trustee permission to comply with the Government's and Avenatti's subpoenas. *See* Tr. 1034; *see also* 8:19-BK-13560 (SC), ECF No. 360. On the morning of January 28, 2022, Avenatti filed his Third Motion to Compel, alerting the Court to the Government's efforts to obtain data from the Servers in the possession of the Bankruptcy Trustee via multiple subpoenas. *See* Def. Third Mot. The Government's "deliberate failure to acquire information favorable to the defendant," Avenatti contended, raised "a host of issues ... relating to *Brady*." *Id.* at 2. On the record at trial the same day, the Government confirmed that the Bankruptcy Court had denied the Bankruptcy Trustee's application for permission to comply with the Government's subpoenas and that it still did not have possession of the Servers. Tr. 1034-35. The Court then denied Avenatti's Third Motion to Compel, noting, among other things, that the Government had no obligation to produce that which it did not possess and, once again, that Avenatti in fact had had possession of the data since September 2021. *Id.* at 1035-36.

Second, on January 28, 2022, the last full day of the Government's case-in-chief, the Court granted the Government's motion to compel Avenatti to comply with the trial subpoena that it had issued on January 10, 2022, which sought certain materials — including Tabs data — from the forensic copy of the Servers in Avenatti's possession. *See* ECF No. 313; Tr. 646, 1031-33. The Court directed Avenatti to produce materials responsive to the subpoena no later than 3:00 p.m. on Saturday, January 29, 2022. Tr. 1033. Five days later, on February 2, 2022, Avenatti represented to the Court that he had complied with the Court's ruling by producing the "the Tabs data ... before the [G]overnment's case rested." Tr. 1690.

As noted, on February 4, 2022, the jury found Avenatti guilty of both counts, wire fraud and aggravated identity theft. *See* Tr. 1842-43.

DISCUSSION

Three motions are at issue here: Avenatti's First Motion to Compel, which sought an order requiring the Government to produce "all *Brady, Giglio*, and 3500 materials in the possession of individuals at Main Justice and the [USAO-CDC]," Def. First Mot. 1; his Second Motion to Compel, which sought an order requiring "the Department of Justice" to disclose certain "data in their possession relating to Ms. Stephanie Clifford in a usable, readily accessible format," Def. Second Mot. 1; and his Third Motion to Compel, which sought an unspecified "inquir[y]" into the Government's unsuccessful efforts to obtain a copy of the Servers from the Bankruptcy Trustee, Def. Third Motion 2. All three motions fail for multiple reasons, some of which are unique to a particular motion, some of which are shared by two or even all three. The Court will address these reasons in turn.

A. Avenatti's Second Motion to Compel Was Untimely

***7** For starters, at least one of Avenatti's Motions to Compel — his Second — was patently untimely when filed. As noted, Avenatti had a copy of the Servers as of September 2021. Thus, he should have known (and probably did know) if there was a technical problem that prevented access to the data he needed for this case long before January 14, 2022, the date on which he sought relief from Judge Selna — let alone January 21, 2022, the first date on which he sought relief from *this* Court. [10] Yet, inexplicably, he waited until after the jury had been selected in this case to raise the issue. Even then, his (later dismissed) counsel was unable to explain the history or precise nature of the issue. It was not until the following day — Saturday, only two days before the parties were to open in this case and, with Software Technology's assistance, the data extraction was to take place in California — that counsel provided the relevant procedural and technological

background. That was too late for the Court to address the issue, particularly since, as Avenatti's own submission and the litigation history leading to Judge Selna's order made plain, *see* Def. Second Mot. 2-5, the Court would have had to give Software Technology an opportunity to be heard before issuing any order granting Avenatti's request.

10 Whether there even was a technical problem is open to question. As noted above, Avenatti produced the Tabs data to the Government on January 29, 2022. *See* Tr. 1690. Given that he did so despite the Court's denial of his Second Motion to Compel suggests that Avenatti could have accessed the relevant data all along. In any event, the Court did not need to delve into that issue as there are several other reasons that Avenatti's motions fail.

Avenatti's attempts to justify his delay in raising the issue fall flat. First, he suggests that it was not until January 12, 2022 — when the Government produced notes of an interview with Regnier mentioning Tabs — that he realized his need for the data. *See id.* at 1. But that suggestion is disingenuous, if not false. Avenatti has known for years that the Government was likely to offer evidence of his and his firm's financial condition, as it did in the Nike Extortion Trial in February 2020. *See* ECF No. 176 ("Gov't Motion *in Limine*"), at 7 nn.1-2. If there was any doubt on that score, it was resolved by the Government's motion *in limine* — filed on December 9, 2021 — seeking leave to present evidence of Avenatti's and his firm's financial condition. *See id.* at 7-9. Nor is there any doubt that Avenatti knew that information relating to his and his firm's financial condition, and information relating to his representation of Ms. Clifford, would be found in the Tabs data. He was the principal of the "relatively small firm," Tr. 1415, and, as testimony at trial revealed, a "micromanager" with respect to its finances, Tr. 385. Moreover, his response to the Government's motion *in limine* and his first request for an adjournment of trial confirm that he knew full well what was on the Servers. *See* Def. Opp'n to Motion *in Limine* 18-20 (noting that the Servers contained "the financial data for the firm and each of its clients, including Ms. Clifford"); Def.'s Mot. for Adjournment 7 ("[A] preliminary review [of the Servers] shows that information highly relevant [to this case] ... are [sic] included on the servers, including ... financial data relating to Mr. Avenatti's representation of Ms. Clifford, including costs and expenses incurred ...."). In short, Avenatti could have, and should have, moved for relief long before January 12, 2022.

Avenatti's effort to minimize the impact of his delay is similarly unavailing. Citing the lengthy procedural history leading to Judge Selna's order resulting in Software Technology's assistance, Avenatti asserts that "even if [he] had specifically requested the Tabs data for Ms. Clifford on September 16, 2021, the day the servers were first produced, he would still be in the exact same position ...: waiting for Software Technology, LLC to conduct the Tabs data segregation with agreement of the Government." Def. Second Mot. 5. But that is entirely speculative and likely wrong. Without an imminent trial date in the California Case, there was little time sensitivity involved in the effort to access the data relevant to the California Case. By contrast, Avenatti has known for over a year that the trial in this case was to start in January 2022. ECF No. 103; *see also* ECF No. 104 (confirming that "Avenatti is aware of the [January 2022] trial date" and "understands that this is a firm date"). Given the looming trial date, if Avenatti had a genuine need for relief (a premise that is dubious to say the least, both because it appears he had long had access to the relevant information and because, as discussed below, it would not have aided his defense), it was incumbent upon him to seek it earlier than the weekend before trial.

***8** In short, Avenatti's Second Motion to Compel was patently untimely and fails for that reason alone. His other two Motions to Compel were arguably untimely as well because he knew or should have known of the facts underlying those motions months, if not years earlier, and yet he waited until the eve of trial to raise them. But the Court need not, and does not, rest its decisions with respect to those two motions on that ground because the motions fail for several other, more fundamental reasons that also doom his Second Motion to Compel. It is to those other reasons that the Court now turns.

B. Avenatti Himself Had the Tabs Data for Months Before Trial

First, Avenatti's motions with respect to any data contained on the Servers fail because the record is clear: He himself had the Servers for months before trial. It is well established that the Government need not disclose materials or information that a defendant has in his own possession long before trial. *See, e.g.*, *United States v. Halloran*, 821 F.3d 321, 341 (2d Cir. 2016) (" '[A]s long as a defendant possesses *Brady* evidence in time for its effective use,' there can be no *Brady* violation.") (quoting *United States v. Coppa*, 267 F.3d 132, 144 (2d Cir. 2001)); *United States v. LeRoy*, 687 F.2d 610, 618 (2d Cir. 1982) ("Evidence is not 'suppressed' if the defendant either knew, or should have known, of the essential

facts permitting him to take advantage of any exculpatory evidence." (citations and quotation marks omitted)); *United States v. Hatfield*, No. 06-CR-0550 (JS), 2009 WL 10673620, at *3 (E.D.N.Y. July 10, 2009) ("[T]he Court finds that the Government did not violate its obligations under *Brady* because [the defendant] was already in possession of the [exculpatory evidence]."). As noted, Avenatti received a complete forensic copy of the Servers, including all the Tabs data, on September 16, 2021. *See* Def. Second Mot. 2; Gov't Adjournment Ltr. 3. Given Avenatti's own familiarity with what was on the Servers, his retention of a technology expert to assist him in conducting a review even before he obtained the Servers, *see* Def. Second Mot. 3, and the tools available to search electronically stored information, that was ample time to make effective use of the Servers at trial. Any suggestions to the contrary are belied by Avenatti's ability to produce the Tabs Data within a single day of being ordered by the Court to comply with the Government's subpoena, as Avenatti conceded he did. *See* Tr. 1690 ("MR. AVENATTI: ... [I]n response to the subpoena, I made a production ... of the Tabs data, as directed to do so by the Court.... THE COURT: All right. Understood. Thank you for making the record on that. It certainly underscores and confirms that you have had the Tabs data and had it prior to this trial."). In short, there was no need or basis to compel the Government to disclose to Avenatti what he already had.

The fact that Avenatti received the Servers from the USAO-CDC, not the USAO-SDNY, is of no moment. *See, e.g.*, *United States v. Tuzman*, No. 15-CR-536 (PGG), 2021 WL 1738530, at *57 (S.D.N.Y. May 3, 2021) (finding no *Brady* violation where the relevant information had been produced to the defendant prior to trial by the Securities and Exchange Commission). [11] Avenatti's suggestion that *Brady* was somehow implicated because the "data segregation" to be done with Software Technology's assistance was to "occur on the copy of the servers in the possession" of the USAO-CDC is even more baseless. Def. Second Mot. 5. The data segregation could just as easily have been conducted on his copy of the Servers. The key point is that Avenatti had an exact copy of whatever was in the Government's possession; to the extent that some of the data was unusable, it was unusable to *both* the Government and to Avenatti. *Brady* and its progeny did not require that the Government do more.

11 Moreover, Avenatti has long maintained (albeit wrongly, as discussed below) that the USAO-CDC and USAO-SDNY are part of a single prosecution team. From his perspective, therefore, it surely did not matter from which office he received the Servers. And regardless, the source of a defendant's possession or knowledge is irrelevant to the analysis. All that matters is whether the defendant already possessed the information or knowledge at issue, which Avenatti indisputably did.

C. The USAO-CDC Is Not Part of the Prosecution Team in This Case

***9** Second, Avenatti's First and Second Motions to Compel failed because the USAO-CDC is not part of the prosecution team in this case for the purposes of *Brady* disclosures. [12] The Government's obligations under *Brady* and *Giglio* "extend[ ] only to material evidence ... that is known to the prosecutor." *United States v. Avellino*, 136 F.3d 249, 255 (2d Cir. 1998); *see also United States v. Bagley*, 473 U.S. 667, 676 (1985) (noting that *Giglio* materials are a species of *Brady* materials). "An individual prosecutor is presumed ... to have knowledge of all information gathered in connection with his office's investigation of the case and ... has a duty to learn of any favorable evidence known to the others acting on the government's behalf in the case." *Avellino*, 136 F.3d at 255-56 (internal quotation marks omitted). Notably, however, "knowledge on the part of persons employed by a *different office* of the government does not in all instances warrant the imputation of knowledge to the prosecutor." *Id.* (emphasis added). That is for good reason. As the Second Circuit explained in *Avellino*, "the imposition of an unlimited duty on a prosecutor to inquire of other offices not working with the prosecutor's office on the case in question would inappropriately require [courts] to adopt a monolithic view of government that would condemn the prosecution of criminal cases to a state of paralysis." *Id.* (internal quotation marks omitted).

12 The fact that the USAO-CDC was not part of the prosecution team for this case does not bear on Avenatti's Third Motion to Compel, which is based solely on the conduct of the USAO-SDNY (namely, its efforts to obtain the Servers from the Bankruptcy Trustee).

Instead, "[i]n the Second Circuit, a prosecutor's constructive knowledge only extends to those individuals who [or entities that] are 'an arm of the prosecutor' or part of the 'prosecution team.' " *United States v. Meregildo*, 920 F. Supp. 2d 434, 440-41 (S.D.N.Y. 2013) (quoting *United States v. Gil*, 297 F.3d 93, 106 (2d Cir. 2002); *United States v. Morell*, 524

F.2d 550, 555 (2d Cir. 1975)), *aff'd sub nom. United States v. Pierce*, 785 F.3d 832 (2d Cir. 2015); *see also United States v. Locascio*, 6 F.3d 924, 949-50 (2d Cir. 1993); *United States v. Middendorf*, No. 18-CR-36 (JPO), 2018 WL 3956494, at *4 (S.D.N.Y. Aug. 17, 2018) ("The prosecution's obligation to disclose *Brady* material extends to any material in the possession of any entity that has acted as an 'arm of the prosecutor' in a given case." (quoting *Morell*, 524 F.2d at 555)). [13] This rule applies not only to other federal agencies, but also to other offices within the Department of Justice, including other United States Attorney's Offices. *See, e.g.*, *Avellino*, 136 F.3d at 256 (describing how in *United States v. Quinn*, 445 F.2d 940 (2d Cir. 1971), the Second Circuit "refused to impute the knowledge of a [federal] Florida prosecutor to an AUSA in New York, rejecting as completely untenable the position that knowledge of any part of the government is equivalent to knowledge on the part of this prosecutor" (cleaned up)); *Gist v. United States*, No. 16-CR-656-6 (GHW), 2021 WL 3774289, at *16 (S.D.N.Y. Aug. 24, 2021) (concluding "the Government did not violate its *Brady* obligations" where it had not disclosed a report from another Department of Justice agency because it "was not in the possession of an arm of the prosecution"); *United States v. Blaszczak*, 308 F. Supp. 3d 736, 741-42 (S.D.N.Y. 2018) (same for materials in possession of the Securities and Exchange Commission); *cf. United States v. Volpe*, 42 F. Supp. 2d 204, 221 (E.D.N.Y. 1999) (holding that Rule 16 of the Federal Rules of Criminal Procedure did not require disclosure of material in the possession of a different prosecution team within the *same* United States Attorney's Office where the two teams were "not involved in a joint investigation, and where the prosecution d[id] not have access to the material requested"). [14]

13 The same "prosecution team" (or "joint investigation") analysis applies to the determination of what qualifies as "in the possession of the United States" for purposes of the Jencks Act. *United States v. Bin Laden*, 397 F. Supp. 2d 465, 490-91 (S.D.N.Y. 2005), *aff'd sub nom. In re Terrorist Bombings of U.S. Embassies in E. Afr.*, 552 F.3d 93 (2d Cir. 2008); *see also United States v. Merlino*, 349 F.3d 144, 155 (3d Cir. 2003) ("In speaking of statements 'in the possession of the United States,' we understand the [Jencks Act] to require production only of statements possessed by the prosecutorial arm of the federal government." (cleaned up)); *United States v. Paternina-Vergara*, 749 F.2d 993, 997 (2d Cir. 1984) ("We have ruled that documents of local police are not subject to the Jencks Act ... in the absence of a joint federal-state investigation.") (citing *United States v. Bermudez*, 526 F.2d 89, 100 & 100 n. 9 (2d Cir.1975)); *United States v. Ferguson*, 478 F. Supp. 2d 220, 240 (D. Conn. 2007) (denying motion for Jencks Act materials in the possession of state entities where those entities had not engaged in a "joint investigation" with the federal prosecutors).

14 To the extent that Avenatti relies on Ninth Circuit case law to support his motion to compel, *see* Def. First Mot. 4-5, that reliance is misplaced. Ninth Circuit case law appears to diverge from Second Circuit case law on the scope of a prosecutor's constructive knowledge with respect to *Brady* obligations. *Compare Avellino*, 136 F.3d at 256, *Middendorf*, 2018 WL 3956494, at *4 (quoting *Morell*, 524 F.2d at 555), *and Meregildo*, 920 F. Supp. 2d at 440-41 (quoting *Gil*, 297 F.3d at 106), *with United States v. Cano*, 934 F.3d 1002, 1023 (9th Cir. 2019) ("Knowledge and access are presumed if the agency participates in the investigation of the defendant."), *United States v. Bryan*, 868 F.2d 1032, 1036 (9th Cir. 1989) ("The prosecutor will be deemed to have knowledge of and access to anything in the possession, custody or control of any federal agency participating in the same investigation of the defendant."), *and United States v. Grace*, 401 F. Supp. 2d 1069, 1075 (D. Mont. 2005) (interpreting Ninth Circuit precedent to foreclose the "prosecution team" concept of the scope of disclosure obligations).

***10** Importantly, although "[a]n investigation may be joint for some purposes[,] it may be independent for others." *United States v. Gupta*, 848 F. Supp. 2d 491, 495 (S.D.N.Y. 2012). Thus, where two prosecution teams jointly conduct a limited number of investigative activities, those activities, without more, do not necessarily create an obligation under *Brady* for either team to search the entirety of the other team's file. Instead, each prosecution team will have "an obligation to review the documents *arising from* [*the*] *joint efforts* to determine whether there is *Brady* material that must be disclosed." *Id.* (emphasis added); *see also, e.g.*, *United States v. Carroll*, No. 19-CR-545 (CM), 2020 WL 1862446, at *9 (S.D.N.Y. Apr. 14, 2020) (noting that "joint fact gathering" does not necessarily "give rise to an

obligation by the Government to review the [other agency's] entire investigative file"); *United States v. Martoma*, 990 F. Supp. 2d 458, 461-62 (S.D.N.Y. 2014) (ordering the Government to review a subset of another agency's files relating to cooperating witnesses). In determining whether another government entity acted as part of the prosecution team for all or part of a given case, courts in this Circuit consider five primary factors: "whether the other [entity] (1) participated in the prosecution's witness interviews, (2) was involved in presenting the case to the grand jury, (3) reviewed documents gathered by or shared documents with the prosecution, (4) played a role in the development of prosecutorial strategy, or (5) accompanied the prosecution to court proceedings." *Middendorf*, 2018 WL 3956494, at *4 (citing *Blaszczak*, 308 F. Supp. 3d at 741-42); *see also, e.g.*, *Gist*, 2021 WL 3774289, at *17 (same factors); *Carroll*, 2020 WL 1862446, at *9-10 (same); *United States v. Collins*, 409 F. Supp. 3d 228, 239 (S.D.N.Y. 2019) (same).

Applying these factors here, the Court concludes the USAO-CDC was not a part of the prosecution team in this case. Three of the five factors weigh heavily in favor of that conclusion. The USAO-CDC was not involved in the USAO-SDNY's grand jury presentations, played no role in the development of the USAO-SDNY's prosecutorial strategy, and did not accompany the USAO-SDNY to court proceedings in this case. Gov't Opp'n 7. [15] It also bears emphasis that the two offices conducted their respective investigations with separate agency partners — the FBI-NY for the USAO-SDNY and the IRS-CI for the USAO-CDC. Gov't Opp'n 1; *see also* No. 19-CR-373 (PGG), ECF No. 318, at 9. And there was limited or no consultation between the two offices on significant developments, including, for instance, the USAO-CDC's decision to move to remand Avenatti just days before trial in the Nike Extortion Case, which was made without any prior notice to the USAO-SDNY team and (presumably to the chagrin of the USAO-SDNY) delayed the start of trial in the Nike Extortion Case. *See* Gov't Opp'n 7.

