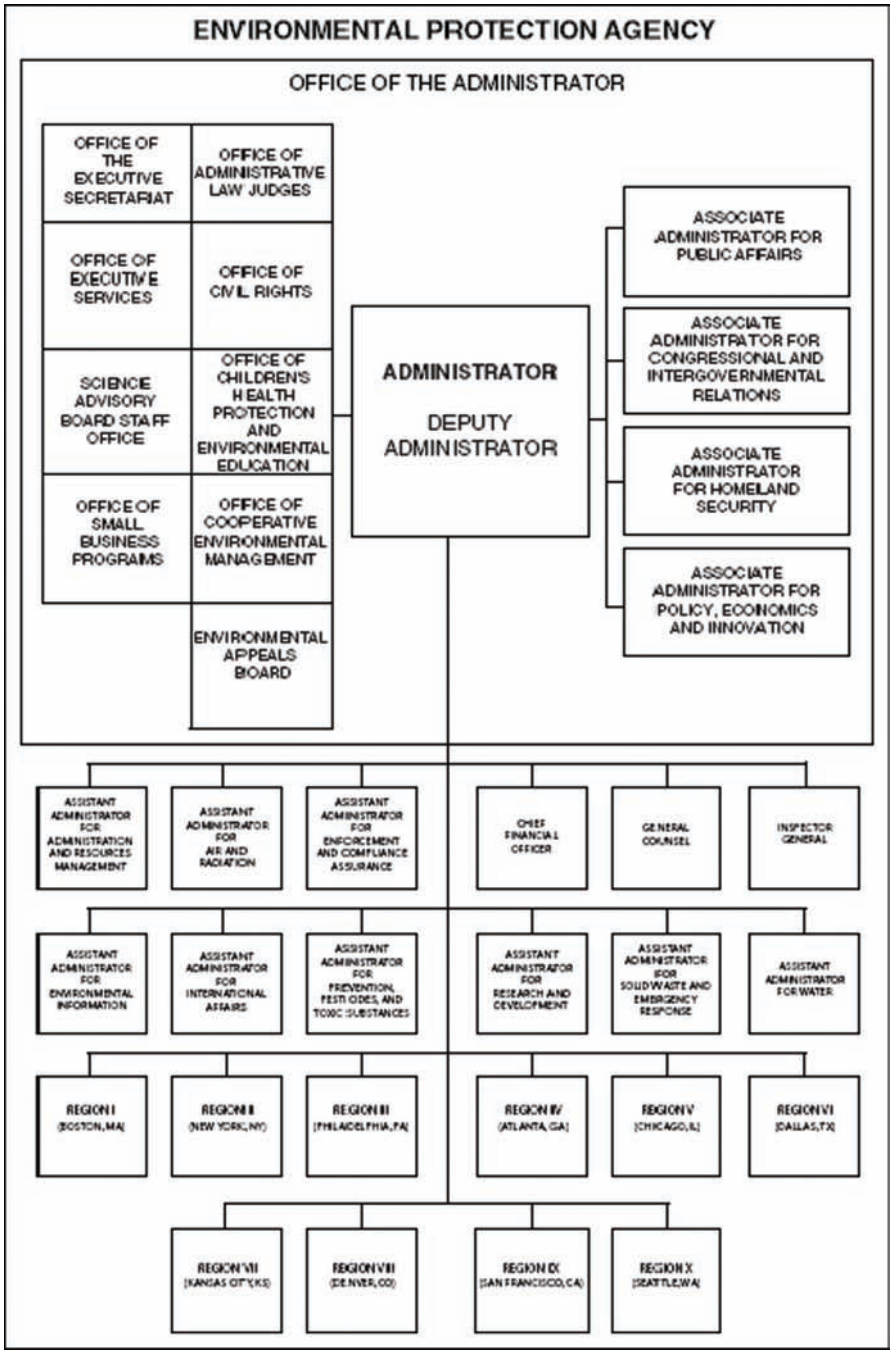


**FIGURE 13.3** Environmental Protection Agency

*Source:* Office of the Federal Register, National Archives and Records Administration, U.S. Government Manual, 2009–2010, p. 369.

### Functions of Administrative Agencies

Administrative agencies came into existence because legislative bodies recognized that they could not achieve desired economic and social goals within the existing governmental structure. Although legislatures could provide general policy direction, they possessed limited subject matter expertise and could not devote continuing attention to the multitude of problems that confront our modern society. Agencies, on the other hand, can assemble experts who focus on one area and work toward achieving legislatively determined objectives.