15 As noted above, members of the USAO-CDC team did attend portions of the Nike Extortion Case trial, but they did so as mere spectators, observing the proceedings from the public gallery. *See* No. 19-CR-373, ECF No. 360, at 8. That does not qualify as "accompan[ying]." And the Court has no reason to believe that anyone from the USAO-CDC attended trial in this case.

To be sure, for sake of "mutual convenience," Gov't Opp'n 6-7, the two offices conducted a total of five joint interviews with two witnesses of mutual interest — four with Regnier and one with Macias. *Id.* at 2. But the two offices conducted more solo interviews with Regnier and Macias than they did joint interviews, and the small number of joint interviews with them was a mere fraction of the 120 interviews with 45 witnesses that the USAO-SDNY conducted in the Nike Extortion Case and this case. *Id.* at 2. Viewed in context, therefore, the five joint interviews of two witnesses do not render the USAO-CDC part of the USAO-SDNY's prosecution team for the entire case. *See, e.g.*, *Collins*, 409 F. Supp. 3d at 241 (holding there was no "joint investigation" between the prosecutors and the another government agency where, among other things, the two teams "both participated in only 16 of 60 interviews of 37 distinct witnesses"); *Ferguson*, 478 F. Supp. 2d at 239 (same where "[o]nly eleven witnesses were interviewed jointly" and the government stated the "purpose of the joint interviews was to spare the witnesses from the burden of multiple sessions with ... different agencies"); *cf. Gupta*, 848 F. Supp. 2d 491 (concluding the prosecutors and the agency at issue were engaged in a joint investigation where, among other things, the two teams "jointly interviewed no fewer than 44 witnesses"); *Martoma*, 990 F. Supp. 2d at 461-62 (same where the prosecutors and the agency "jointly conducted twenty interviews of twelve witnesses").

***11** The same goes for the limited document sharing between the two offices. Accommodating "a small number of specific, discrete requests for certain materials," Gov't Opp'n 7, without engaging in any joint "review[ ] [of the] documents," *Middendorf*, 2018 WL 3956494, at *4, does not, without more, render a separate United States Attorney's Office part of the same prosecution team for *Brady* purposes, *see, e.g.*, *Collins*, 409 F. Supp. 3d at 240-42 (concluding the SEC was not part of the prosecution team even where, among other things, there was some "sharing of information between the SEC and the Government," including sharing of "information gathered from search warrants"); *United States v. Chow*, No. 17-CR-667 (GHW), ECF No. 69, at 89 (S.D.N.Y. Feb. 9, 2018) (same where the agency in question "provided documents that it collected" to the prosecutors but "there [was] no assertion that [those documents] were collected at the direction of or in coordination with" the prosecutors).

At most, the USAO-CDC could arguably qualify as part of the USAO-SDNY prosecution team for the purposes of fact-

gathering related to Regnier and Macias based on the offices' joint interviews of those witnesses. But that is debatable and, in any event, little help to Avenatti here. Assuming for the sake of argument that the USAO-SDNY's *Brady* obligations extended to "documents arising from [its] joint efforts" related to Regnier and Macias, *Gupta*, 848 F. Supp. 2d at 495, the issue is immaterial because, before trial, the Government turned over all documentation from the USAO-CDC's meetings with Regnier and Macias that the USAO-SDNY did not attend, *see* Gov't Opp'n 2.

Notably, the Court's conclusion is consistent with Judge Gardephe's recent ruling in the Nike Extortion Case. *See United States v. Avenatti*, No. 19-CR-373 (PGG), 2022 WL 394494, at *10-11 (S.D.N.Y. Feb. 9, 2022) ("Nike Extortion Op."). [16] There, Judge Gardephe held, on a nearly identical record, that, except perhaps as to Regnier, "the New York and California prosecutors were not engaged in a joint investigation or prosecution" for *Brady* purposes. *Id.* at *11. [17] The two offices' "collaborat[ion] with respect to Regnier" and sharing of "certain documents regarding [Avenatti's] finances," Judge Gardephe concluded, did not "demonstrate that the two offices were engaged in a joint investigation and prosecution." *Id.* With respect to the documents shared between the two offices, Judge Gardephe explained, Avenatti "d[id] not contend that the New York and California prosecutors jointly analyzed those documents or pursued a joint strategy to introduce them at the two trials." *Id.* "[T]he absence of a joint investigation or prosecution," Judge Gardephe concluded, "is fatal to [Avenatti's] *Brady* claim" based on documents and information in the possession of the USAO-CDC alone. *Id.* That absence is similarly fatal to Avenatti's First and Second Motions to Compel here.

16 Prior to Judge Gardephe's February 9, 2022 decision, Avenatti attempted to rely on an earlier ruling by Judge Gardephe to suggest that the USAO-SDNY and USAO-CDC were part of the same prosecution team for *Brady* purposes. *See* ECF No. 291-1, at 2 (citing *United States v. Avenatti*, No. 19-CR-373 (PGG), ECF No. 336, 2021 WL 2809919, at *45 (S.D.N.Y. July 6, 2021)). Avenatti's misreading of that earlier ruling — whether ingenuous or not — is confirmed by Judge Gardephe's recent decision. *See* Nike Extortion Op., at *10-11.

17 Macias does not appear to have testified in, or been relevant to, the Nike Extortion Case.

In short, the limited collaboration between the USAO-CDC and the USAO-SDNY is insufficient to conclude that the two offices were part of the same prosecution team for all purposes in this case. As such, the knowledge and possession of materials by the USAO-CDC cannot be imputed to the USAO-SDNY in this case for *Brady, Giglio*, or Jencks Act purposes. For that reason alone, Avenatti's First and Second Motions to Compel fail.

D. In Any Event, Avenatti Has Not Demonstrated Any *Brady* Violation

***12** Finally, even if Avenatti had not had the relevant data himself *and* the USAO-CDC was part of the prosecution team for purposes of this case, his *Brady* arguments (which are the primary basis of his motions) fail for an even more basic reason: He has not established that the Government violated its obligations. Under *Brady* and its progeny, the Government is required "to disclose evidence favorable to the accused when it is material to guilt or punishment." *United States v. Madori*, 419 F.3d 159, 169 (2d Cir. 2005) (citing *Brady v. Maryland*, 373 U.S. 83, 87 (1963)). To demonstrate a *Brady* violation, therefore, "a defendant must show that: (1) the Government, either willfully or inadvertently, suppressed evidence; (2) the evidence at issue is favorable to the defendant; and (3) the failure to disclose this evidence resulted in prejudice." *Coppa*, 267 F.3d at 140 (citing *Strickler v. Greene*, 527 U.S. 263, 281-82 (1999)).

The Government "suppresses" evidence within the meaning of the first element only when it has evidence in its "possession." *United States v. Brennerman*, 818 F. App'x 25, 29-30 (2d Cir. 2020) (summary order). Put differently, *Brady* does not obligate the Government "to seek out ... information like a 'private investigator and valet ... gathering evidence and delivering it to opposing counsel.' " *United States v. Thomas*, 981 F. Supp. 2d 229, 239 (S.D.N.Y. 2013) (quoting *United States v. Tadros*, 310 F.3d 999, 1005 (7th Cir. 2002)). Evidence is "favorable" to the defendant if it undermines the Government's proof or supports a valid defense, a universe that includes both "exculpatory information" and "information that could be used to impeach government witnesses, so-called *Giglio* material." *Madori*, 419 F.3d at 169 (2d Cir. 2005) (citing *Giglio v. United States*, 405 U.S. 150, 154 (1972)). Finally, "prejudice" (sometimes called "materiality") is established when "there is a reasonable probability that, had the evidence been disclosed to the

defense, the result of the proceeding would have been different." *Id.* (quoting *Pennsylvania v. Ritchie*, 480 U.S. 39, 57 (1987)). "A reasonable probability of a different result is one in which the suppressed evidence undermines confidence in the outcome of the trial." *Turner v. United States*, 137 S. Ct. 1885, 1887 (2017) (internal quotation marks omitted). "To make that determination," courts "evaluate the withheld evidence in the context of the entire record." *Id.* (cleaned up). "Where the evidence against the defendant is ample or overwhelming, the withheld *Brady* material is less likely to be material than if the evidence of guilt is thin." *Gil*, 297 F.3d at 103.

These well-established principles doom all of Avenatti's arguments with respect to *Brady*. First, the gravamen of Avenatti's Third Motion to Compel was that the Government had made insufficient efforts to acquire data from the Servers from the Bankruptcy Trustee. *See* Def. Third Mot. 2 (arguing that the Government had long "known of the importance of the data ... and yet purposely disregarded it and avoided acquiring it" and that "the Government's deliberate failure to acquire information favorable to the defendant" raises "issues relating to *Brady*"). But *Brady* does not require the Government to "acquire" evidence or information from others (let alone evidence or information that is already in the defendant's possession). *See, e.g.*, *Thomas*, 981 F. Supp. 2d at 239; *see also, e.g.*, *United States v. Raniere*, 384 F. Supp. 3d 282, 325 (E.D.N.Y. 2019) ("*Brady* does not require the government to search for exculpatory material not within its possession or control."); *Meregildo*, 920 F. Supp. 2d at 445 ("Because the Government never possessed [defendant's] Facebook account, it had no obligation to acquire it."). At most, it requires disclosure of evidence or information in the Government's possession. *See, e.g.*, *Brennerman*, 818 F. App'x at 29-30. So *Brady* did not require the Government to make efforts to "acquire" the Servers from the Bankruptcy Trustee or anyone else. [18]

18 Relatedly, it is worth noting that if Avenatti had needed to obtain the Servers from the Bankruptcy Trustee — which he did not, as he had them himself as of September 2021 — he could have sought them himself. In fact, for reasons that are unclear, Avenatti *did* in fact subpoena the Bankruptcy Trustee for the Servers. *See* ECF No. 344, at 4. The record is unclear with respect to what efforts, if any, Avenatti made to enforce the subpoena.

***13** More significantly, Avenatti has not shown that any of the information or data on the Servers are favorable or would have been material to the outcome of the trial. According to Avenatti, the information on the Servers would have been relevant for two purposes: first, to prove the quantity (and perhaps the quality) of the work that he and his firm did, and the costs they incurred, on behalf of Ms. Clifford; and second, to prove that his firm's financial condition was not as dire as the Government suggested. ECF No. 344, at 4. But Avenatti did not need the Server data to establish the former. There was ample evidence at trial that Avenatti and his firm did a lot of work and incurred substantial costs on Ms. Clifford's behalf. Indeed, those facts were basically undisputed. *See, e.g.*, GX 2; Tr. 341-51, 524-30, 1082-83. As for the latter, most of the evidence from the Server — including all of the evidence from the California Case to which Avenatti has pointed, *see* ECF Nos. 336-1 (under seal), 342, 345 — would have been inadmissible because it related to periods that were irrelevant to this case. *See* Tr. 1508-10 (granting on these grounds a motion to quash a subpoena Avenatti had served on an expert hired by the USAO-CDC to analyze the financial condition of Avenatti's firm for purposes of the California Case).

Moreover, the Government's proof that Avenatti and his firm were in financial straits at the time relevant to this case — July 2018 through February 2019 — was simply overwhelming. It included evidence that the firm's bank accounts incurred charges throughout the Summer and Fall of 2018 because the accounts lacked sufficient funds, *see, e.g.*, GX 302A, at 1, 7; GX 302B, at 1, 9, 17; GX 302C, at 3, 6-7, 13, 15, 21-23; GX 803; Tr. 426, 615-16, 692-93; that from July 2018 to February 2019 the firm was unable to make payments, including payroll, on time, *see* Tr. 413 ("MS. REGNIER: [The financial situation at the defendant's law firm between July 2018 and February 2019] was not good. Payments were running late. We were having trouble making ends meet.... Payroll was late."); that the firm was unable to pay an $11,997.01 healthcare premium for its employees in September 2018, *see* GX 610; Tr. 418-20, resulting in cancellation of its health insurance plan in November 2018, Tr. 420; and that the firm was ultimately evicted from its offices in late November 2018 due to nonpayment of rent, *see* Tr. 413, 471-72. Additionally, Macias — a friend of Avenatti's —testified that Avenatti came to him in September 2018 seeking a $250,000 "bridge loan" in order to cover payroll and rent for his firm. Tr. 733-36 ("[MR. MACIAS]: He said that he was about to be evicted from his office space and that he needed money for his payroll."); *see also id.* 736-750 (describing efforts to secure a loan for

Avenatti from other sources in September 2018); GX 604-06 (text and email communications regarding the loan).

On top of that, Avenatti has not shown, and almost certainly could not show, that more granular evidence of the work he and his firm did and the expenses they incurred on behalf of Ms. Clifford, or evidence that his firm's financial condition was stronger than the evidence suggested, would have affected the outcome of the trial. That is because evidence of Avenatti's guilt was overwhelming and largely undisputed. It showed that Avenatti forged Ms. Clifford's signature on a document diverting book proceeds to an account controlled by him, *see* GX 213; Tr. 411-13; Tr. 995-97; *see also* GX 107; GX 701; that, after the funds were wired to that account, Avenatti converted most, if not all, of the proceeds to his own personal use or his firm's use, *see* GX 302A-G; GX 702; and that he repeatedly lied to Ms. Clifford, orally *and* in writing, claiming that the money — money he had received and already spent — had not yet been paid, *see* GX 26-29, 34-42, 44-45, 48-50; *see also, e.g.*, Tr. 927-29, 940-41, 956-58. To highlight just a few of the *many* examples of Avenatti's written lies:

- On October 2, 2018, more than two weeks after the third payment had already been sent to the account controlled by Avenatti and largely spent, Ms. Clifford wrote to Avenatti over WhatsApp, "Which reminds me ... publisher owes me a payment today." GX 35. Avenatti responded "On it. We need to make sure we have the publicity requirement met." *Id.*

***14** • On November 13, 2018, Ms. Clifford asked over WhatsApp, "Where is my book payment? I've texted [my editor at St. Martin's Press] but no response." GX 39. Avenatti replied, "Let me check." *Id.*

- On November 30, 2018, nearly two-and-a-half months after the publisher had sent the third payment to the account controlled by Avenatti, and nearly two months after Avenatti had spent that money, Ms. Clifford said over WhatsApp, "And let's not forget the publisher." GX 45. Avenatti responded, "I haven't. That's complete bullshit." *Id.*

In short, the Government's evidence of Avenatti's and his firm's dire financial condition certainly provided important context — it helped to explain what might otherwise have seemed to be inexplicable misconduct. *See* Tr. 1632-35. But it was not the main event. The main event was the extensive documentary evidence demonstrating beyond doubt Avenatti's lies and deceit.

Notably, Avenatti did not really dispute these facts at trial. Instead, his primary, if not sole, defense was that he believed in good faith that he was entitled to take Ms. Clifford's book advance payments, either pursuant to their fee agreement, GX 3, or under the equitable doctrine of *quantum meruit*. *See, e.g.*, Tr. 1753 (instructing the jury that the defense theory was "that Mr. Avenatti had a good-faith belief that he was legally entitled to take the money at issue [in] this case (1) as a reasonable fee for his work in obtaining the book deal; (2) as compensation for his and his law firm's work as Ms. Clifford's attorney and (3) as reimbursement for costs he advanced for her or incurred for her benefit"). [19] In his closing, for example, Avenatti argued that, "[u]nder the contract," he and his firm were entitled to "our hourly and out-of-pocket costs" and "a reasonable percentage" of any "book deal or other media opportunities" in the event that Avenatti assisted Ms. Clifford in finalizing any such opportunities. Tr. 1657. He asserted that the Government's position was that "a reasonable percentage is zero," which "makes no sense." *Id.* To support his theory, Avenatti also emphasized that "people expect to be paid for their work," *id.* at 1654, and repeatedly stressed the "huge amount of work [that] was done under th[e] contract," *id.* at 1659; *see also id.* at 1664 (claiming the evidence showed the "huge amount of costs and fees owed by Ms. [Clifford] to [him] and [his firm]). According to Avenatti, this evidence "establishe[d] a good-faith belief that [he] was entitled to some of the book money." *Id.* at 1664; *see also id.* at 1663 ("[I]t establishes a good-faith belief in my mind that I was entitled to be paid" and "a good-faith belief ... is a complete defense to all of these charges.").

19 With respect to Count Two, the aggravated identity theft charge, Avenatti also argued that he "acted with lawful authority when he used Ms. Clifford's name and signature" on the document directing the publisher to wire the book payments to an account he controlled. Tr. 1753. Avenatti has never suggested that the Server data had any relevance to that theory, so the Court focuses here on the wire fraud charge and Avenatti's good faith defense.

But that is not even a valid defense. Indeed, the Second Circuit has squarely held that "a claim of right to funds obtained through a false statement is not a defense negating fraudulent intent." *United States v. Blake*, 558 F. App'x 129, 130 (2d Cir. 2014) (summary order); *accord United States*

v. Gole, 158 F.3d 166, 168 (2d Cir. 1998) ("[C]ourts have uniformly held that a claim-of-right is not a defense to mail fraud." (citing cases)). That is, the wire fraud law prohibits obtaining money through false and misleading statements even if the perpetrator holds an honest belief that he is legally entitled to the money. *See Blake*, 558 F. App'x at 130 (holding that the evidence was sufficient to support conviction of a defendant who believed himself entitled to his former wife's life insurance and made false statements on insurance form); *Gole*, 158 F.3d at 168 (affirming a conviction where the defendant "intentionally misrepresented his income in order to retain pension overpayments" and rejecting as a matter of law the defendant's argument that "he lacked fraudulent intent because he believed ... he would be entitled to the overpayments"); *United States v. Lauersen*, No. 98-CR-1134 (WHP), 1999 WL 637237, at *2-4 (S.D.N.Y. Aug. 20, 1999) ("Where an insurance claimant submits false and misleading invoices and thereby deprives the carrier from determining for itself the merit of the claim based on truthful representations, the carrier has been defrauded."). [20]

20 Throughout trial, Avenatti placed heavy reliance on *United States v. Rossomando*, 144 F.3d 197 (2d Cir. 1998), in which the Second Circuit stated that, in order to show fraudulent intent, "the government [had] to prove that [the defendant had] lied with the intent to deprive [the victim] of monies he *knew* he was not entitled to," *id.* at 203; *see* Tr. 767, 779-80, 1461, 1793, 1801-02. In *Gole*, however, the Circuit explained that *Rossomando*'s holding applies only where the defendant "kn[ew] of the immateriality of the false statements he made," 158 F.3d at 168, thus effectively limiting *Rossomando* to its facts. Indeed, Judge Jacobs, concurring, wrote that "*Rossomando* is thus limited to the quite peculiar facts that compelled the *Rossomando* result under the only holding that *Rossomando* will support: a defendant's belief that information is immaterial to a disbursement decision amounts to a defense to mail fraud only if the disbursement is mechanical as opposed to discretionary ... and a jury finds that such a belief is reasonable." *Id.* at 169 (Jacobs, J., concurring).