Legislatures establish an administrative agency by enacting a statute called an **enabling act.** In addition to creating the agency, this act determines its organizational structure, defines its functions and powers, and establishes basic operational standards and guidelines. These standards and guidelines help reviewing courts control the abuse of discretion. Courts also use written directives to assess whether an agency is operating according to the legislature's intent. Administrative agencies can also be created by executive orders authorized by statute.

Agencies perform a variety of functions. For example, they monitor businesses and professions in order to prevent the use of unfair methods of competition and the use of deceptive practices; they help ensure that manufacturers produce pure medications and that food products are safe to consume; and they function to protect society from environmental pollution and insider stock-trading practices.

## ADMINISTRATIVE AGENCY POWERS

Administrative agencies regulate individual and business decision making by exercising legislatively delegated **rulemaking, investigative,** and **adjudicative powers.** Although the separation of powers doctrine states that the legislative, executive, and judicial functions of government should not exist in the same person or group of persons, the courts have ruled that combining such functions within a single agency does not conflict with the doctrine. Even though a wide range of powers may be delegated to an agency in its enabling act, there are checks on its activities. The creator of the agency, which is generally the legislature, retains the power to eliminate it or to alter the rules governing it. In addition, agency decisions are subject to judicial review.

### Rulemaking Power

The rulemaking power of administrative agencies covers a vast range of business and government functions. Rulemaking is often referred to as the quasi-legislative function of administrative agencies. Agencies that have been granted rulemaking powers are authorized to make, alter, or repeal rules and regulations to the extent specified in their enabling statutes. The enabling acts set general standards, authorize the agencies to determine the content of the regulations, and provide general sanctions for noncompliance with the rules. A federal agency possessing the rulemaking power is obliged to comply with duly established procedures when making and promulgating rules, and the rules themselves must be necessary for the agency to fulfill its statutory duties.

There are essentially three types of administrative rules: substantive, interpretive, and procedural.

**Substantive rules** are used to establish and implement policies that assist an agency in accomplishing its statutorily established objectives. Substantive rules normally apply prospectively but not retroactively. If a federal agency properly exercises its rulemaking power in developing and promulgating substantive rules and the rules are necessary to achieving the objectives established for it by Congress in the enabling act, the rules will have the same legal force and effect as a statute. The "notice and comment" process (which is explained below) is the most common procedure used when agencies develop and promulgate substantive rules.

Courts generally uphold substantive rules if they are satisfied that the agency has examined the issues, appropriately reached its decision, followed established procedures, and acted within the scope of its authority.

An **interpretive rule** is used to explain an agency's interpretation of an ambiguous statute, or its understanding of the meaning of an important term that Congress has neglected to define. Interpretive rules are not to be used to make substantive policy changes. Because of an APA exemption, agencies need not follow the "notice and comment" procedures when developing and promulgating interpretive rules. Although interpretive rules are not enforceable to the same extent as laws, courts will often find interpretive rules persuasive if the agency has relied on its own expertise and experience in the rule's development, and the agency's actions are within its statutory scope of authority.

**Procedural rules** are developed to establish standard operating procedures within an agency. These process-oriented rules are devoid of substantive content and agencies are exempted by the APA from compliance with the "notice and comment" procedures.

## Formal and Informal Rulemaking

Congress sometimes specifies in an agency's enabling statute that formal rulemaking procedures must be followed. The procedural requirements for formal rulemaking are found in Section 554 of the APA and provide for a trial-like hearing process "on the record," complete with witnesses and recorded testimony, as well as findings of fact and conclusions of law.

More commonly, when an agency seeks to make or promulgate substantive rules, it engages in informal rulemaking (also known as "notice and comment" procedures), pursuant to Section 553 of the APA. In informal rulemaking, agencies are required to publish proposed rules in the Federal Register, thereby providing notice of the agency's intended action to anyone interested in the matter. Agencies must also accept written submissions from persons interested in commenting on the proposed rule, and if the agency so desires, permit oral presentations. The APA also provides that the agency publish its final version of each rule and an accompanying explanation of the purpose and rationale for the rule in the Federal Register no less than thirty days prior to when the rule takes effect.