***15** The Second Circuit's holding was compelled by the language of the wire fraud statute, which "does not mention [a claim-of-right] as a defense." *Gole*, 158 F.3d at 168. It was also "command[ed]" by "common sense." *Id.* As the Second Circuit explained in *Gole*:

> If Gole's theory of self-help were the law, anyone who believed that he was legally entitled to benefits from a pension plan, or an insurance policy, or a government program, but who was concerned that he or she might nevertheless be denied such benefits, would be given carte blanche simply to lie to obtain those benefits. Such a course of action would often be much easier than pursuing legal remedies through civil actions in court, and would guarantee success as long as the misrepresentation remained undiscovered. We will not encourage people to lie to obtain benefits rather than pursue their rights in civil actions. Such controversies may be resolved by civil suit or settlement, but cannot be won by using lies and deception.

Id.; *see also, e.g.*, *United States v. Catapano*, No. 05-CR-229 (SJ) (SMG), 2008 WL 3992303, at *8 (E.D.N.Y. Aug. 28, 2008) ("Defendants cannot prevail by engaging in 'self-help.' If Defendants believed that the program had expired and that further enforcement would therefore be unconstitutional, they had the option of going through the appropriate legal channels ...."). In other words, whether or not Avenatti genuinely believed that he was ultimately entitled to the money he took, pursuant to either the contract or *quantum meruit*, was irrelevant. To qualify as "good faith," Avenatti would have had to hold an honest belief that his false and misleading statements to Ms. Clifford were, in fact, true, or an honest belief that the law entitled him to engage in self-help — to take and spend his client's money, without her knowledge and consent and despite his false and misleading statements to her, rather than going through "appropriate legal channels." *Catapano*, 2008 WL 3992303, at *8; *see also Blake*, 558 F. App'x at 130 ("[An] honest misstatement is insufficient to prove fraudulent intent."). [21]

21 Strictly speaking, the Court's instructions to the jury on good faith — that "if the defendant in good faith believed that he was entitled to take the money or property from the victim, even if that

> belief was mistaken, then you must find him not guilty," Tr. 1739 — were not inconsistent with the foregoing. That said, as the Court acknowledged during the jury's deliberations (after the jury sent a note seeking further instructions on the meaning of "good faith" and the Government — belatedly — brought *Gole* and *Blake* to the Court's attention), the phrase "entitled to take the money or property" may not have drawn sharply enough the distinction "between a good faith belief that Defendant was ultimately entitled to Ms. Clifford's money, which is not a valid defense, and a good faith belief that the defendant was entitled to engage in self help by taking Ms. Clifford's money when and in the manner he did, which is a valid defense." ECF No. 367.

But there was zero evidence in the record to support such a finding of good faith. One need look no further than Avenatti's summation for confirmation of that fact. As noted above, he argued at length that the jury should find that he held a good faith belief that he was entitled to the money he took as a reasonable fee and reimbursement of expenses. [22] But nowhere did he argue, or even suggest, that there was evidence in the record from which the jury could infer that he had a good faith belief that he was entitled to take Ms. Clifford's money at the time or in the manner that he did — by resorting to self-help and lying or misleading her rather than going through appropriate legal channels. That is perhaps not surprising, as Avenatti conceded in a colloquy with the Court that he could not cite any authority for the proposition that he was "entitled to take this money as [his] own without telling Ms. [Clifford] — in fact, with lying to Ms. [Clifford] about the fact that [he] took it — ... as opposed to [his] bringing a lawsuit, whether in arbitration or any court of law, bringing a *quantum meruit* claim seeking a reasonable fee for the work that [he] did on her behalf." Tr. 1461-65.

22 In advance of closings, the Court had expressed the view that Avenatti could not argue good faith because there was no evidence in the record to support such a finding, but reversed course because the Government took the view that Avenatti "may be able to point to circumstantial evidence that he could then argue to the jury they can infer good faith from." Tr. 1518-24. Upon reflection, the Court is of the view that the Government was wrong and that Avenatti should not have been able to make the arguments he did in closing. That is, the Court arguably erred in giving Avenatti too much latitude in his closing argument (which may well be why the jury sought clarification of the "good faith" defense). In any event, Avenatti certainly has no basis to complain that he was allowed to make an argument that was unsupported by law.

***16** In short, the evidence that Avenatti engaged in wire fraud was overwhelming and largely undisputed; his sole "defense" was no valid defense at all. In the face of that evidence, Avenatti has failed to show that any information on the Servers was favorable or material within the meaning of *Brady*. Not to beat a dead horse, but this failing is all the more notable given that Avenatti had the Servers for over four months before trial in this case began. It stands to reason that, if there were information on the Servers favorable to Avenatti's defense or material to the outcome of the trial, he would have sought to use it at trial or at least referenced it in one of his three Motions to Compel (not to mention one of his many other submissions, before and during trial, discussing the Servers). The fact that he did not is additional proof that there was and is no merit to Avenatti's Motions to Compel.

CONCLUSION

In sum, there was no merit whatsoever to Avenatti's Motions to Compel — or to his general complaints about access to the Server and the Tabs data. That may explain why, in contrast to his repeated requests in the California Case, Avenatti did not even bother to raise the issue in this case until the eve of trial. But he certainly made up for lost time and pressed the point with frequency and vigor from December 23, 2021, through trial. It is hard to avoid the conclusion that he did so based on the hope or belief that, having used Tabs to secure a mistrial in the California Case, he could accomplish the same here (or plant a seed for eventual appeal). But this case is not the California Case. The Servers were not, and have never been, in the possession of the USAO-SDNY. There is no reason to believe that anything on the Servers is favorable or would have altered the outcome of *this* case. And perhaps most significant: Avenatti himself had the Servers for over four months before trial in this case began. In short, for purposes of *this* case, Avenatti's arguments with respect to the Servers are nothing more than a smoke screen; there is no there there.

In fact, if anything, the party with a legitimate grievance regarding the Servers is the Government, not Avenatti. In the lead up to trial, Avenatti was privy to what was on the Servers and could have made use of their contents

(if admissible); the Government here was not. In light of Avenatti's December 24, 2021 representation that he had identified relevant information on the Servers, *see* Def.'s Mot. for Adjournment 7, the Government served a subpoena on Avenatti on January 10, 2022. Yet it was not until January 29, 2022, with only about two hours remaining in the Government's case-in-chief, that Avenatti — faced with a Court order and the threat of "consequences" if he failed to comply, Tr. 1033 — finally complied with the subpoena and turned over materials from the Server to the Government. Given the history recounted above, it is hard not to think that that was a pure act of gamesmanship on Avenatti's part: It effectively deprived the Government of a meaningful opportunity to use the Server data as part of its case-in-chief — yet enabled him to oppose a curative instruction with respect to his arguments about the Tabs data in summation on the ground that the data had technically been disclosed to the Government. *See* Tr. 1690. But whether the timing of Avenatti's compliance was or was not an act of gamesmanship is beside the point here. The point is that, for purposes of this case, Avenatti had, and has, no legitimate grievance with respect to the Servers.

In short, Avenatti's Motions to Compel were without merit and remain DENIED.

SO ORDERED.

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Denis Marc AUDET et al., Plaintiffs,
v.
Stuart A. FRASER et al., Defendants.

No. 3:16-cv-00940 (MPS)
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Signed 05/04/2020

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RULING ON MOTION TO DECERTIFY/BIFURCATION

Michael P. Shea, U.S.D.J.

I. INTRODUCTION

***1** This securities class action stems from the collapse of an expansive and allegedly fraudulent cryptocurrency enterprise. Defendant Stuart A. Fraser has moved to decertify the class as to damages. As set forth below, because there does not appear to be a method by which a jury could determine aggregate damages with reasonable accuracy, and because bifurcation serves the interests of judicial economy, I find that bifurcation is the most appropriate course of action. I will determine how best to proceed with determining damages—including whether decertification as to damages is warranted—if and when the question of liability is resolved in the Plaintiffs' favor. Accordingly, Fraser's motion to decertify is DENIED without prejudice.

II. BACKGROUND

I assume familiarity with the history of this case and the Court's prior rulings, including the Ruling on Class Certification, in which I granted the Plaintiffs' motion for class certification but authorized further discovery into individual damages issues. ECF No. 141. Upon the completion of discovery, Defendant Stuart A. Fraser moved to decertify the class as to damages. ECF No. 179. Fraser argues that calculating each class member's damages requires a highly individualized inquiry. Specifically, Fraser points to multiple offsets he argues complicate the damages inquiry: credit card chargebacks, reseller sales, Paycoin sales, Paycoin-to-Ion conversions, account sales, sales on the GAW Miners Marketplace, and netting gains and losses for individuals with multiple accounts. Each of these is described in turn in the sections that follow.

A. Credit Card Chargebacks

Chargebacks are refunds that some class members received through their credit card companies. While it is unclear how many class members received chargebacks, the evidence before the Court indicates that this number is not insubstantial. Three of the seven class members deposed by Fraser indicated that they received chargebacks. For example, class member John Tuberosi indicated that he received chargebacks from all but two of the credit cards he used to purchase products from GAW Miners LLC ("GAW"). ECF No. 179-2 at 94. Similarly, Teresa Crivello indicated that she received approximately $100,000 in chargebacks. ECF No. 179-2 at 98. [1] As the Plaintiffs point out, however, Fraser chose which class members to depose, so these seven class members cannot be presumed to be representative of the class as a whole.

1 Ms. Crivello indicated that her losses, net of any chargebacks she received, were between $200,000 and $215,000. ECF No. 179-2 at 103.

A spreadsheet compiled by Named Plaintiff Dean Allen Shinners ("the Shinners Spreadsheet"), which includes data for 490 class members, indicates that 40 received chargebacks —approximately 8%. ECF No. 191 at 12 (citing ECF No. 191-3). But this data was self-reported by the class members and appears to be inaccurate as to at least some class members. For example, Teresa Crivello, one of the seven class members Fraser deposed, admitted to having received substantial chargebacks, even though the Shinners Spreadsheet indicates she did not receive any "refunds or chargebacks." ECF No.

179-2 at 21-29. Class member Daniel Simpson likewise testified to receiving chargebacks "after fighting tooth and nail for over a year," even though the Shinners Spreadsheet indicates he did not receive any "refunds or chargebacks." ECF No. 179-2 at 111; ECF No. 191-3 at 3. The Spreadsheet does, however, indicate that Mr. Simpson had requested chargebacks the day before he submitted data to Mr. Shinners, but had not yet received any. ECF No. 191-3 at 3. Regardless of how these discrepancies came about, they suggest that the Shinners Spreadsheet may understate the number of class members who received chargebacks.

***2** Shinners also indicated in his Victim Impact Statement that he "started a drive to help many investors recover some of their losses through the credit card charge-back process." ECF No. 181-1 at 3; *see also* ECF No. 179-2 at 126 (post by Shinners encouraging GAW investors to request chargebacks and indicating that "[m]ost of the [credit card] customer service reps are already aware of what is happening with GAW, since there has been a tsunami of recent activity and effort to charge back these transactions."). This evidence further suggests that chargebacks were not isolated occurrences. [2]

2 Fraser also cites evidence of several other instances of chargebacks, ECF No. 179 at 9 & nn. 19-21, but this evidence is anecdotal and does not present any method by which this Court might determine the proportion of class members who received chargebacks.

For those class members who did receive chargebacks, the available evidence indicates that the amount of these chargebacks relative to the class member's total investment in GAW products varied, but that these chargebacks were not insubstantial. For example, Crivello testified that she recovered approximately $100,000 of her roughly $300,000 investment through chargebacks. ECF No. 179-2 at 98, 104. And several class members appear to have recovered the entirety of their investment. ECF No. 179-1 at 140-47.

Chargebacks are not reflected in the ZenCloud database. [3] The proof of these transactions includes the testimony of class members as well as credit card statements and other documents evidencing chargebacks. *See, e.g.*, ECF No. 191-10 at 3 (credit card statement showing a refund); ECF No. 191-5 at 4 (letter from Citibank indicating a refund of $24,975). Further, although Fraser was not able to obtain any discovery from several financial institutions he subpoenaed, Fraser's counsel indicated at oral argument that this request did not identify any specific class members. It is difficult to imagine that financial institutions do not have records of the chargebacks class members received, and that they could not locate these records upon receiving targeted requests for specific class members with accounts at the institution. Finally, no party has suggested any reasonably accurate method for calculating the aggregate value of the chargebacks based on available data.

3 The ZenCloud database is a relational database that stores numerous data related to purchases of GAW products, including order history and user information. The parties dispute the reliability of this database. *See* ECF No. 179-1 at 27-28; ECF No. 191 at 33-35.

B. Sales to Third Parties

1. Reseller Sales

Some class members acted as resellers through the Companies' Value Added Reseller ("VAR") program. For example, class member Ryan Grimes participated in the VAR program and maintained a web store, "Hoosier Miner," that sold hashlets. ECF No. 179-2 at 167, 173. Resellers under the VAR program could buy codes from GAW that could be used to activate hashlets at a reduced price, and then resell those codes at the same price that GAW charged the public. ECF No. 179-2 at 173; ECF No. 191-6 at 15-16.

The number of active resellers does not appear to have been substantial. Fraser identifies two class members he claims were resellers: Grimes and Tuberosi. ECF No. 179-1 at 12-13. [4] While it is undisputed that Grimes was a reseller, the Plaintiffs contend that Tuberosi was not a reseller in the sense of purchasing hashlets for his own account and then reselling these hashlets, but that he simply referred customers to GAW and then conveyed their payment information to GAW. ECF No. 191. This activity would not pose the same concern as reselling under the VAR program, since Tuberosi never owned the products, and thus could not claim losses associated with them in a claims process.

4 Fraser suggests that Grimes' losses are misrepresented in the Shinners Spreadsheet. Fraser argues that the $140,000 listed in the Spreadsheet are not real losses, because Grimes resold the hashlets he purchased for at least as much as he

paid for them, and that Grimes in fact suffered "no losses." ECF No. 179-1 at 13. But as a reseller, Grimes asserts that he was subject to losses from chargebacks from the customers to whom he resold. *See, e.g.*, ECF No. 191-7 at 3 ($2,422.58 chargeback); ECF No. 191-8 at 2 ($747.50 chargeback). Further, at his deposition, he indicated that to estimate his losses he had "totaled up what we had bought and totaled up what we had charged back to us from our clients." ECF No. 191-6 at 8. This seems to suggest that the purchases he included in this calculation do not include purchases of hashlets that were later resold, but only those purchased for his own account.

***3** Plaintiffs indicate that they have identified six active resellers under the VAR program, based on the confirmation emails these resellers sent to their customers. ECF No. 191 at 16. Plaintiffs also point to the fact that, of the 111 class members who submitted written responses to Fraser's questions, 108 indicated they were not resellers. ECF No. 191-2 at 3 ¶ 11. Of the remaining three, one indicated that he had an "affiliate / reseller account," one indicated that he "attempted" to be a reseller on the Amazon Platform, and one indicated that he "applied to be a reseller but never resold anything." ECF No. 191-24. Thus, it appears that at least 109 of the 111 class members who provided written responses did not engage in any reselling, and it is unclear whether the remaining two individuals in this subset of class members actually engaged in reselling.

Resellers under the VAR program appear to have received email receipts from GAW memorializing their purchase and sent email receipts to their customers memorializing their sales. ECF No. 179-2 at 169. [5] It further appears that whether an individual was engaging in reselling under the VAR program can be determined by examining the ZenCloud database. Fraser's expert opined that "non-marketplace transactions," including resale transactions, "leave a specific trail in the ZenCloud database that [can be used] to determine whether any given device held by a given account was either purchased from GAW Miners, purchased indirectly from another user in the GAW Miners marketplace, or purchased indirectly from a seller outside of the marketplace." ECF No. 179-2 at 228. The terms of the transaction between the reseller and the purchaser, however, do not appear to have been tracked in the ZenCloud database. *Id.* at 228-29. It is unclear whether the ZenCloud database can be used to estimate the aggregate total of reseller transactions with reasonable accuracy.

5 Class member Grimes, who was a reseller, testified that he "[didn't] know if [he had] a hundred percent of the records." ECF No. 179-2 at 169.

2. Paycoin Sales

Paycoins, unlike the other GAW products at issue in this case, could be withdrawn from ZenCloud and sold on public exchanges. ECF No. 179-2 at 63. Proceeds from the sale of Paycoin appear to be relevant to the calculation of damages for two types of transactions. The first is purchases of Paycoin directly from GAW. Plaintiffs state that such transactions were "relatively uncommon." *Id.* The second is purchases of GAW products that produced income in the form of Paycoins, such as hashlets, in which case Fraser argues that proceeds from the sale of these Paycoins should be subtracted from any losses associated with the purchase of these products.

The magnitude of the potential offset from Paycoin sales depends heavily on the timing of any sales. According to Fraser's expert, if all class members sold their Paycoins immediately upon withdrawing it from the ZenCloud database, this would reduce class-wide damages under the Exchange Act by $4.3 million. ECF No. 179-2 at 234. [6] On the other hand, today, each Paycoin is worth a fraction of a penny, and all of the Paycoins in circulation are worth approximately $10,000. [7] Thus, if all class members held on to their Paycoins and sold them only recently, the value of any offset would be negligible.

6 Exchange Act damages under the model suggested by Plaintiffs' expert, which do not account for Paycoin sales, are approximately $12 million. ECF No. 179-2 at 594.

7 *PayCoin*, CoinMarketCap, https://coinmarketcap.com/currencies/paycoin2 (last visited April 28, 2020).

Fraser has produced evidence that some class members sold Paycoin before it had become worthless. For example, the Shinners Spreadsheet indicates that class member Kevin Calabrese sold off all of his Paycoin "when it became apparent that GAW was not going to live up to the Honors program" and "sold off the last of [his Paycoin] ... (at a substantial loss) by early February [2015]." ECF No. 191-3 at 3. [8] Class member Tuberosi also testified that he sold some of his Paycoin, including approximately two percent of his holding, on an exchange called "Cryptsy." ECF No. 191-14

at 3-4. Two additional class members indicated that they sold some Paycoins but do not have complete records of these sales. *See* ECF No. 179-2 at 407 (Roman Gorodnev), 662 (Christopher Alan Crane). At least one other class member, Martin Ammann, sold Paycoin. This class member provided a transaction log from a public exchange. ECF No. 191 at 18; ECF No. 191-29.

8 In early February, one Paycoin was worth approximately one dollar. *PayCoin*, CoinMarketCap, https://coinmarketcap.com/currencies/paycoin2 (last visited April 28, 2020).

***4** Fraser's expert also suggests that the high volume of Paycoin trading through April 3, 2014 (the end of the available data on Paycoin withdrawals from ZenCloud), which was six times the cumulative volume of withdrawals from ZenCloud, indicates that class members actively traded Paycoin. ECF No. 179-2 at 232. Plaintiffs argue that much of this activity can be attributed to the 12,000,000 Paycoins released into the market by GAW, which, according to Plaintiffs, was almost four times as many coins as were assigned to class members. ECF No. 191 at 18.

There is also some evidence, however, suggesting that the sale of Paycoin for more than negligible value was not widespread. Plaintiffs note that five of the seven class members Fraser deposed testified that they did not sell Paycoin, and the sixth witness testified that he initially "doubled and tripled down on PayCoin" and only sold it "when it was worthless," probably for "cents on the dollar." ECF No. 191-28 at 4-5.

In short, while it is possible that a substantial number of class members received significant value in exchange for Paycoin withdrawn from ZenCloud, it is unclear at this stage whether this is the case. Similarly, while there is some indication that documentation of Paycoin sales is limited, it is unclear how many class members lack documentation of their Paycoin sales. Finally, other than the estimate provided by Fraser's expert, which assumes that all Paycoin was sold the day it was withdrawn from ZenCloud, ECF No. 179-2 at 234, and which likely significantly overstates the value of Paycoin sales, there does not appear to be a reasonably accurate method for calculating the aggregate value of this offset.

3. Exchange of Paycoin for Ion

In June of 2015, a project called xpy.io was started to try to make Paycoin a viable cryptocurrency. ECF No. 191-1 at 2. Eventually, it was determined that Paycoin would never recover, and the team working on xpy.io decided to create a new cryptocurrency called Ion. *Id.* Ion launched in April 2016. *Id.* One of the ways to acquire Ion was to trade Paycoin for Ion. *Id.* One Ion coin could be acquired for eight Paycoins. *Id.*

Of the 111 class members who submitted responses to written questions, twenty-two (approximately 20%) indicated that they exchanged their Paycoin for Ion. ECF No. 179-1 at 15. It is unclear, however, whether class members received substantial value from such conversions. By the time Ion was launched, Paycoin was trading at roughly $0.02 per coin, less than 1% of its all-time high. [9] In the first six months after its launch, Ion generally traded for roughly $0.20 per coin or less. [10] A class member exchanging Paycoin for Ion during this time period would have received approximately $0.025 in value per Paycoin—still less than 1% of Paycoin's all-time high. But the price of Ion began to rise in early 2017, peaking at $8.18 in January of 2018, before falling again in late 2018. [11] As of April 28, 2020, Ion traded at approximate $0.025 per coin. [12] To the extent that class members exchanged Paycoin for Ion during its peak period in early 2018, they could have derived significant value from the exchange. There is no evidence, however, indicating that a material number of class members held on to their withdrawn Paycoin until early 2018 before exchanging it for Ion around its peak.

9 *PayCoin*, CoinMarketCap, https://coinmarketcap.com/currencies/paycoin2 (last visited April 28, 2020).

10 *Id.*

11 *Id.*

12 *Id.*

No party has suggested a method for estimating the aggregate value of the Ion received by class members in exchange for Paycoin. While there is some indication that the availability of documentation for these transactions is limited, it is unclear how many class members lack documentation for these exchanges.

4. Account Sales

***5** Some class members sold entire ZenCloud accounts by exchanging their username and password for payment. The acquiror would then change the password and assume

ownership of the account. Often, escrow agents were used to facilitate these transactions.

Named Plaintiff Michael Pfeiffer, for example, testified that he used escrow agents to purchase whole accounts. ECF No. 179-2 at 84-86. Class member Daniel Simpson testified that he had purchased four accounts. ECF No. 179-2 at 109-10. Fraser has produced evidence of six other such transactions. ECF No. 179-2 at 501 (Martin Ruzek to Dimitrios Anastasakis), 504 (negotiations between Martin Ruzek and Bart Kant), 507 (Guillaume Barlier), 509 (Nacer Laradji to David Mah), 516 ("limburatorul" to David Mah), 519 (Ian MacPhee).

Private sales of whole accounts were widespread enough that there was a guide for engaging in these transactions on the HashTalk forum. ECF No. 179-2 at 529-31 ("Private Marketplace [Official Guide]."") Also, a GAW representative posted a "Warning About Buying and Selling Accounts" on the forum, expressing concerns that GAW had about the practice. ECF No. 179-2 at 521-27.

In short, while the evidence before the Court indicates that these transactions were not isolated occurrences, it is unclear what portion of the class engaged in them.

Private sales of accounts were typically negotiated and memorialized via email, providing some documentation of the transactions. *See, e.g.*, ECF No. 179-2 at 509. In at least some cases, the escrow agent provided a more formal receipt. *See, e.g.*, ECF No. 179-2 at 501. No party has suggested a method for calculating the aggregate value of accounts sold by class members to third parties.

5. Sales on the GAW Marketplace

Hashlets and Hashstakers could also be sold to third parties on the GAW Miners Marketplace ("GAW Marketplace"). For example, class members Ryan Grimes and Mahendra Phagu testified that they sold hashlets on the GAW Marketplace. ECF No. 179-2 at 165 (Grimes), 544 (Phagu). Phagu further testified that he thought the GAW Marketplace was "very active." *Id.* at 544. It is unclear how many class members actually engaged in this practice.

It is undisputed that sales on the GAW Marketplace were documented in the ZenCloud database, although Fraser questions the reliability of this database. ECF No. 179-1 at 17; ECF No. 191 at 19. The methodology suggested by the Plaintiffs' expert for calculating aggregate damages, which is based on the ZenCloud database, appears to account for these transactions.

C. Netting Gains and Losses for Individuals with Multiple Accounts

Fraser argues that, for individuals who had multiple ZenCloud accounts, some of which made money, these gains should be used to offset any losses. Of the 173 people who submitted documents to Shinners, 31 indicated they had multiple accounts. *See* ECF No. 179-2 at 243-46 (ID Numbers 2, 13, 17, 33, 35, 36, 44, 49, 53, 54, 55, 58, 62, 64, 66, 67, 75, 81, 85, 92, 98, 12, 107, 127, 128, 129, 141, 143, 156, 161, 163). According to Fraser's expert, 27 of the 173 class members self-reported ownership of multiple accounts, and 11 of these 27 owned at least one account that incurred losses and at least one account that realized gains. ECF No. 179-2 at 227. Fraser's expert opined that netting gains and losses for these 27 individuals would reduce their damages by $75,163. *Id.*

***6** Individuals often obtained multiple accounts by purchasing whole accounts from third parties. *See, e.g.*, ECF No. 179-2 at 109-10, 243 (Daniel Simpson). As discussed above, such transactions were often negotiated and memorialized via email, *see, e.g.*, ECF No. 179-2 at 509, and in some cases, escrow agents provided more formal receipts, *see, e.g., id.* at 501.

The ZenCloud database can, at least to some extent, be used to identify individuals with multiple accounts based on identifying information stored in the database. For example, Fraser's expert was able to identify additional, undisclosed accounts apparently owned by Named Plaintiff Michael Pfeiffer. ECF No. 179-1. According to Fraser's expert, however, these data are inadequate to link together all of the accounts owned by each class member. ECF No. 179-2 at 227.

Although the Plaintiffs contend that the law does not require netting gains and losses across multiple accounts, the Plaintiffs' expert opined that, if necessary, the aggregate value of this offset can be estimated using the ZenCloud database by netting gains and losses across all accounts as if they were owned by a single individual. ECF No. 179-2 at 622-23. Such an approach would understate damages, however, because it is likely that at least some accounts with gains were owned by individuals with no other accounts.

III. DISCUSSION

Before oral argument, I notified the parties that they should be prepared to discuss the possibility of bifurcating liability and damages and trying the liability issues first, in addition to the motion for decertification. ECF No. 203. At oral argument, the parties indicated their amenability to bifurcation. [13] For the reasons that follow, I now adopt this approach, bifurcate the proceedings in this case, and deny without prejudice the motion to decertify the class.

13 Both parties indicated, however, that bifurcation was not their first preference, with the Plaintiffs preferring a single trial where a jury could determine an aggregate damages award, and the Defendants favoring decertification of the class as to damages.

Rule 42 provides that, "[f]or convenience, to avoid prejudice, or to expedite and economize, the court may order a separate trial of one or more separate issues, claims, crossclaims, counterclaims, or third-party claims." Fed. R. Civ. P. 42(b). District Courts in the Second Circuit enjoy broad discretion in determining whether to bifurcate a trial. *See, e.g.*, *Johnson v. Celotex Corp.*, 899 F.2d 1281, 1289 (2d Cir. 1990) ("The decision to bifurcate is within the discretion of the trial judge."). "In exercising its discretion, however, the court must consider—as the rule indicates—whether bifurcation would (1) avoid unfair prejudice to a party, (2) provide for convenience, and (3) expedite the proceedings and be more economical." *Carson v. City of Syracuse*, 1993 WL 260676, at *2 (N.D.N.Y. July 7, 1993); *see also* 4 Newberg on Class Actions § 11:5 (5th ed.) (indicating that "courts may consider a variety of factors," and "no one test [has emerged] as most prevalent," but that "[w]hat the tests share is a focus on economy and prejudice").

In the class action context, Courts often bifurcate the determination of liability and damages where individual inquiries are required to determine damages. *See, e.g., In re Playmobil Antitrust Litig.*, 35 F. Supp. 2d 231, 248 (E.D.N.Y. 1998) ("[The damages] inquiry, however, is likely to require individualized proof. Accordingly, the Court finds that the most efficient way to proceed in this case is to bifurcate the trial of these actions."); *In re Master Key Antitrust Litigation*, 70 F.R.D. 23, 28-29 (D. Conn. 1975) (bifurcating liability and damages in a class action because "the proof as to damages is likely to be much more individualized" and, "if we must reach it, may be easily resolved only by reference to a special master or through a long series of separate minitrials"); *see also Simon v. Philip Morris Incorporated*, 200 F.R.D. 21, 39 (E.D.N.Y. 2001) ("The court of appeals for the Second Circuit has supported the trial judge's power to sever issues for trial before separate juries in class action lawsuits under Rule 42(b) and 23(c)(4)(A) so long as there are proper safeguards.").

***7** Here, too, bifurcation of liability and damages is warranted. First, a combined trial on liability and damages, resulting in a jury verdict awarding aggregate damages to the Plaintiffs, is likely to prejudice Fraser. The evidence before the Court suggests that the proper measure of damages likely requires accounting for multiple, substantial offsets. The Plaintiffs have proposed a reasonably accurate method for calculating the aggregate value of some of these offsets. At least the chargebacks, however, appear to defy reasonable estimation on an aggregate basis. A material number of class members have indicated that they received chargebacks, or credit card refunds, related to their purchases of GAW products. Some class members indicated that they recovered the entirety of their investment. ECF No. 179-1 at 140-47. Another class member testified that she recovered around $100,000 of her roughly $300,000 investment. ECF No. 179-2 at 98. Data collected by Named Plaintiff Dean Allen Shinners indicates that approximately 8% of class members received chargebacks, ECF No. 191 at 12 (citing ECF No. 191-3), but there is some evidence suggesting that this figure understates the number of class members who received chargebacks. Despite this evidence suggesting a material number of chargebacks, the Plaintiffs have not articulated any reasonably accurate method by which a jury might calculate the aggregate value of these chargebacks. [14]

14 Plaintiffs also have not proposed any method for calculating aggregate damages for purchases of Paycoin and Hashpoints from GAW.

While "[a]ggregate computation of class monetary relief is lawful and proper" and "[c]ourts have not required absolute precision as to damages," *Hart v. Rick's Cabaret Intern., Inc.*, 73 F. Supp. 3d 382, 391 (S.D.N.Y. 2014) (quoting 3 Herbert B. Newberg & Alba Conte, *Newberg on Class Actions* § 10.5, at 483-86 (4th ed. 2002)), a District Court must nonetheless "ensure that the damages awards roughly reflect the aggregate amount owed to class members." *Hickory Securities Ltd. v. Republic of Argentina*, 493 Fed. Appx. 156, 159 (2d Cir. 2012) (quoting *Seijas v. Republic of Argentina*, 606 F.3d 53, 58-59 (2d Cir. 2010)); *see also id.* at 160 (If "an aggregate approach cannot produce a reasonable approximation of the actual loss, the district court must adopt

an individualized approach."). Moreover, the Second Circuit has rejected "[r]oughly estimating the gross damages to the class as a whole and only subsequently allowing for the processing of individual claims" because such an approach "would inevitably alter defendants' substantive right to pay damages reflective of their actual liability." *McLaughlin v. American Tobacco Co.*, 522 F.3d 215, 231 (2d Cir. 2008).

Bifurcating also serves the interests of judicial economy. After a trial on liability, the Court will have before it a more fulsome factual record and will be better positioned to determine how best to structure the subsequent proceedings. Moreover, depending on which of their claims the Plaintiffs prevail on (if any), the relevant measure of damages may differ in material respects, which may also impact the best approach to determining damages. And in the event that Fraser prevails at the liability stage, the need to decide on a method for determining damages will of course be obviated entirely.

Bifurcation subject to a later decision regarding how to proceed with the damages phase is not uncommon in the class action context. *See, e.g., In re Playmobil Antitrust Litig.*, 35 F. Supp. 2d 231, 248 (E.D.N.Y. 1998) ("[T]he most efficient way to proceed in this case is to bifurcate.... In the event that the jury finds the Defendant liable, the Court will then reconsider the issue of whether class treatment of damages is feasible. At that point, the Court has a number of options, including utilizing a formula to calculate damages, referring the damage issues to a special master or trying these issues, perhaps after certifying appropriate subclasses, if necessary." (quotation marks and internal citations omitted)); *Houser v. Pritzker*, 28 F. Supp. 3d 222, 254 (S.D.N.Y. 2014) ("If and when the litigation reaches [the damages] stage, the Court will have a number of management tools at its disposal to help resolve these issues. For example, the Court could appoint a special master to preside over individual damages proceedings, or could decertify the class after the liability phase and provide notice to plaintiffs as to how to proceed to prove damages. ... There is no need to decide at this time which avenue to pursue." (citation omitted)); *see also In re Visa Check/MasterMoney Antitrust Litig.*, 280 F.3d 124, 141 (2d Cir. 2001) ("There are a number of management tools available to a district court to address any individualized damages issues that might arise in a class action, including: (1) bifurcating liability and damage trials with the same or different juries; (2) appointing a magistrate judge or special master to preside over individual damages proceedings; (3) decertifying the class after the liability trial and providing notice to class members concerning how they may proceed to prove damages; (4) creating subclasses; or (5) altering or amending the class." (footnotes omitted)).

***8** In short, taking into account the likelihood of prejudice to Fraser as well as considerations of judicial economy, I find that this case warrants bifurcation. In light of this, Fraser's motion to decertify is DENIED without prejudice. The Court will determine how to structure the damages phase of this case—including whether individual damages issues predominate over all common issues, such that decertification as to damages is warranted—if and when the question of liability is resolved in the Plaintiffs' favor.

IV. CONCLUSION

For the foregoing reasons, Fraser's motion to decertify the class as to damages is DENIED without prejudice. This case will proceed on a bifurcated basis, and the trial currently scheduled for August will be focused on liability.

Significant questions remain regarding the scope of the liability trial and the extent to which it should include some issues related to damages that might be resolvable on a class-wide basis. On these questions the Court would benefit from further briefing. By **May 25, 2020**, the parties are directed to submit supplemental briefs of no more than **twenty-five pages** addressing the following issues:

- Should any discrete issues pertaining to damages be determined by the jury in the class-wide liability trial? For example, should the reliability of the ZenCloud database be determined by the jury? Which other damages-related issues, if any, should be determined in the class-wide liability trial? The parties should also address whether trying any such issues during the liability phase raises concerns under the Reexamination Clause of the Seventh Amendment.

- What questions should the Court decide as a matter of law during the liability phase of this case? Of these, which questions should the Court decide prior to trial, and which questions should it decide after hearing the evidence but prior to approving the final jury instructions? Each party should address the merits of any questions it would have the Court decide prior to trial.

Reply briefs of no more than **ten pages** will be due by **June 8, 2020**.

Finally, as the Court discussed with the parties at the conclusion of oral argument, although the trial remains scheduled for August 5, 2020, and the Court has set other trial-related deadlines, there is some uncertainty about these dates at this time because of the current pandemic. In addition, the Court recognizes that the briefing schedule set forth above will require the parties to incur additional time and expense in litigating this case. Therefore, if the parties would prefer to use the next month or two to engage in any settlement discussions, the Court is prepared to accommodate such a request, and would even consider moving the trial date if that is necessary. Should the parties wish to make such a request, they must file, within **14 days** of this ruling, a joint statement certifying that (1) counsel have conferred with their clients and each other, (2) the parties wish to proceed to mediation, (3) the parties are willing to participate in settlement efforts at such mediation in good faith, and (4) counsel believe that a mediation stands at least a reasonable chance of resolving the case without trial. Any such statement should also indicate whether the parties seek the Court's assistance in arranging for a mediator (i.e., a U.S. Magistrate Judge or Court-appointed Parajudicial Officer) or whether they wish to pursue private mediation on their own.

IT IS SO ORDERED.

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Denis Marc AUDET, Michael Pfeiffer, and Dean Allen Shinners, Plaintiffs,
v.
Stuart A. FRASER, Defendant.

No. 3:16-cv-940 (MPS)
|
Signed 06/03/2022

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RULING ON POST-VERDICT MOTIONS

Michael P. Shea, UNITED STATES DISTRICT JUDGE

I. Introduction

***1** In this case alleging securities law violations and common law fraud arising out of a cryptocurrency mining company's sale of various cryptocurrency-related products, the jury returned a verdict for the defendant, Stuart Fraser, after eight days of evidence. The plaintiffs have filed a motion for judgment as a matter of law and, in the alternative, for a new trial on their securities claims. ECF No. 351. For the reasons set forth below, I deny their motion for judgment as a matter of law and grant in part and deny in part their motion for a new trial.

II. Procedural History

At trial, the plaintiffs asserted five claims against Fraser: (1) control person liability for GAW Miners, LLC's (the "Company" or "GAW") sale of unregistered securities in violation of the Connecticut Uniform Securities Act ("CUSA"); (2) control person liability for the Company's fraud in the offer or sale of securities in violation of the CUSA; (3) liability for aiding and abetting the Company's fraud in the offer or sale of securities in violation of the CUSA; (4) control person liability for the Company's fraud in the offer or sale of securities in violation of the Federal Securities Exchange Act; and (5) liability for aiding and abetting the Company's common law fraud. ECF No. 326 at 19-20. To find for the plaintiffs on any of the first four counts, the jury had to find first that one or more of four products sold by the Company—Hashlets, Paycoin, HashStakers, and Hashpoints (the "Products")—were securities and, more specifically, that they were "investment contracts."

Both parties made motions for judgment as a matter of law under Rule 50(a) before Fraser rested his case. ECF No. 354. Plaintiffs' Rule 50(a) motion sought judgment as a matter of law on the affirmative defenses Fraser asserted against the class representatives. *Id.* at 27, 32-43. Fraser's motion sought judgment as a matter of law on each of the plaintiffs' claims against him. *Id.* at 11. I reserved ruling on both motions. *Id.* at 32, 49.

The case was submitted to the jury, which returned a verdict for Fraser on all counts. With respect to the securities claims (the first four counts), the jury concluded that none of the four Products were investment contracts and thus none were securities. ECF No. 330 at 2. Despite not making a Rule 50(a) motion arguing that the Products *were* investment contracts, the plaintiffs have now filed a Rule 50(b) motion that raises that argument, as well as a motion for a new trial under Rule 59 arguing that the jury's finding that the Products were not investment contracts was against the weight of the evidence. ECF No. 351. [1] I heard oral argument on the motions on May 26, 2022.