## Prelude to *Gonzales v. Oregon*

The next case involves Oregon's judicial challenge to an "interpretive" rule promulgated by former U.S. Attorney General John Ashcroft. The rule purported to "interpret" the federal Controlled Substances Act (CSA) as forbidding licensed physicians in Oregon from prescribing specified drugs when assisting their patients to commit suicide even though the physicians were acting lawfully according to Oregon's Death with Dignity Act.

The State of Oregon and other plaintiffs responded to the promulgation of the interpretive rule by filing suit in federal court. Oregon was successful in the district court in obtaining a permanent injunction and also prevailed in the Court of Appeals.

Many readers of the Oregon case will wonder why a case that focuses on former U.S. Attorney John Ashcroft is captioned *Gonzales v. Oregon*. The explanation is that Ashcroft, in his capacity as the U.S. attorney general, promulgated the interpretive rule at issue. The rule's constitutionality was litigated all the way to the U.S. Supreme Court. Ashcroft resigned his position on February 23, 2005, the very day after the U.S. Supreme Court granted the government's petition for certiorari in this case. His successor, Alberto Gonzales, was nominated by President George W. Bush and confirmed by the Senate, and he replaced Ashcroft as a party in this case.

## Alberto Gonzales, Attorney General v. Oregon

*546 U.S. 243*
*U.S. Supreme Court*
*January 17, 2006*

**Justice Kennedy delivered the opinion of the Court.** The question before us is whether the Controlled Substances Act allows the United States Attorney General to prohibit doctors from prescribing regulated drugs for use in physician-assisted suicide, notwithstanding a state law permitting the procedure. As the Court has observed, "Americans are engaged in an earnest and profound debate about the morality, legality, and practicality of physician-assisted suicide." *Washington v. Glucksberg*, 521 U.S. 702, 735 (1997). The dispute before us is in part a product of this political and moral debate, but its resolution requires an inquiry familiar to the courts: interpreting a federal statute to determine whether Executive action is authorized by, or otherwise consistent with, the enactment.

In 1994, Oregon became the first State to legalize assisted suicide when voters approved a ballot measure enacting the Oregon Death With Dignity Act (ODWDA).... ODWDA, which survived a 1997 ballot measure seeking its repeal, exempts from civil or criminal liability state-licensed physicians who, in compliance with the specific safeguards in ODWDA, dispense or prescribe a lethal dose of drugs upon the request of a terminally ill patient.

The drugs Oregon physicians prescribe under ODWDA are regulated under a federal statute, the Controlled Substances Act (CSA or Act). 84 Stat. 1242, as amended, 21 U.S.C. § 801 et seq. The CSA allows these particular drugs to be available only by a written prescription from a registered physician. In the ordinary course the same drugs are prescribed in smaller doses for pain alleviation.

A November 9, 2001 Interpretive Rule issued by the Attorney General addresses the implementation and enforcement of the CSA with respect to ODWDA. It determines that using controlled substances to assist suicide is not a legitimate medical practice and that dispensing or prescribing them for this purpose is unlawful under the CSA. The Interpretive Rule's validity under the CSA is the issue before us.

*I*

*A*

We turn first to the text and structure of the CSA. Enacted in 1970 with the main objectives of combating drug abuse and controlling the legitimate and illegitimate traffic in controlled substances, the CSA creates a comprehensive, closed regulatory regime criminalizing the un-authorized manufacture, distribution, dispensing, and possession of substances classified in any of the Act's five schedules.... The Act places substances in one of five schedules based on their potential for abuse or dependence, their accepted medical use, and their accepted safety for use under medical supervision. Schedule I contains the most severe restrictions on access and use, and Schedule V the least.... Congress classified a host of substances when it enacted the CSA, but the statute permits the Attorney General to add, remove, or reschedule substances. He may do so, however, only after making particular findings, and on scientific and medical matters he is required to accept the findings of the Secretary of Health and Human Services (Secretary). These proceedings must be on the record after an opportunity for comment....

The present dispute involves controlled substances listed in Schedule II, substances generally available only pursuant to a written, nonrefillable prescription by a physician. 21 U.S.C. § 829(a). A 1971 regulation promulgated by the Attorney General requires that every prescription for a controlled substance "be issued for a legitimate medical purpose by an individual practitioner acting in the usual course of his professional practice."...

To prevent diversion of controlled substances with medical uses, the CSA regulates the activity of physicians. To issue lawful prescriptions of Schedule II drugs, physicians must "obtain from the Attorney General a registration issued in accordance with the rules and regulations promulgated by him."... The Attorney General may deny, suspend, or revoke this registration if, as relevant here, the physician's registration would be "inconsistent with the public interest."...

Oregon voters enacted ODWDA in 1994. For Oregon residents to be eligible to request a prescription under ODWDA, they must receive a diagnosis from their attending physician that they have an incurable and irreversible disease that, within reasonable medical judgment, will cause death within six months.... Attending physicians must also determine whether a patient has made a voluntary request, ensure a patient's choice is informed, and refer patients to counseling if they might be suffering from a

psychological disorder or depression causing impaired judgment.... A second "consulting" physician must examine the patient and the medical record and confirm the attending physician's conclusions.... Oregon physicians may dispense or issue a prescription for the requested drug, but may not administer it....

The reviewing physicians must keep detailed medical records of the process leading to the final prescription.... Physicians who dispense medication pursuant to ODWDA must also be registered with both the State's Board of Medical Examiners and the federal Drug Enforcement Administration (DEA).... In 2004, 37 patients ended their lives by ingesting a lethal dose of medication prescribed under ODWDA....

In 1997, Members of Congress concerned about ODWDA invited the DEA to prosecute or revoke the CSA registration of Oregon physicians who assist suicide. They contended that hastening a patient's death is not legitimate medical practice, so prescribing controlled substances for that purpose violates the CSA. Letter from Sen. Orrin Hatch and Rep. Henry Hyde to Thomas A. Constantine (July 25, 1997).... The letter received an initial, favorable response from the director of the DEA,... but Attorney General Reno considered the matter and concluded that the DEA could not take the proposed action because the CSA did not authorize it to "displace the states as the primary regulators of the medical profession, or to override a state's determination as to what constitutes legitimate medical practice." ... Legislation was then introduced to grant the explicit authority Attorney General Reno found lacking; but it failed to pass....

In 2001, John Ashcroft was appointed Attorney General....

On November 9, 2001, without consulting Oregon or apparently anyone outside his Department, the Attorney General issued an Interpretive Rule announcing his intent to restrict the use of controlled substances for physician-assisted suicide. Incorporating the legal analysis of a memorandum he had solicited from his Office of Legal Counsel, the Attorney General ruled "assisting suicide is not a 'legitimate medical purpose... and that prescribing, dispensing, or administering federally controlled substances to assist suicide violates the Controlled Substances Act. Such conduct by a physician registered to dispense controlled substances may 'render his registration... inconsistent with the public interest' and therefore subject to possible suspension or revocation.... The Attorney General's conclusion applies regardless of whether state law authorizes or permits such conduct by practitioners or others and regardless of the condition of the person whose suicide is assisted."...

There is little dispute that the Interpretive Rule would substantially disrupt the ODWDA regime. Respondents contend, and petitioners do not dispute, that every prescription filled under ODWDA has specified drugs classified under Schedule II. A physician cannot prescribe the substances without DEA registration, and revocation or suspension of the registration would be a severe restriction on medical practice. Dispensing controlled substances without a valid prescription, furthermore, is a federal crime....

In response the State of Oregon, joined by a physician, a pharmacist, and some terminally ill patients, all from Oregon, challenged the Interpretive Rule in federal court. The United States District Court for the District of Oregon entered a permanent injunction against the Interpretive Rule's enforcement.

A divided panel of the Court of Appeals for the Ninth Circuit granted the petitions for review and held the Interpretive Rule invalid....

We granted the Government's petition for certiorari....

*II.*

Executive actors often must interpret the enactments Congress has charged them with enforcing and implementing. The parties before us are in sharp disagreement both as to the degree of deference we must accord the Interpretive Rule's substantive conclusions and whether the Rule is authorized by the statutory text at all. Although balancing the necessary respect for an agency's knowledge, expertise, and constitutional office with the courts' role as interpreter of laws can be a delicate matter, familiar principles guide us. An administrative rule may receive substantial deference if it interprets the issuing agency's own ambiguous regulation. *Auer v. Robbins, 519 U.S. 452... (1997).* An interpretation of an ambiguous statute may also receive substantial deference. *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984).* Deference in accordance with *Chevron*, however, is warranted only "when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority."... Otherwise, the interpretation is "entitled to respect" only to the extent it has the "power to persuade."...

The Government first argues that the Interpretive Rule is an elaboration of one of the Attorney General's own regulations, 21 CFR § 1306.04 (2005), which requires all prescriptions be issued "for a legitimate medical purpose by an individual practitioner acting in the usual course of his professional practice." As such,

the Government says, the Interpretive Rule is entitled to considerable deference in accordance with *Auer*.