1 The plaintiffs do not seek judgment as a matter of law or a new trial on the common law fraud claim.

III. Evidence at Trial

To assess Plaintiffs' motions, it is necessary to discuss the trial evidence regarding each of the four Products in some detail.

A. Hashlets

At trial, the parties presented a variety of testimony and other evidence regarding what, exactly, Hashlets were. For example, Audet agreed during his testimony that a Hashlet was "either a stand-alone physical machine or part of a physical machine that was mining for cryptocurrency," ECF No. 359-2 at 43.[2] On its website on August 18, 2014, GAW described Hashlets as miners, i.e., computers that mine for cryptocurrency: "Hashlet is the world's first Digital Cloud Miner (DCM), perfectly optimized to thrive in large, controlled datacenters and achieve massive economies of scale. All Hashlets are hosted in the most robust mining data center in the world ...." ECF No. 351-11 at 4. Likewise, an August 21, 2014 press release referred to a Hashlet as a "Bitcoin miner." ECF No. 351-10 at 2.

2 Although Audet also testified on direct that he "understood Hashlets to be a slice of the total computing power that was in the – by the equipment in a GAW Miners' data center," ECF No. 363-2 at 9-10, and at the start of cross that he "understood [he] was buying a slice of the computing power," ECF No. 346 at 115, he agreed after reviewing his deposition testimony that a Hashlet was either a physical machine or a part of a physical machine.

***2** Other witnesses testified that Hashlet purchasers were buying a "share of" or a "certain percentage or amount of" the mining power at GAW's mining farm. ECF No. 359-2 at 54 (Shinners's testimony that he "was definitely buying a specific quantifiable share of mining power that was at the mining farm" when he purchased a Hashlet); *id.* at 55 (Pfeiffer's testimony that he "understood Hashlets to be a contract to own a certain percentage or amount of ... the mining power of the mining machines ... that GAW Miners held ... in their data centers.).

Still other evidence suggested that Hashlet purchasers were buying a share of the profits of GAW's mining activities. *See* ECF No. 351-4 at 8 (Plaintiffs' expert's testimony that Hashlet customers were told that they were purchasing the "right to profit from a slice of computing power or mining power owned by GAW."). Fraser likewise agreed that a Hashlet owner "would be entitled to a portion of the cryptocurrency that was being mined by GAW Miners." *Id.* at 33 (Q: "And you understood, therefore, that the purchaser of a Hashlet would be entitled to a portion of the cryptocurrency that was being mined by GAW Miners; correct?" A: "That's my understanding, yes, sir."). The jury also learned that the plea agreement signed by GAW's CEO, Josh Garza, related to his federal conviction for wire fraud defined Hashlets as "the rights to profit from a slice of the computing power owned by GAW Miners," ECF No. 351-8 at 10, and that the SEC complaint against Garza and GAW described Hashlets as follows:

> Buying a Hashlet entitled an investor to a share of the profits that GAW Miners ... would purportedly earn by mining virtual currencies using the computers that were maintained in their data centers. Hashlets were purported to earn a return based on the number of virtual currency units generated when the pools to which their computing power was directed succeeded in processing and confirming virtual currency transactions .... [A] Hashlet was "a divisible and assignable allocation of hashing power from GAW-owned and hosted mining hardware" .... Unlike Cloud Hosted Mining customers, Hashlet customers were not buying computer hardware ... Hashlet customers were buying the rights to profit from a slice of the computing power owned by GAW Miners ...

ECF No. 351-3 at ¶¶ 38-39.

The jury also heard evidence regarding the Company's role in the mining process. Audet testified that the Company was responsible for hosting, running, and maintaining the mining machines. ECF No. 351-4 at 50 (Q: "And you understood that what the companies would be doing ... is hosting those machines, those miners, and running them and maintaining them; is that correct?" A: "That's correct, yes."). Fraser agreed during his testimony that "Hashlet customers were relying on GAW Miners' expertise to own and operate the mining equipment that would support the Hashlets." *Id.* at 33. Dr. Narayanan, the plaintiffs' expert, testified that operation of mining equipment from home "requires a lot of know-how" because "it's a messy, technical process" and that, as a result, mining data centers like that purportedly run by GAW offered a "data center operator" that "would provide the space for all of these machines, provide the electricity for the machines, provide the know-how for operating and perhaps upgrading the machines." *Id.* at 9-10. In August 2014, GAW advertised on its website that "[d]atacenters cut power costs in half, maximize uptime, and save you from having noisy miners in your home .... All Hashlets are hosted in the most robust data center in the world and come with a 99.9% uptime guarantee." ECF No. 351-11 at 4.

***3** The Company promoted Hashlets as easy to use, and both Audet and Pfeiffer testified that they were interested

in purchasing Hashlets for that reason. An August 21, 2014 GAW Miners press release included the following quote from Garza: "Hashlets are different. If you can open an email you can operate a Hashlet .... Hashlet is grandma-approved!" ECF No. 351-10 at 2; *see also* ECF No. 351-4 at 27 (Fraser's testimony that the Hashlet "tag line" was that it was "grandma proof"); ECF No. 351-11 at 3 (statement on GAW Miners' website that "If you can open an email you can setup and operate a Hashlet."). Audet testified that Hashlets' "ease" appealed to him, stating "[t]hey were very convenient to set up. You just basically bought them, and they were ready to go. They started mining Bitcoins immediately once you activated them." ECF No. 351-4 at 39. Pfeiffer also testified that Hashlets were "easy to use," described as "grandma proof or grandma friendly," and "didn't require a lot of technical expertise." *Id.* at 72. He observed that "GAW Miners sort of seemed to have their finger on the pulse of something that was keeping mining only to the domain of the people who were, like technicians, and um, sort of geeks rather than the general public.... [T]hey recognized the limitation and they were trying to solve that." *Id.* The SEC complaint also emphasized the minimal effort required of Hashlet investors and the Companies' control over the mining process:

> Hashlet investors were required to do very little to purportedly mine virtual currency. Investors only needed to log into their ... accounts and click-and-drag their Hashlet icons over the icons of the mining pools in which they wished their Hashlets to mine. From there, investors relied solely on the efforts of GAW Miners ... to generate Hashlets' expected profits by owning, housing, operating, maintaining, and connecting the computer hardware that would engage in mining ...

ECF No. 351-3 at ¶ 40.

The jury heard testimony from Audet, Pfeiffer, and Dr. Narayanan that Hashlet owners could select the pools in which their Hashlets mined. Audet testified as follows:

> Q Okay. Now you could pick the pool – you, as a customer of GAW Miners and a Hashlet owner, could pick the pool in which you were mining your Hashlets; is that correct?
>
> A That's correct, yes.
>
> Q So if you and I both owned the same kind of Hashlet, let's say you chose to mine it in the Clevermining pool and I decided to mine it in the Waffle mining pool, we could have very different payouts; correct?
>
> A That's correct, yes.
>
> Q You could do really well one day, and I could do really poorly; correct?
>
> A In theory, yes.
>
> Q Now, you could also change your pools with your Hashlets; is that correct?
>
> A That's correct, yes.
>
> Q So the idea was that you could get up in the morning, you could check the payout rates for different pools and just switch the pool that your Hashlet was mining in; correct?
>
> A That's correct, yes.
>
> Q And you, in fact, did that; right? You would check your payouts daily; is that correct?
>
> A That's right, yes.
>
> [...]
>
> Q You, in fact, did keep track of the payouts and switched the pools that you were mining in; correct?
>
> A That's correct, yes.

ECF No. 359-2 at 46-47. Pfeiffer likewise acknowledged that Hashlet owners at least ostensibly had some control over the mining power:

> Q Okay. You had the choice to direct your mining power in certain ways?
>
> A Ostensibly.
>
> Q And you could change your allocation on a daily basis if you so chose; right?
>
> A I believe so.

Id. at 63. Dr. Narayanan also testified that Hashlet owners had some ability to select the pools in which their Hashlets mined:

> Q Is it also the case that, with respect to Hashlets, customers could choose from different pools?
>
> A I believe – my understanding is that there was a limited ability to choose pools.
>
> Q Each pool could be – withdraw. The mining power from each different pool could be targeted to something different than another pool; correct?
>
> A Different pools could mine for different cryptocurrencies. It could be Bitcoin; it could be a different cryptocurrency.
>
> Q So one customer of GAW Miners could choose to direct the mining power to one type of cryptocurrency while another customer might direct its mining power to a different cryptocurrency; correct?
>
> A I believe that was possible, yes.
>
> Q The customer in that way had the ability to determine how his or her money would be used; correct?
>
> A That's how it was represented, yes.
>
> Q Is it also your understanding, sir, that customers could change the allocation of their mining power on a daily basis?
>
> ***4** A I don't know if it was on a daily basis, but my understanding is that there was some ability to change the allocation of the mining power, yes.

Id. at 22-23. He also testified that these mining pools included people who were not customers of GAW Miners:

> Q Was it your understanding that the pools to which people could focus their mining power included customers outside of GAW Miners?
>
> A I believe that was the case for at least some of the pools, yes.
>
> Q So if a customer buys a Hashlet and focuses its mining power into a specific pool, there could be people around the world in that pool who are not customers of GAW Miners.
>
> A Yes, sir.

Id. at 24-25.

The jury also heard testimony that Hashlet owners could "boost" their Hashlets to receive a higher payout. Audet testified regarding boosting as follows:

> Q Now, another way that you could impact your payouts was by something known as boosting; correct?
>
> A Yes.
>
> Q Okay. So the idea was that every day you could log onto the GAW Miners' website, click a button, and boost your Hashlet; correct?
>
> A That's right, yes.
>
> Q And it would pay out more than if you don't boost your Hashlet; correct?
>
> A That's correct, yes.
>
> Q Okay. So, again, taking the same example, if you and I owned the same Hashlet, which is mining in the same pool but you boost your Hashlets every day, you could make more in payouts than I would; correct?
>
> A Probably, yes.

Id. at 48.

Finally, the jury heard evidence regarding the fees GAW received from the Hashlet owners. First, the customer would pay a fee to acquire the Hashlet. *Id.* at 21 (Dr. Narayanan's testimony), 59-60 (Pfeiffer's testimony). Then, GAW would charge Hashlet owners "an ongoing maintenance fee in order to maintain and operate the equipment." ECF No. 351-4 at 75. Pfeiffer testified as follows regarding that fee:

> Q So that machine would generate some kind of cryptocurrency coin, and the return that you got would be that coin minus your maintenance fee; correct?
>
> A That's correct.
>
> Q The maintenance fee wouldn't change depending on how much coin the machine had generated; correct?
>
> A That's almost right.
>
> Q And where is the -- where's the little bit that stops you from saying it's completely accurate?
>
> A GAW had a policy and practice that when there was mining --and so say the mining revenues were a dollar and

> they charged a revenue of -- sorry -- a maintenance fee of 15 cents. You would get the difference, 85 cents. But if the mining revenue were, say, you know, 15 cents, um, they would still charge you 15 cents. You would just get like the smallest fraction, which was like one ten million[th] of a Bitcoin. And that's the amount you would get as your daily payout for that Hashlet would be one ... ten million[th], I think, of a Bitcoin.
>
> Q So -- and when you explained, the fee itself didn't change; correct? As you said, it would still be the 15 would be the fee. But if the fee happened to cover everything that had been generated, they would give you a fraction of a penny essentially as a return.
>
> A That's right.
>
> Q But the fee itself didn't change; right?
>
> A I guess that's right.

Id. at 76-77. He further testified:

> Q Would you similarly get a tiny payout if the maintenance fee were 15 cents and your original reward were zero?
>
> ***5** A That's my understanding, yes.
>
> Q So if you did not make a profit from a Hashlet on a particular day, GAW would not receive anything from you either?
>
> A That's correct.
>
> Q And, therefore -- so if you did not make a profit from a Hashlet on a particular day, GAW would not profit that day either.
>
> A That's correct.

Id. at 78. At his deposition, Audet also testified that the fee was fixed, although he did not testify that the full fee was not charged if the cryptocurrency amount earned was less than the amount of the fee:

> Q So you didn't know if the fee was 10 percent one day and then 50 percent another day?
>
> A I don't recall, no. I think the fee was a fixed cost thing based on the cost of electricity and running, you know, the -- to run the establishment -- no -- the server farm where all these machines were being used or stored and run. So it was sort of like a fixed cost. So the percentage doesn't -- you know, one day if you had a big payout, the fee was relatively small. If you had a small payout, then it was large. But GAW always took their fee out first and then anything left over was your payout. I don't remember if they actually published the fee. I think they just gave you your payout.
>
> Q Did the fees vary based on the different types of Hashlets or Hashstakers or GAW products?
>
> A I don't know. I don't know how they priced it.

ECF No. 359-4 at 3. *See also* ECF No. 359-2 at 45 (Audet's trial testimony that he "believed back then [at his deposition]" that "the service fee that GAW Miners charged for running and operating the miners was a fixed fee."). At trial, before reviewing his deposition testimony, Audet testified that he believed the fee was proportional to the amount of the payout the Hashlet owner received:

> Q And then they also charged you a maintenance fee for operating the miners; correct?
>
> A They called it a service fee. It was proportional to the payout.
>
> Q So they charged you a service fee. And your testimony here today is that it was proportional to your payout?
>
> A I -- like I said, it was six years ago. I think it was proportional -- you know, yes, I think it was related to – it was a fixed fee. I think it was proportional to the payout you got that day.
>
> Q Would you be surprised, Mr. Audet, to learn that three years ago when you testified, you testified that it was a fixed fee?
>
> A No, I wouldn't be surprised, no.

Id. at 44. When shown his deposition testimony, Audet testified that he believed at the time of the deposition that the maintenance fee was a fixed amount. *Id.* at 45.

The plaintiffs' expert testified at trial that he was not sure whether GAW earned any profits from mining separate from the Hashlet acquisition and service fees (by, for example, participating in the mining pools in which its customers ostensibly mined their Hashlets). *See* ECF No. 344 at 12-13.

B. Paycoin

i. GAW's Promotion of Paycoin

In the fall of 2014, GAW Miners announced the launch of a new cryptocurrency called Paycoin. *See* ECF No. 351-22 at 2 (October 29, 2014 email in which Fraser forwarded a GAW Miners' announcement that "HashCoin [3] [wa]s coming!" and wrote "NEW WORLD COMING! ICO!!"). The jury saw evidence of various efforts by the Company to promote Paycoin. On its website, GAW promoted Paycoin as follows:

> ***6** No cryptocurrency in history has had the financial backing of a company with the capital and resources of [Paycoin], ever. Driving adoption has always been the most difficult task facing any new technology, including cryptocurrency. We will be placing industry-changing resources behind this effort and committed to making [Paycoin] a success. 100% of the revenue from [Paycoin's] release and continued use go directly to [a] Coin Adoption Fund to further back the efforts of dedicated, full-time staff to ensure that [Paycoin] enjoys the type of wide-spread visibility and use that other cryptocurrencies, including bitcoin, have lacked.

ECF No. 351-16 at 2. GAW emphasized merchant adoption of Paycoin as key to Paycoin's long-term success:

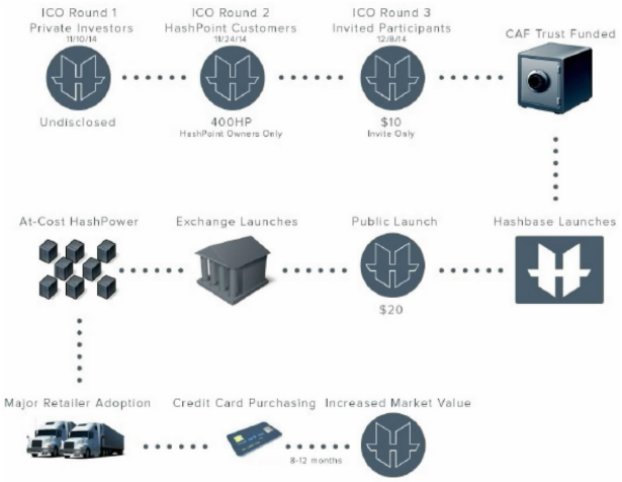
> While grassroots campaigns have seen some limited success in the past, the missing piece of the puzzle is a truly professional, fully-funded effort to ensure that a new crypto payment technology reaches the widest range of merchants possible. [Paycoin]'s ICO fills in the missing piece by supporting continual adoption efforts .... Ultimately, [Paycoin]'s long-term value will be pinned on not only merchants adopting it as a consumer payment method, but also on transactions with suppliers and vendors with [Paycoin].

Id. It included a graphic illustrating how it planned to use funds accrued via the ICO to grow Paycoin:

3 Paycoin was initially referred to as Hashcoin. ECF No. 351-13 at 3 (noting that Paycoin was "previously codenamed 'Hashcoin' ").

Id. at 3. GAW issued a whitepaper that, like the graphic above, emphasized that Paycoin's creation of the Coin Adoption Fund ("CAF") via its Initial Coin Offering ("ICO") made it "unique among cryptocurrencies" and stated that the CAF funds would be used to promote adoption, maintain the fiat reserve, and develop hardware to distribute to Paycoin miners. ECF No. 351-15 at 8.

GAW also issued a timeline, beginning with the ICO and leading to a Paycoin public launch, the launch of the Hashbase (later, Paybase) platform, retailer adoption and, ultimately, "increased market value" for Paycoin:



351-16 at 3-4. A November 24, 2014 GAW Miners press release similarly emphasized the way in which GAW Miners would use the ICO funds to support Paycoin's adoption, quoting Garza:

> [A]ll existing cryptocurrencies have failed to achieve an adoption path leading to mainstream use .... [C]hanging the world economy from fiat to cryptocurrency required enormous effort. A decentralized currency leaves behind no parties with a financial incentive to do the work needed in order to promote global adoption. Until now that is. Paycoin's ICO fills in the missing piece by supporting continual adoption efforts allowing us to be the first to both legitimize and bring cryptocurrency to the mass market.

ECF No. 351-14 at 3-4.

The Company also stated that Paycoin was backed by a $100 million reserve, and that it would maintain a $20 price floor for Paycoin after its public launch. *See* ECF Nos. 351-16 at 4 (Paycoin launch timeline noting $20 price at public launch); 351-23 at 2 (Fraser retweet of GAW Miners' January 12, 2015 tweet stating "PayBase Honors $20 Paycoin"); 351-13 at 3 (November 25, 2014 Wall Street Journal article stating that "[w]hen the coin opens to the public on Jan. 2 ... the company will partly back [it] with a store of fiat currency worth around $100 million. While those funds won't function as a 100% reserve, they will combine with added features within the Paycoin protocol, including a supply schedule that fluctuates depending on the level of miner demand, to reduce exchange-rate volatility and thus seek to resolve one of bitcoin's biggest barriers to mass adoption.") At trial, Fraser testified that GAW advertised that it would use its $100 million fund to keep the price of Paycoin over $20. ECF No. 351-4 at 35 (agreeing that it was "[m]ore or less" correct that "GAW Miners had been advertising that it would use its $100 million fund to keep the price of Paycoin over $20").

ii. The Launch of Paybase & Paycoin's Price Decline

***7** GAW launched Paybase in January 2015. *See* ECF No. 351-4 at 67 (Shinners's trial testimony that "Paybase was another platform that was integral in order for all of these promises GAW Miners had made to, you know, come to fruition, meaning that they would be delivered after the first of the year in 2015"); *id.* at 56 (Audet's trial testimony that Paycoin's $20 price floor "was going to be supported when this thing called Paybase was going to be launched, and that was in January [2015]"). Shinners testified at trial that Paybase was intended to function as "the whole backbone ... for things like merchant adoption, for an exchange, an active exchange, the Paycoin $20 floor, etc., etc." *Id.* at 67. Dr. Narayanan also testified that Paybase was supposed to function as the mechanism that would allow merchant adoption to occur:

> GAW Miners released a payment platform called Paybase. Now, in general, a payment platform is an intermediary that sits between users and merchants in order to make transactions easier in Paycoin or whatever other cryptocurrency. Specifically, with Paybase, GAW Miners promised that Paybase could be used to be able to make purchases at retailers like Target and Walmarts. And this would be one potential way to increase the usefulness and potentially the value of Paycoin for all of its users.

ECF No. 343 at 61-62. Shinners testified that, contrary to GAW's promises, when Paybase was deployed "after the new year in 2015," "there was no merchant adoption. There was

no exchange at all. And, yeah, it was – fundamentally it was just an online wallet basically." ECF No. 351-4 at 64; *see id.* at 69 (Shinners's trial testimony that, "after the new year in 2015, the only thing that was there was an online wallet, a place to store your Paycoin and nothing else.")

After the new year, Paycoin continued to trade, but its price fell swiftly. ECF No. 351-20 (Coinmarketcap.com record showing Paycoin's opening price at $12.39 on December 31, $9.97 on January 1, $4.34 on January 5, $3.05 on January 15, $2.22 on January 25, and $1.87 on January 31). Paycoin's price opened below $1.00 on February 14. *Id.* at 12. By April, its price hovered at or below 50 cents, *id.* at 10-11, and by June it was at or below 10 cents, *id.* at 9.

iii. Evidence Regarding Whether Paycoin Was a "Centralized" Cryptocurrency

Dr. Narayanan opined that his consideration of four factors led him to conclude that Paycoin was a highly centralized cryptocurrency. Those factors were: Paycoin's software, the concentration of currency ownership, the concentration of mining power, and the trading and payment ecosystem.

With respect to Paycoin's software, Dr. Narayanan testified:

> The software behind a cryptocurrency is available for anyone to look at. And anyone can propose changes to the software. Now, in a cryptocurrency like Bitcoin, there is usually a process based on careful deliberation and consensus for determining which of those changes will make it into the next version of the cryptocurrency. In Paycoin, in contrast, what I found is that GAW Miners released the software under its own online account. GAW Miners exercised unilateral control over updates to the software and was able to make changes to the cryptocurrency, to the rules of the cryptocurrency, without any notice or advance deliberation.

ECF No. 343 at 58. He agreed on cross examination that Paycoin was "open source," that "[a]nybody could see the source code" and "suggest improvement to the source code" or "suggest fixes to the source code." ECF No. 359-2 at 28.

With respect to the concentration of Paycoin ownership, Dr. Narayanan testified that GAW owned 96 percent of the initial allotment of Paycoin:

> GAW Miners announced that it was creating an initial allotment of 12.5 million units of the cryptocurrency, 12.5 million units of Paycoin, and that of these 12.5 million units, it had allotted 12 million units to itself to do as it saw fit. So that's 96 percent. That an extremely high level of concentration around currency ownership .... GAW said that a portion of those 12 million would be used for paying investors, and a portion of it would be used for paying previous customers in exchange for something called Hashpoints.

***8** ECF No. 343 at 59. He noted that this factor was "particularly important in a proof of stake cryptocurrency ... because ... whoever controls a lot of stake in the system has a lot of control over the mining process and, in turn, over the blockchain. They would have control over what is considered a legitimate or illegitimate cryptocurrency transaction." *Id.* at 58-59. [4]

4 According to Dr. Narayanan, Paycoin was a "proof of stake" cryptocurrency (unlike Bitcoin, which is a "proof of work" cryptocurrency). ECF No. 343 at 56. With a proof of work cryptocurrency, "miners who have a lot of computational power have more of a chance to add blocks to the blockchain and get a reward in exchange." *Id.* In contrast, with a proof of stake currency, "miners or entities who own a lot of coins in the system, that is, a lot of units of the cryptocurrency, that is, entities who have a lot of stake in the system, are going to be the ones who have a higher chance to put in blocks into

> the blockchain and earn rewards as a result." *Id.* at 56-57.
>
> While Dr. Narayanan testified that Paycoin was a proof of stake cryptocurrency, the jury also heard testimony that Paycoin began as a proof of work cryptocurrency. Two witnesses, both former employees of GAW, testified at their depositions that Paycoin began as a proof of work currency. ECF No. 359-5 at 5 (deposition testimony of Madeline Eden that "[i]nitially, [Paycoin] was a work block chain .... I don't remember for how long exactly"); 359-6 at 11 (deposition testimony of Jonah Dorman confirming that Paycoin would "transition from proof-of-work to proof-of-stake ... by the mining of an initial preset amount of coins," and that "anybody could download the software necessary to mine Paycoin during the proof-of-work phase"). According to Eden, the "ledger for Paycoin [was] decentralized" as a result. ECF No. 359-5 at 5.

With respect to concentration of mining power, Dr. Narayanan testified:

> GAW had created a number of special Paycoin accounts, 50 Paycoin accounts, which had a much higher degree of returns to stake compared to normal Paycoin accounts—in fact, 70 times higher returns to stake. And because they had so much control over – over the stake in the system, these 50 accounts, by the way, were primarily controlled by GAW itself. And because of that, they were set up to have the majority of control over Paycoin mining, in turn, over the Paycoin blockchain.

Id. at 60.

With respect to the trading and payment ecosystem, Dr. Narayanan testified that, "[f]or a cryptocurrency to be useful, customers have to be able to purchase it and trade it, such as on an exchange. Customers also have to be able to make payments using the cryptocurrency, for example, on a retailer's website." *Id.* He testified further that "GAW promised that it had a hundred million dollar reserve called a Coin Adoption Fund, and this would be used to promote the adoption of Paycoin. One of the things that GAW said it would do with this fund is to purchase Paycoin on exchanges as necessary so that the price of Paycoin would stay at or above $20 for everyone." *Id.* at 61. He acknowledged that while GAW promised to control the prices on the public exchanges, he "ha[d] not seen evidence that they actually did." ECF No. 359-2 at 29. He also pointed to the Paybase platform as a component of Paycoin's payment ecosystem that would be controlled by GAW. ECF No. 343 at 61-62.

***9** Paycoin traded on public exchanges not controlled by GAW Miners. ECF Nos. 359-2 at 28-29 (Dr. Narayanan's trial testimony) and 40-41 (Audet's trial testimony); 351-20 (Coinmarketcap.com record tracking Paycoin trading on public exchanges). It continued to trade on public exchanges after GAW Miners had demonstrated its inability to support the $20 price floor and after the SEC had announced its investigation of the Company (on January 19, 2015). ECF No. 351-20 at 3-13. Dr. Narayanan acknowledged at trial that "[w]hen a currency is traded on an exchange, a public exchange, its price is determined by market forces." ECF No. 359-2 at 29.

iv. Evidence Regarding Purchasers' Motives in Purchasing Paycoin

The jury saw posts made on GAW's "Hashtalk" forum regarding Paycoin. One poster wrote, "we are positioned to do well if GAW succeeds, so cheer on the team and enjoy the show!" ECF No. 351-21 at 12. Another explained, "the cryptocurrency sector is getting a lot of attention and investment. This stuff is not going away and we have a chance with GAW to be on the leading/bleeding edge of something big. I am willing to risk 3 months income to have a share in something will give me a 5-fold increase on my investment in a few years." *Id.* A third wrote, "GAW is addressing the big issue of price stability of the new coin, and this may be enough to get the coin widely accepted, and in such a case, the whole Paycoin/Paybase would yield good returns. Investing in GAW is risky because it is a start-up venture, however, I am also not investing more than I [c]an afford to lose" *Id.* at 10.

In addition, the class representatives testified regarding their interest in purchasing Paycoin. For example, Audet testified that he purchased Paycoin while its price was below $20 based on GAW's promise of a $20 price floor when Paybase launched:

> Q And why did you continue to buy Paycoin at the time you knew it was below $20?
>
> A Because in December, that was before the initial coin offering; and, therefore, the price was not supported yet. It was going to be supported when this thing called Paybase was going to be launched, and that was in January. And, therefore, everything I bought in December would have been at a discounted price compared to the $20 floor that they were going to provide in whenever they had the initial coin offering or Paybase.

ECF No. 351-4 at 56. Shinners testified that he expected to earn a profit on his Paycoin after Paycoin's public launch:

> Q And does this document depict Hashpoints converting to Paycoin?"
>
> A Uh yes. On the top row, second row from the left, there's – it says "ICO Round 2." "Hashpoint customers." And then below it says "400 Hashpoints."
>
> Q So did you expect that when your Hashpoints converted to Paycoin, that you would have the option of selling them?
>
> A Yes.
>
> Q And based on this document we're looking at, did you expect that you'd be able to earn a profit if you sold them?
>
> A Yes, absolutely.
>
> Q And do you see that somewhere in this diagram?
>
> A Yes. The public launch was for $20. And the – we were told that 400 Hashpoints was actually $4. So the difference between 20 and 4, 16.

Id. at 60-61. Pfeiffer testified that he was interested in GAW's assertion that it "had a $100 million fund to back up [Paycoin] to promote the development and to promote the ecosystem that would make Paycoin valuable." *Id.* at 74. According to Pfeiffer, that $100 million fund distinguished GAW (and Paycoin) from other cryptocurrencies trying to solve the problem of cryptocurrencies' slow transaction speeds. *Id.* He testified,

> The ambition – well, GAW's ambition for Paycoin, as I said, was to develop an ecosystem that would add value. And one of the ways they were going to do this was to develop a product that would have faster transaction times .... If you're trying to buy something at, say, a grocery store or coffee shop and you have to wait ten minutes before your transaction is confirmed, you're going to hold up the line and you're going to be cold. So it's not that useful. GAW was trying to solve that problem, and they said they had a technical way to do that.

***10** *Id.* at 73.

C. Hashpoints

At trial, the jury also heard evidence—in the form of testimony from the class representatives, the plaintiff's expert, and Garza—regarding Hashpoints. They heard that Hashpoints were "like an in-house credit from GAW Miners" that Hashlet owners could receive in exchange for their Hashlet mining, and which they could then trade in for Paycoin (at a price of 400 Hashpoints for one Paycoin). ECF Nos. 359-2 at 39 (Audet's testimony that "towards the end of October, early November 2014," his Hashlets began paying out in Hashpoints rather than Bitcoin, and that Hashpoints were "like an in-house credit from GAW Miners where ... eventually you would be able to trade them in to buy—rather, you could convert them to ... Paycoin"); 359-7 at 12 (Garza's deposition testimony that Hashpoints were "almost like an in-store credit, like sort of like an internal value within GAW Miners to then eventually use to purchase Paycoin"); 351-4 at 15-16 (Dr. Narayanan's testimony that "GAW Miners gave [Hashlet] customers the option of mining this new thing called Hashpoints instead of Bitcoin or another cryptocurrency, and GAW Miners said that these Hashpoints could later be converted to Paycoin when Paycoin launched").

D. HashStakers

The jury heard testimony from two of the class representatives that they were also able to acquire Paycoin through another GAW product called HashStakers. Pfeiffer testified at trial:

> Q Did you also acquire Paycoin through any other means?
>
> A Yes. There was another GAW product called HashStakers, and this was a specialized Paycoin wallet.

> And you could basically put your coins in this and lock them up for a period of time. Maybe it was one month or three months or six months. But at the end of that time period, you would ... get not only the original principal you put in but also interest on top of that. So you would get more Paycoin in the end.
>
> Q And why were you interested in HashStakers?
>
> A I viewed Paycoin as a long-term investment. I wasn't in a hurry. So the idea of getting more Paycoin a little bit later sounded good to me.

ECF No. 351-4 at 74. Shinners, in turn, compared HashStakers to certificates of deposit:

> [A] Hashstaker is similar to what you would see from a bank, like a certificate of deposits, where you are depositing, in this case, Paycoin. And then it's locked up for a period of time. And for that, you get paid an inherent rate of return or interest.

ECF No. 359-2 at 49.

IV. Legal Standards

A. Rule 50 Motion

Rule 50(a) of the Federal Rules of Civil Procedure permits the entry of judgment as a matter of law if a "party has been fully heard on an issue during a jury trial and the court finds that a reasonable jury would not have a legally sufficient evidentiary basis to find for the party on that issue ...." If the court does not grant the motion made under Rule 50(a), "the movant may file a renewed motion for judgment as a matter of law" within 28 days from the entry of judgment or, if the motion concerns a matter not decided by a verdict, within 28 days after discharge of the jury. Fed. R. Civ. P. 50(b). A party who does not move for judgment as a matter of law under Rule 50(a) is barred from challenging the verdict under Rule 50(b). *Lambert v. Genesee Hosp.*, 10 F.3d 46, 53-54 (2d Cir. 1993), *overruled on other grounds by Greathouse v. JHS Sec. Inc.*, 784 F.3d 105 (2d Cir. 2015) ("[B]ecause a j.n.o.v. motion made under Fed. R. Civ. P. 50(b) ... is in reality a renewal of a motion for a directed verdict, it cannot assert new grounds for relief."); *Villara v. City of Yonkers Police Dep't*, No. 95 CIV. 1654(JSR), 1997 WL 399660, at *1 (S.D.N.Y. July 15, 1997) ("Failure to raise the relevant issue in a Rule 50(a) motion is therefore tantamount to waiver and a complete bar to 'renewing' it in a Rule 50(b) motion ...."). This procedural requirement "may not be waived by the parties or excused by the district court." *Bracey v. Bd. of Educ. of City of Bridgeport*, 368 F.3d 108, 117 (2d Cir. 2004). Nevertheless, a party who has failed to comply with the procedural requirements of Rule 50 is not foreclosed from challenging the verdict by means of a Rule 59 motion. *La France v. N.Y., N. H. & H. R. Co.*, 191 F. Supp. 164, 166 n.1 (D. Conn.), *aff'd*, 292 F.2d 649 (2d Cir. 1961) (treating defendant's motion as a motion made under Rule 59(a) because defendant was barred from bringing the motion under Rule 50(b)).

B. Rule 59 Motion

***11** Rule 59 of the Federal Rules of Civil Procedure allows a district court to grant a new trial "for any reason for which a new trial has heretofore been granted in an action at law in federal court." Fed. R. Civ. P. 59(a). The Second Circuit has held that a district court should grant a motion for a new trial when it finds that "the jury has reached a seriously erroneous result or the verdict is a miscarriage of justice." *Song v. Ives Laboratories, Inc.*, 957 F.2d 1041, 1047 (2d Cir. 1992). In assessing such a motion, the "trial judge is free to weigh the evidence himself, and need not view it in the light most favorable to the verdict winner," and the court may grant such a motion "even if there is substantial evidence supporting the jury's verdict." *Manley v. AmBase Corp.*, 337 F.3d 237, 244–45 (2d Cir. 2003). "A new trial may be granted ... when the jury's verdict is against the weight of the evidence." *DLC Mgmt. Corp. v. Town of Hyde Park*, 163 F.3d 124, 133 (2d Cir. 1998). "A court considering a Rule 59 motion for a new trial must bear in mind, however, that the court should only grant such a motion when the jury's verdict is 'egregious.' " *Id.* at 134.

V. Discussion

A. Rule 50 Motion

The plaintiffs did not move for judgment as a matter of law on the issue of whether the Products were securities before the case was submitted to the jury and thus are barred from making a Rule 50 motion following the jury verdict. While the plaintiffs made a Rule 50(a) motion "on the affirmative defenses" before the case was submitted to the jury, ECF No. 354 at 27 and 32-43, a Rule 50(b) motion is "limited to those

grounds that were specifically raised in the prior motion for JMOL; the movant is not permitted to add new grounds after trial." *Tolbert v. Queens College*, 242 F.3d 58, 70 (2d Cir. 2001) (internal quotation marks and alteration omitted). The plaintiffs' Rule 50 motion is, therefore, denied.

B. Rule 59 Motion

The plaintiffs argue that they are entitled to a new trial because the jury's finding that Hashlets, Paycoin, Hashpoints, and Hashstakers were not investment contracts was against the weight of the evidence. ECF No. 351-1 at 42. I agree that the plaintiffs are entitled to a new trial with respect to Paycoin only.

i. Jury Instructions on Investment Contracts

I instructed the jury that, "[t]o establish that a Product [was] an 'investment contract,' the plaintiffs [had to] prove that there was, with regard to that Product: (1) an investment of money, (2) in a common enterprise; (3) with profits to be derived solely from the efforts of others." ECF No. 326 at 21; *see also S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 301, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946). I further instructed: "For each of these elements, you must focus on what the buyers of the Products were led to expect about the nature of the Product." ECF No. 326 at 21; *see also S.E.C. v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 352-53, 64 S.Ct. 120, 88 L.Ed. 88 (1943) (courts consider the "character the instrument is given in commerce by terms of the offer, the plan of distribution, and the economic inducements held out to the prospect").

With respect to the second element, common enterprise, I instructed the jury that the plaintiffs had to

> prove with respect to a specific Product, either: (1) that each individual buyer's fortunes were tied to the fortunes of the other buyers by the pooling of their assets, usually combined with the pro-rata distribution of profits, *i.e.*, distribution proportionate to the buyer's investment; or (2) that the individual buyer's fortunes were tied to the fortunes of GAW Miners, *i.e.*, that the fortunes of the buyers and the Company were linked so that they would rise and fall together.

ECF No. 326 at 21; *see also Revak v. SEC Realty Corp.*, 18 F.3d 81, 87 (2d Cir. 1994); *In re J.P. Jeanneret Assocs., Inc.*, 769 F. Supp. 2d 340, 359-360 (S.D.N.Y. 2011).

With respect to the third element, profits derived solely from the efforts of others, I instructed the jury that the word "solely" should not be taken literally and that they

> ***12** should consider whether the [P]roduct was being promoted primarily as an investment, in which case it would be an investment contract, or whether the product was being promoted as a means whereby participants could pool their activities, money, and the promoter's contribution in a meaningful way, in which case it would not be an investment contract. If there was a reasonable expectation of significant investor control, then profits would not be considered derived solely from the efforts of others. But if the expectation was that the participants would be passive investors, then profits would be considered derived solely from the efforts of others. The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.

ECF No. 326 at 21-22; *see also S.E.C. v. Aqua-Sonic Prods. Corp.*, 687 F.2d 577, 582 (2d Cir. 1982); *United Housing Found., Inc. v. Forman*, 421 U.S. 837, 852, 95 S.Ct. 2051, 44 L.Ed.2d 621 (1975).

ii. Hashlets

The plaintiffs argue that the jury's finding that they failed to show that Hashlets were investment contracts was against

the weight of the evidence. I disagree. The parties do not dispute that the plaintiffs proved that the purchase of Hashlets involved an "investment of money." Accordingly, I consider only whether a finding that either the second or third *Howey* prongs were not satisfied would have been against the weight of the evidence.

a. Common Enterprise: Horizontal Commonality

The jury could reasonably have found, based on the evidence presented at trial, that no horizontal commonality existed because Hashlet owners "could make profits or sustain losses independent of the fortunes of other purchasers." *Revak v. SEC Realty Corp.*, 18 F.3d 81, 88 (2d Cir. 1994). Audet, Pfeiffer, and Dr. Narayanan all testified that Hashlet owners could select the pools in which their Hashlets mined, and Dr. Narayanan testified that at least some of the people mining in those pools were not GAW customers. ECF No. 359-2 at 22-25, 46-47, 63. Audet testified that owners of the same kind of Hashlet could receive "very different payouts" depending on the mining pool they selected. *Id.* at 46-47. He confirmed that, "[i]n theory," one Hashlet owner "could do really well one day, and [another] could do really poorly." *Id.* at 47. Audet further testified that Hashlet owners could "boost" their Hashlets in order to generate a larger payout, and he agreed that it was "[p]robably" the case that, if two customers "owned the same [type of] Hashlet, which is mining in the same pool but [one] boost[ed] [his] Hashlets every day, [he] could make more in payouts than [the other customer] would." *Id.* at 48. Based on this testimony from the class representatives and their expert, the jury could reasonably have found that each individual Hashlet owner's fortunes were not tied to the fortunes of the other Hashlet owners, given each Hashlet owner's ability to select on any given day the pool in which the Hashlet mined and whether to boost the Hashlet.

The plaintiffs argue that "the fact that two Hashlet owners could, in theory, earn different payouts on a given day if their Hashlets had mined in different pools" does not undermine their argument that horizontal commonality was present because the "key feature" of horizontal commonality is that "investors' profits at any given time are tied to the success of the enterprise." ECF No. 351-1 at 19 (quoting *S.E.C. v. Kik Interactive, Inc.*, 492 F. Supp. 3d 169, 179 (S.D.N.Y. 2020)). But the Second Circuit has made clear that horizontal commonality requires "the tying of each individual investor's fortunes to the fortunes of the other investors," *Revak v. SEC Realty Corp.*, 18 F.3d 81, 87 (2d Cir. 1994), as I instructed the jury. And the evidence that different Hashlet owners could earn different payouts from their Hashlets based on the mining pools they selected and on whether they chose to "boost" their Hashlets could reasonably support a finding that the fortunes of a particular Hashlet owner were not tied to those of his or her fellow Hashlet owners. For this reason, the plaintiffs' additional argument that the evidence regarding selection of mining pools and boosting is relevant only to the third *Howey* prong is unavailing.

***13** The plaintiffs also argue that GAW never actually allocated the hashing power to the selected mining pools —it only pretended to—and that courts appropriately focus on economic reality when determining whether a particular product is an investment contract. ECF No. 363 at 5. But as I instructed the jury, the *Howey* test "focus[es] on what the buyers of the Products were led to expect about the nature of the Product." ECF No. 326 at 21. "The enterprise and the described materials, by the very nature of the operation of the securities laws, must be examined as of the time that the transaction took place, together with the knowledge and the objective intentions and expectations of the parties at that time." *S.E.C. v. Aqua-Sonic Prods. Corp.*, 524 F. Supp. 866, 876 (S.D.N.Y. 1981), *aff'd*, 687 F.2d 577 (2d Cir. 1982); *see also Joiner,* 320 U.S. at 352–53, 64 S.Ct. 120 ("The test [for determining whether an instrument is a security] ... is what character the instrument is given in commerce *by the terms of the offer,* the plan of distribution, and the economic inducements held out to the prospect." (emphasis added)). As discussed, the jury heard evidence that the Company presented Hashlets as a product that would allow Hashlet owners to select the pools in which their Hashlets mined and to "boost" their Hashlets to receive higher payouts. Accordingly, even if the jury found that GAW later failed to allocate the Hashlets' mining power based on the owners' selections or to boost the Hashlets when directed to do so, a finding that no horizontal commonality existed would still have been reasonable and supported by the evidence presented.

While the plaintiffs point to the Second Circuit's holding in *United States v. Leonard* as support for their argument that I should consider whether GAW actually allocated mining power and boosted Hashlets as directed, that case is distinguishable from this one. In *Leonard*, the Second Circuit, discussing the third *Howey* prong, noted that while organizational documents prepared by the defendant "would lead [the court] to believe that [investors] were expected to play an active role in the management of the companies,"

in reality, investors "played an extremely passive role in the management and operation of the companies." 529 F.3d 83, 89 (2d Cir. 2008). The Court emphasized, however, that this fact aligned with "[r]ecord evidence allow[ing] the jury to conclude that—notwithstanding the language in the organizational documents suggesting otherwise—from the start there could no 'reasonable expectation' of investor control." *Id.* at 90; *see also id.* (noting that "under the organizational documents, the members' managerial rights and obligations did not accrue until the LLCs were 'fully organized,' " and that "so-called 'interim managers' initially held legal control rights, and they decided almost every significant issue prior to the completion of fundraising."). Here, in contrast, the plaintiffs have identified no evidence suggesting that "from the start" there was no reasonable expectation that GAW would allocate mining power and boost Hashlets in compliance with the Hashlet owners' directions.

b. Common Enterprise: Vertical Commonality

A finding that there was no vertical commonality would also not have been against the weight of the evidence. The evidence at trial supported the finding that GAW earned profits from Hashlets only via the Hashlet acquisition and service fees; there was no evidence that GAW profited directly from the mining by, for example, owning portions of the miners and directing that mining power to mine in the pools in which Hashlet owners ostensibly mined their Hashlets. *See* ECF No. 344 at 12-13 (testimony of Dr. Narayanan). The fee a customer paid GAW to acquire a Hashlet was a flat, up-front free; accordingly, it did not link the fortunes of the Hashlet owner to those of GAW. The plaintiffs argue, however, that "unrebutted evidence" regarding Hashlet service fees showed that GAW "did not earn profits from a Hashlet on a given day unless the owner of the Hashlet earned a profit that day; accordingly, the fortunes of GAW Miners and the Hashlet investor rose and fell together." ECF No. 351-1 at 20. I disagree.

The evidence that GAW Miners did not profit from a Hashlet on a particular day unless the owner did—Pfeiffer's testimony that, if the Hashlet owner's profit on a given day were less than or equal to the amount of the service fee, GAW Miners would still pay the customer "the smallest fraction ... of a Bitcoin" above the amount of the fee, ECF No. 351-4 at 76—was not unrebutted, nor was the jury required to credit it. Notably, Pfeiffer's fellow class representative, Audet, testified at his deposition that the service fee was fixed, i.e., that it was "based on the cost of electricity and running ... the server farm ...." ECF No. 359-4 at 3. Further, he never testified, as Pfeiffer did, that Hashlet owners were, in effect, not charged the full fixed fee if their payout was less than the fee amount. *See id.*; ECF No. 359-2 at 44. Confronted with this conflicting evidence, it would not have been unreasonable for the jury to decide not to credit Pfeiffer's testimony regarding the service fee structure.

***14** Further, even if the jury did credit that testimony, it could still have found that the plaintiffs failed to prove vertical commonality. If the fee structure operated as Pfeiffer described, then there was no "one-to-one relationship between [GAW] and [Hashlet owners] such that there [was] an interdependence of *both profits and losses*." *Marini v. Adamo*, 812 F. Supp. 2d 243, 256 (E.D.N.Y. 2011) (emphasis in original) (internal quotations omitted). While Pfeiffer's description suggested that GAW only profited if a Hashlet owner did, GAW's profit was not proportional to that of the Hashlet owner—it earned the same amount regardless of whether the Hashlet owner earned a huge profit or a small one. Thus, the fee structure differed from the proportional fee arrangements at issue in many of the district court decisions within this Circuit finding strict vertical commonality. *See, e.g.*, *In re J.P. Jeanneret Assocs., Inc.*, 769 F. Supp. 2d 340, 360 (S.D.N.Y. 2011) (holding at the motion to dismiss stage that the plaintiffs had alleged sufficient facts from which a trier could conclude that strict vertical commonality was present, where the plaintiffs alleged that "[t]he investment manager [was] paid (1) a basic quarterly fee in the amount of one-eighth of one percent (.00125) of the 'closing value' of the assets in the investment account, and (2) a performance fee equal to 20% of the profits in the investment account that exceed the preferred return and the basic quarterly fee" and distinguishing that fee arrangement from that of a "stockbroker, who collects a fee for every consummated transaction"); *Marini*, 812 F. Supp. 2d at 259-60 (finding that "disputed issues of material fact exist[ed] as to whether [the defendant] earned commissions on the sale of [the plaintiff]'s coins" such that his "fortunes would rise and fall with the plaintiffs' fortunes"). Further, the fee structure Pfeiffer described would on days when a Hashlet owner earned no mining reward allow that owner to earn a small profit (the "smallest fraction ... of a Bitcoin" paid out by GAW) while GAW sustained a loss (because it earned no fee but gave the owner a small fraction of a Bitcoin). *See* ECF No. 351-4 at 78 (Q: "Would you ... get a tiny payout if the maintenance fee were 15 cents and your original reward were zero?" A (Pfeiffer): "That's my understanding, yes." A: "Q So if you

did not make a profit from a Hashlet on a particular day, GAW would not receive anything from you either?" A: "That's correct.") Here, it would not have been against the weight of the evidence to find that the fee structure did not truly link the fortunes of the Hashlet owners and GAW so that they would rise and fall together.

c. Efforts of Others

A finding that the plaintiffs failed to show that Hashlet purchasers had a reasonable expectation of profits to be derived primarily from the entrepreneurial or managerial efforts of GAW also would not have been against the weight of the evidence. In particular, the jury could reasonably have found that Hashlets involved a pooling of the contributions of the Hashlet owners (money and decisions regarding selection of mining pools) with those of GAW (the physical mining equipment and the electricity and other resources required to maintain it) in a manner that allowed the Hashlet owners to exercise "significant investor control." ECF No. 326 at 21. It could have found that Hashlets enabled their owners to outsource the "messy, technical process" of operating physical mining equipment to GAW, while retaining the control over the selection of mining pools that they would have exercised had they operated mining equipment in their own homes. *See* ECF No. 351-4 at 9-10. Fraser's acknowledgment that "Hashlet customers were relying on GAW Miners' expertise to own and operate the mining equipment that would support the Hashlets," *id.* at 33, supports the conclusion that GAW's contribution was its ability to operate the physical mining equipment rather than, for example, its expertise in selecting profitable mining pools. Evidence that Hashlets were marketed as easy to use and "grandma approved" could similarly support the inference that GAW's handling of the physical aspects of the mining process would make it easier for people interested in cryptocurrency mining to participate in that process without having to operate mining equipment in their own homes; it does not, however, compel the conclusion that those people would not exercise significant control over the non-physical aspects of the mining process. In addition, evidence that one Hashlet owner could "do really well" on a day when another Hashlet owner "d[id] really poorly" depending on the mining pools each selected, ECF No. 359-2 at 46-48, supports the conclusion that whether or not a Hashlet owner profited depended in large part on the decisions he or she made regarding how to allocate his or her Hashlet's mining power.

The authority plaintiffs cite does not compel a different result. Hashlets, which were mechanisms for mining bitcoin and other established cryptocurrencies, are distinguishable from the cryptocurrency products involved in *Telegram, Kik*, and *ATBCOIN*, the profitability of which depended almost entirely on their promoters' success in launching promised blockchains or digital ecosystems. *S.E.C. v. Telegram Grp., Inc.*, 448 F. Supp. 3d 352, 375 (S.D.N.Y. 2020) ("to realize a return on their investment, the [purchasers] were entirely reliant on Telegram's efforts to develop, launch, and provide ongoing support for the TON Blockchain and [the cryptocurrency]"); *Kik*, 492 F. Supp. 3d 169, 180 (S.D.N.Y. 2020) ("without the promised digital ecosystem, [the cryptocurrency] would be worthless ... [it has] no inherent value and will generate no profit absent an ecosystem that drives demand"); *Balestra v. ATBCOIN, LLC*, 380 F. Supp. 3d 340, 355-56 (S.D.N.Y. 2019) ("the success of ATB Coins was entirely dependent on Defendants' following through on their promise to launch and improve the ATB Blockchain .... purchasers had no control over whether the new ATB Blockchain technology worked"). Here, in contrast, the jury could reasonably have concluded that the value of the Hashlets depended both on GAW's competent operation of the physical mining equipment and on a particular Hashlet owner's decisions regarding where to direct his or her Hashlet's mining power. *Howey* and *Aqua-Sonic* are also distinguishable in that the defendants in both cases offered investors the opportunity to profit with the expectation that they would exercise no direct control over their investments. The plaintiffs have identified no evidence suggesting that a Hashlet purchaser's ability to select mining pools was merely a "legal right[ ]" he or she was not reasonably expected to exercise. *Aqua-Sonic Prods. Corp.*, 687 F.2d at 585; *see also* ECF No. 359-2 at 47 (Audet testifying that he checked his payouts daily and switched the pools he was mining in).

iii. Paycoin

***15** The plaintiffs argue that any finding by the jury that they failed to satisfy the "common enterprise" and "efforts of others" prongs of the *Howey* test was against the weight of the evidence, and I agree.

a. Common Enterprise: Horizontal Commonality [5]

5 Because the second *Howey* prong requires a finding of horizontal commonality *or* strict vertical commonality, and because I conclude that any finding that there was no horizontal commonality among Paycoin purchasers would have been against the weight of the evidence, I do not address the parties' arguments regarding strict vertical commonality.

A finding that the fortunes of the Paycoin owners were not tied together via a pooling of their assets would have been against the weight of the evidence. GAW's own promotional materials described its plan to use funds raised via the various ICO stages to create a "Coin Adoption Fund" that it would use to guarantee a $20 price floor and facilitate widespread adoption, thereby increasing Paycoin's market value. In exchange for their contribution of assets, the Paycoin purchasers received Paycoin, the price of which rose and fell across the board, so that its purchasers gained or lost in proportion to the amount of Paycoin they owned. Thus, "[r]ather than receiving a pro-rata distribution of profits, which is not required for a finding of horizontal commonality, [Paycoin purchasers] reaped their profits in the form of the increased value of [Paycoin]." *Kik*, 492 F. Supp. 3d at 178.

Other district courts within this Circuit have concluded that facts comparable to these are indicative of horizontal commonality. For example, in *Kik*, the court found horizontal commonality based on evidence that the defendant had used funds it earned by selling its new cryptocurrency to support the creation of a "digital ecosystem," the success of which the defendant emphasized would "dr[i]ve demand for [the cryptocurrency] and thus dictate[ ] investors' profits." *Id.* (granting SEC's motion for summary judgment on securities claims). Similarly, in *Telegram*, the court concluded that the SEC had shown horizontal commonality where the defendant "pooled the money received from the Initial Purchasers [of its new cryptocurrency] and used it to develop the TON Blockchain" and "[t]he ability of each Initial Purchaser to profit was entirely dependent on the successful launch of the TON Blockchain." 448 F. Supp. 3d at 369 (granting SEC's motion for a preliminary injunction preventing defendant from selling its new cryptocurrency on the basis that such a sale would be an unregistered offering of securities). Likewise, in *ATBCOIN*, the court concluded that the plaintiff had adequately alleged horizontal commonality where he alleged that "funds raised through the ICO [for the defendant's new cryptocurrency] were pooled together to facilitate the launch of the ATB Blockchain, the success of which, in turn, would increase the value of Plaintiff's ATB Coins." 380 F. Supp. 3d at 353.

The defendant argues that there was no pooling of assets and, thus, no horizontal commonality with respect to Paycoin. The defendant points out that the named plaintiffs received Paycoin in exchange for "their right to receive their normal Hashlet mining rewards for Hashpoints" and, later, Hashpoints themselves. ECF No. 359 at 39. He argues that there is "no evidence how those contributions ... were or could actually be 'pooled' together in the so-called 'Coin Adoption Fund,' " and he notes that the assets involved in the cryptocurrency schemes described in the other district court decisions from within this circuit all were either money or cryptocurrency. *Id.* at 40. The defendant has failed, however, to identify any authority suggesting that that the assets contributed to a common enterprise involving cryptocurrency must be either money or an existing cryptocurrency. Black's law dictionary defines an asset as "an item that is owned and has value," *Asset*, Black's Law Dictionary (10th ed. 2014), and the defendant has cited no authority indicating that a narrower definition applies in the context of the *Howey* test. As a result, I conclude that the weight of the evidence indicated that the Paycoin enterprise, as described by GAW Miners, involved the contribution of assets—whether money, cryptocurrency, or Hashpoints—that were then pooled together to create the CAF, which in turn supported the creation and promotion of Paycoin. [6]

6 To the extent the defendant argues that there was no "investment of money" because the class representatives paid for their Paycoin in Hashpoints (rather than money or another cryptocurrency), that argument is unpersuasive. Other federal courts have held that some exchange of value is sufficient to satisfy this prong of the *Howey* test. *See, e.g.*, *Uselton v. Com. Lovelace Motor Freight, Inc.*, 940 F.2d 564 (10th Cir. 1991), *cert. denied sub. nom. Alcox v. Uselton*, 502 U.S. 983, 112 S.Ct. 589, 116 L.Ed.2d 614 (1991) (collecting cases in support of the conclusion that "cash is not the only form of contribution or investment that will create an investment contract ... the 'investment' may take the form of 'goods and services' or some other 'exchange of value' ") (citations omitted). Here, the plaintiffs gave up the right to receive mining payouts of Bitcoin or other cryptocurrency in exchange for Hashpoints (a kind of "in-house credit"), which they then used to

> acquire Paycoin. In turn, GAW retained the Bitcoin or other cryptocurrency it would have paid out to the plaintiffs and ultimately gave the plaintiffs Paycoin in exchange for Hashpoints. Thus, the exchange of Hashpoints for Paycoin constituted an "exchange of value" sufficient to satisfy the "investment of money" prong.

b. Expectation of Profit from the Efforts of Others

***16** A finding that Paycoin did not involve "a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts" of GAW would have been against the weight of the evidence. *See* ECF No. 326 at 21; *Forman*, 421 U.S. at 852, 95 S.Ct. 2051. GAW's own promotional materials emphasized the role it would play in increasing Paycoin's "market value" after its public launch. According to those materials, "[d]riving adoption has always been the most difficult task facing ... cryptocurrency." ECF No. 351-16 at 2 (GAW Miners' website on November 4, 2014); *see also* ECF No. 351-14 at 3-4 (November 24, 2014 press release stating that "all existing cryptocurrencies have failed to achieve an adoption path leading to mainstream use"). But, GAW Miners maintained, Paycoin differed from other cryptocurrencies because it had "the financial backing of a company with the capital and resources" that "[n]o cryptocurrency in history" had enjoyed, which GAW Miners would use to "support[ ] continual adoption efforts." ECF No. 351-16 at 2. It emphasized that Paycoin was "unique ... in that its Initial Coin Offering (ICO) created the world's first Coin Adoption Fund (CAF), a multi-tier, organized strategy for increasing global adoption." ECF No. 351-15 at 8. Paycoin's "long-term value," would, GAW Miners advertised, depend on "merchants adopting it as a consumer payment method," as well as on "transactions with suppliers and vendors." ECF No. 351-16 at 2. And the pathway to creation of that value (as the Company advertised in a graphic on its website) was the creation of the CAF via three ICO rounds, and GAW Miners' use of the CAF Funds to launch Paycoin at a $20 price point and facilitate "major retailer adoption" and credit card purchasing. *Id.* at 4; *see also id.* at 3 (graphic demonstrating how ICO funds would be distributed to "[g]row[ ] adoption by building payment plugins, apps, meeting high-volume merchants, & producing training resources," "[b]uild datacenters to distribute at-cost hash power to individual miners for [Paycoin]s," and "establish a large, fiat-backed exchange to provide a safe floor price & ease merchant acceptance"). None of the evidence presented at trial suggested that the average Paycoin purchaser unaffiliated with GAW would exercise significant control over this value-creation process. Rather, the evidence indicated that GAW was promoting an enterprise in which Paycoin purchasers contributed funds to support work done by GAW.

The defendant offers a series of arguments in support of his position that plaintiffs failed to show that Paycoin entailed an "expectation of profits to be derived solely from the efforts of others." He first argues that evidence that "anybody" could mine Paycoin indicates that Paycoin was not a "centralized" cryptocurrency and, therefore, not a product whose profits were expected to be derived solely from the efforts of GAW. ECF No. 359 at 32-36; *see also* ECF Nos. 359-5 at 5 (Eden deposition testimony that, at least initially, "anybody" could participate in the "consensus process for determining whether transactions would become part of the [Paycoin blockchain]); 359-11 (Dorman deposition testimony that, at least during Paycoin's proof-of-work phase, "any miners wishing to participate in Paycoin [would] be allowed to commence mining"). Although this evidence could provide a basis for concluding that some aspects of Dr. Narayanan's testimony regarding centralization were not true (specifically, his testimony that Paycoin was a proof-of-stake currency), it does not indicate that GAW Miners did not promote Paycoin as a product whose value would depend almost entirely on GAW Miners' efforts to promote its adoption by merchants and others and to guarantee its $20 price floor.

Likewise, evidence that Paycoin used "open source" software, and that anyone could view its source code and suggest improvements to it, does not undermine the conclusion that Paycoin's growth in value would depend on GAW's entrepreneurial and managerial efforts. In fact, such evidence does not even undermine Dr. Narayanan's analysis regarding the relative "centralization" of Paycoin, as he testified that his conclusion that Paycoin was a centralized cryptocurrency was based in part on GAW's exercise of "unilateral control over updates to the software and [ability] to make changes to the cryptocurrency, to the rules of the cryptocurrency, without any notice or advance deliberation," in contrast to "a cryptocurrency like Bitcoin," whose software was changed "based on careful deliberation and consensus." ECF No. 343 at 58. The distinguishing feature, according to Dr. Narayanan, was not that people unaffiliated with GAW were unable to view or propose changes to Paycoin's software, but rather that GAW alone controlled what changes were made to that software.

Similarly, while evidence that Paycoin was traded on public exchanges might indicate that it was less centralized than other cryptocurrencies, in light of Dr. Narayanan's testimony that one relevant factor when determining whether a currency is centralized is its trading ecosystem (ECF No. 343 at 60), it does not suggest that the profits to be derived from Paycoin would depend on the efforts of anyone other than GAW. The defendant points to Dr. Narayanan's testimony that, when a cryptocurrency is traded on a public exchange, its price is determined by market forces (ECF No. 359-2 at 29) as evidence in support of its argument that the jury's finding was supported by the evidence presented at trial, but this argument "ignores the essential role of [GAW] in establishing the market." *Kik*, 492 F. Supp. 3d at 180.

***17** Further, the defendant argues that evidence that Paycoin continued to trade on public exchanges after GAW Miners failed to honor its promises regarding Paycoin and after the SEC announced its investigation on January 19, 2015 demonstrated that Paycoin's value was not dependent on the efforts of GAW Miners. Defendant's argument ignores evidence that showed that Paycoin's price fell dramatically after GAW Miners failed to follow through on its promises regarding Paybase, merchant adoption, and the $20 price floor. The mere fact that Paycoin retained some slight value after this development is insufficient to support an inference that its value did not depend primarily on the efforts of GAW.

Finally, the defendant argues that the jury could reasonably have determined that the plaintiffs failed to prove that GAW Miners promoted Paycoin primarily as an investment. ECF No. 359 at 36-39. I disagree. The Supreme Court has held that there is no "reasonable expectation of profits" where "a purchaser is motivated by a desire to use or consume the item purchased." *Forman*, 421 U.S. at 852-53, 95 S.Ct. 2051. The defendant argues that the jury reasonably could have concluded that the plaintiffs were motivated by a desire to use Paycoin as a medium of exchange to make purchases from merchants such as Target and Walmart. He points to evidence that GAW Miners emphasized the promise of widespread merchant adoption in its marketing materials, and that the CAF and the $20 price floor were intended to facilitate that adoption. But this argument overlooks the fact that GAW's marketing materials described merchant adoption as a pathway to "increased market value" for Paycoin. ECF No. 351-16 at 4; *see also id.* at 2 ("Ultimately, [Paycoin]'s long-term value will be pinned on not only merchants adopting it as a consumer payment method, but also on transactions with suppliers and vendors with [Paycoin].").

The defendant also points to testimony from Pfeiffer and Shinners regarding their interest in Paycoin's promised "faster transaction times" and "merchant adoption" as evidence that the named plaintiffs acted with consumptive intent, but this testimony does not indicate that the two wished to use their Paycoin to make purchases. In fact, Pfeiffer emphasized that the promised faster transaction times were "one of the ways" that GAW planned to "develop an ecosystem that would *add value*," ECF No. 351-4 at 73 (emphasis added), and that he "viewed Paycoin as a long-term investment," *id.* at 74. Shinners testified specifically that he "absolutely" expected to earn a profit when he sold his Paycoin following the public launch. *Id.* at 61 (Q: "[D]id you expect that you'd be able to earn a profit if you sold [your Paycoin]?" A: "Yes, absolutely .... The public launch was for $20. And the—we were told that 400 Hashpoints [the amount Shinners spent to acquire a Paycoin] was actually $4. So the difference between 20 and 4, 16."). Audet also testified that he bought Paycoin in December at what he thought was "a discounted price compared to the $20 floor that they were going to provide in whenever they had the initial coin offering or Paybase." *Id.* at 56. The class representatives' testimony, viewed in context, made clear that they were interested in purchasing Paycoin because they stood to profit when it publicly launched for $20, not because they were excited at the prospect of using it to buy groceries. [7]

7 Because the *Howey* test is an objective one —based upon what purchasers were "led to expect" (ECF No. 326 at 21)—the subjective intent of individual plaintiffs in purchasing Paycoin is not determinative of the issue of whether Paycoin purchasers had a reasonable expectation of profit. Nevertheless, as the defendant acknowledges, this evidence is probative on the issue of what a reasonable purchaser would have expected. *See Warfieldd v. Alaniz*, 569 F.3d 1015, 1021 (9th Cir. 2009) (noting that "the subjective intent of the purchasers may have some bearing on the issue of whether they entered into investment contracts," even if the ultimate inquiry must focus "on what the purchasers were offered or promised"); *Telegram*, 448 F. Supp. 3d at 374 ("The Court's finding that the [cryptocurrency purchasers] had a reasonable expectation of profit is buttressed by [the purchasers'] subjective views .... The subjective intent of the [purchasers] does not necessarily establish the objective intent of the

> reasonable purchaser. However, the stated intent of prospective and actual purchasers, though not considered for the truth of their content, may be properly considered in the Court's evaluation of the motivations of the hypothetical reasonable purchaser.")

***18** The jury also saw posts from the Hashtalk forum describing the purchase of Paycoin as an investment. ECF No. 351-21 at 10 ("GAW is addressing the big issue of price stability of the new coin, and this may be enough to get the coin widely accepted, and in such a case, the whole Paycoin/Paybase would yield good returns. Investing in GAW is risky because it is a start-up venture, however, I am also not investing more than I [c]an afford to lose"); *id.* at 12 ("I am willing to risk 3 months income to have a share in something will give me a 5-fold increase on my investment in a few years.").

Further, at the time that the class representatives (and any other class members who purchased Paycoin prior to the launch of Paybase) acquired their Paycoin, there was no mechanism that allowed them to use that Paycoin in a consumptive fashion. And the jury saw no evidence indicating that such a mechanism materialized after Paybase launched. *See* ECF No. 351-4 at 64 (Shinners's trial testimony that Paybase was "fundamentally ... just an online wallet basically"). Such evidence suggests that these Paycoin purchasers were not motivated by the desire to use Paycoin in a consumptive fashion. *See Kik*, 492 F.Supp.3d at 180 (concluding that the fact that seller of cryptocurrency marketed it as a medium for consumptive use did not mean that the cryptocurrency could not constitute an investment contract, where "none of this 'consumptive use' was available at the time of distribution [and] would materialize only if the enterprise advertised by [the seller] turned out to be successful").

Taken together, the overwhelming weight of the trial evidence indicated that a reasonable purchaser of Paycoin was motivated by the expectation of profits to be generated by GAW's efforts to promote adoption and support a $20 price floor, and not by the desire to use Paycoin for a consumptive purpose. Accordingly, any finding that Paycoin was not an investment contract because its purchasers did not have a "reasonable expectation of profits" from the efforts of GAW would have been against the weight of the evidence.

iv. Hashpoints and Hashstakers

As plaintiffs' counsel acknowledged at the charge conference, the jury heard very little evidence regarding Hashpoints and HashStakers at trial. The jury heard, via testimony from the class representatives, the plaintiffs' expert, and Garza, that Hashpoints were like an "in-house credit" that could be used to purchase (or be converted into) Paycoin, and that HashStakers were "specialized Paycoin wallet[s]" or "like ... certificate[s] of deposits." As the defendants point out, I instructed the jurors that they had to determine, with respect to each product individually, whether that product was an investment contract. The fact that both of these Products may have been used to acquire or hold Paycoin does not (assuming that Paycoin is an investment contract) render them investment contracts in their own right. Accordingly, I conclude that, in light of the scant evidence presented regarding these Products, the jury's finding that neither was an investment contract was not against the weight of the evidence.

VI. Conclusion

For the reasons set forth above, I DENY the plaintiffs' Rule 50 motion for judgment as a matter of law. I GRANT the plaintiffs' Rule 59 motion for a new trial with respect to Paycoin and DENY it with respect to Hashlets, Hashpoints, and HashStakers.

IT IS SO ORDERED.

All Citations

--- F.Supp.3d ----, 2022 WL 1912866

NOVEMBER 18, 2021

Federal Jury Finds Cryptocurrency Products Not Securities in Landmark Verdict

On November 2, 2021, a federal jury in *Audet* v. *Fraser* found that four cryptocurrency-related products were not securities under the Securities Exchange Act of 1934 and the Connecticut Uniform Securities Act. This case is significant because it appears to be the first time a jury has reached a verdict on whether cryptocurrency products are securities under the test articulated by the Supreme Court in *SEC* v. *W.J. Howey Co.*, 328 U.S. 293 (1946). This case thus is instructive in the developing area of law as to whether digital assets and other crypto-related products may be considered to be securities.

Plaintiffs brought suit on behalf of a class of individuals who purchased cryptocurrency-related products called "Hashlets," "Hashpoints," "Paycoin," and "Hashstakers" (the "Products"). Plaintiffs initially sued GAW Miners, LLC and ZenMiner, LLC, the companies that developed the Products, along with GAW CEO Homero Joshua Garza and investor and director Stuart A. Fraser. But the two companies defaulted[1] and plaintiffs later dismissed Garza from the suit after he pleaded guilty to wire fraud in a related DOJ action,[2] leaving Fraser as the sole remaining defendant at trial.

GAW and ZenMiner initially sold physical crypto mining hardware to customers who would use its computing power to "mine" for virtual currency. Customers who purchased GAW and ZenMiner's hardware-hosted mining products were told that they had purchased specific pieces of physical mining equipment and that they could request that their equipment be shipped to them at any time. Plaintiffs alleged that, in reality, the companies never had sufficient designated equipment to support the hosted mining services they sold to customers or to ship to customers upon request.[3] Unable to fulfill customers' orders, the companies introduced "Hashlet contracts," which entitled their customers to a share of the profits from the companies' crypto mining profits. Plaintiffs alleged that defendants sold far more Hashlets worth of computing power than they actually had in their computing centers, and there was no equipment to back up the vast majority of Hashlets sold.[4] Defendants collected roughly $19 million in revenue from their sales of Hashlets.[5] Plaintiffs further alleged that, when the Hashlets scheme began to unravel, defendants pivoted and began selling "Hashpoints,"convertible promissory notes that could be converted into a new virtual currency called Paycoin. Before it launched Paycoin, GAW also sold "HashStakers," which were digital wallets that could lock up

1 GAW Miners Class Action FAQ, available at https://www.gawminersclassaction.com/Home/FAQ.

2 Charlie Osborne, "GAW Miners CEO earns prison time for defrauding customers of $9 million," Zero Day Net (Sept. 17, 2018), available at https://www.zdnet.com/article/gaw-miners-ceo-earns-prison-time-for-defrauding-customers-of-9-million/.

3 *Audet* v. *Fraser*, No. 3:16-cv-940, ECF No. 57 at ¶ 6 (D. Conn. 2021).

4 *Id*. at ¶ 7.

5 *Id*.

Paycoin for 30, 90 or 180-day terms and generate fixed returns. Defendants launched Paycoin by promoting a $20 price floor and its wide acceptance by well-known merchants, neither of which ultimately proved to be true.[6]

Plaintiffs brought claims under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 and Sections 36b-29(a)(1) and (2) of the Connecticut Uniform Securities Act, as well as claims for common law fraud. With respect to the common law fraud claims, the jury found that GAW Miners had engaged in a fraud concerning Hashlets but that plaintiffs did not prove that Fraser had aided and abetted in the company's fraud.[7]

Some key takeaways from the jury instructions are as follows:

- **The jury found that none of the four Products were securities**. The court explained that four of the plaintiffs' five claims against Mr. Fraser required plaintiffs to prove that one or more of the Products were securities, and that the jury should therefore begin its deliberations with this question.[8] Plaintiffs relied on the fact that the SEC had previously asserted in a successful civil fraud action against Garza that Hashlets were securities.[9] The court instructed the jury on application of the *Howey* test, stating that "to establish that a Product is an 'investment contract,' the plaintiffs must prove that there was, with regard to that Product: (1) an investment of money; (2) in a common enterprise; (3) with profits to be derived solely from the efforts of others." The instructions noted that "[f]or each of these elements, you must focus on what the buyers of the Products were led to expect about the nature of the Products."[10] The court also gave specific guidance on the second and third elements. With respect to the "common enterprise" element, the instructions provided that "Plaintiffs must prove with respect to a specific Product, either: (1) that each individual buyer's fortunes were tied to the fortunes of the other buyers by the pooling of their assets, usually combined with the pro-rata distribution of profits, i.e., distribution proportionate to the buyer's investment; or (2) that the individual buyer's fortunes were tied to the fortunes of GAW Miners, i.e., that the fortunes of the buyers and the Company were linked so that they would rise and fall together."[11] And with respect to third element—whether profits are derived solely from the efforts of others—the court instructed the jury that "[i]f there was a reasonable expectation of significant investor control, then profits would not be considered derived solely from the efforts of others," but "if the expectation was that the participants would be passive investors, then profits would be considered derived solely from the efforts of others."[12] The jury found that none of the four Products were investment contracts.[13]

- **The court instructed the jury that a currency is not a security and defined "currency" as broader than merely fiat**. With respect to the federal securities claim, the court noted in the jury instructions that "there is an exception to the definition of 'securities' available under the Exchange Act that is not available under the [Connecticut Uniform Securities Act]. Specifically, the Exchange Act provides that a currency is not a security. That means that, for the Exchange Act claim only, even if a Product meets the definition of an 'investment contract', it is not a 'security' if it is a currency." Fraser had asserted an affirmative defense that Paycoin, GWC's virtual currency, was properly considered a currency and therefore could not be a security. The court defined currency as "an item (such as a coin, government note, or banknote) that is generally accepted as payment in a transaction and recognized as a standard of value." The court cautioned in the jury instructions that "it is important to note that merely describing a product as a 'currency' does not make it one. You should

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6 *Id*. at ¶ 8.

7 *Audet* v. *Fraser*, No. 3:16-cv-940, ECF No. 330 at 13-14 (D. Conn. 2021).

8 *Audet* v. *Fraser*, No. 3:16-cv-940, ECF No. 326 at 20 (D. Conn. 2021).

9 Connecticut-Based Bitcoin Mining Fraudster Sentenced to Prison, SEC Litigation Release No. 24281 (Sept. 20, 2018), available at https://www.sec.gov/litigation/litreleases/2018/lr24281.htm.

10 *Audet* v. *Fraser*, No. 3:16-cv-940, ECF No. 326 at 21.

11 *Id*.

12 *Id*. at 21-22.

13 *Audet* v. *Fraser*, No. 3:16-cv-940, ECF No. 330 at 2 (D. Conn. 2021).

focus on the substance and economic reality of Paycoin, not its name or label. The Defendant has the burden of proving that Paycoin is a currency."[14]

Implications

Over the last few years, courts have increasingly grappled with the question of when digital assets constitute securities. For example, in *Securities and Exchange Commission* v. *Telegram,* the court granted the SEC's motion for a temporary restraining order to enjoin Telegram from engaging in a plan to distribute a new cryptocurrency to certain sophisticated entities and high net-worth individuals.[15] And in *United States Securities and Exchange Commission* v. *Kik Interactive Inc.*, the court granted summary judgment in favor of the SEC, holding that the defendant's digital token product was an investment contract under Section 2(a)(l) of the Securities Act.[16] This case is significant because it is the first time a jury has reached a verdict on the question of whether particular cryptocurrency-related assets are securities, let alone found that such assets are not securities. The jury instructions in the *Audet* matter may serve as useful guidance for litigants and market participants considering whether digital assets may be securities. The court also provided a defendant-friendly instruction on the third element of the *Howey* test—often the most hotly contested element—by instructing the jury that profits are not derived solely from the efforts of others where there is "a reasonable expectation of significant investor control." It will be interesting to see how defendants utilize this verdict in future cases.

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[14] *Audet* v. *Fraser*, No. 3:16-cv-940, ECF No. 326 at 20-21 (D. Conn. 2021).

[15] *Secs. & Exch. Comm'n* v. *Telegram, et al*, 448 F. Supp. 3d 352 (S.D.N.Y. 2020).

[16] *Secs. & Exch. Comm'n* v. *Kik Interactive Inc*., 492 F.Supp.3d 169 (S.D.N.Y. 2020).

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content.

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