In our view *Auer* and the standard of deference it accords to an agency are inapplicable here.... Here... the underlying regulation does little more than restate the terms of the statute itself. The language the Interpretive Rule addresses comes from Congress, not the Attorney General, and the near-equivalence of the statute and regulation belies the Government's argument for *Auer* deference....

The regulation uses the terms "legitimate medical purpose" and "the course of professional practice"... but this just repeats two statutory phrases and attempts to summarize the others. It gives little or no instruction on a central issue in this case: Who decides whether a particular activity is in "the course of professional practice" or done for a "legitimate medical purpose"? Since the regulation gives no indication how to decide this issue, the Attorney General's effort to decide it now cannot be considered an interpretation of the regulation. Simply put, the existence of a parroting regulation does not change the fact that the question here is not the meaning of the regulation but the meaning of the statute. An agency does not acquire special authority to interpret its own words when, instead of using its expertise and experience to formulate a regulation, it has elected merely to paraphrase the statutory language....

Just as the Interpretive Rule receives no deference under *Auer*, neither does it receive deference under *Chevron*. If a statute is ambiguous, judicial review of administrative rule making often demands *Chevron* deference; and the rule is judged accordingly. All would agree, we should think, that the statutory phrase "legitimate medical purpose" is a generality, susceptible to more precise definition and open to varying constructions, and thus ambiguous in the relevant sense. *Chevron* deference, however, is not accorded merely because the statute is ambiguous and an administrative official is involved. To begin with, the rule must be promulgated pursuant to authority Congress has delegated to the official....

The Attorney General has rule-making power to fulfill his duties under the CSA. The specific respects in which he is authorized to make rules, however, instruct us that he is not authorized to make a rule declaring illegitimate a medical standard for care and treatment of patients that is specifically authorized under state law....

The CSA gives the Attorney General limited powers, to be exercised in specific ways. His rule-making authority under the CSA is described in two provisions: (1) "The Attorney General is authorized to promulgate rules and regulations and to charge reasonable fees relating to the registration and control of the manufacture, distribution, and dispensing of controlled substances and to listed chemicals,"... and (2) "The Attorney General may promulgate and enforce any rules, regulations, and procedures which he may deem necessary and appropriate for the efficient execution of his functions under this subchapter,"... As is evident from these sections, Congress did not delegate to the Attorney General authority to carry out or effect all provisions of the CSA. Rather, he can promulgate rules relating only to "registration" and "control," and "for the efficient execution of his functions" under the statute.

Turning first to the Attorney General's authority to make regulations for the "control" of drugs, this delegation cannot sustain the Interpretive Rule's attempt to define standards of medical practice. Control is a term of art in the CSA. "As used in this subchapter," *§ 802—the subchapter that includes § 821—*

> "The term 'control' means to add a drug or other substance, or immediate precursor, to a schedule under part B of this subchapter, whether by transfer from another schedule or otherwise." *§ 802(5)*

To exercise his scheduling power, the Attorney General must follow a detailed set of procedures, including requesting a scientific and medical evaluation.... The statute is also specific as to the manner in which the Attorney General must exercise this authority: "Rules of the Attorney General under this subsection [regarding scheduling] shall be made on the record after opportunity for a hearing pursuant to the rule making procedures prescribed by [the Administrative Procedure Act.] ... The Interpretive Rule now under consideration does not concern the scheduling of substances and was not issued after the required procedures for rules regarding scheduling, so it cannot fall under the Attorney General's "control" authority.

... [T]he CSA's express limitations on the Attorney General's authority, and other indications from the statutory scheme, belie any notion that the Attorney General has been granted this implicit authority. Indeed, if "control" were given the expansive meaning required to sustain the Interpretive Rule, it would transform the carefully described limits on the Attorney General's authority over registration and scheduling into mere suggestions....

The Interpretive Rule … is … an interpretation of the substantive federal law requirements (under 21 CFR § 1306.04 (2005)) for a valid prescription. It begins by announcing that assisting suicide is not a "legitimate medical purpose"… and that dispensing controlled substances to assist a suicide violates the CSA.… Violation is a criminal offense, and often a felony.… The Interpretive Rule thus purports to declare … that using controlled substances for physician-assisted suicide is a crime, an authority that goes well beyond the Attorney General's statutory power to register or deregister.…

The problem with the design of the Interpretive Rule is that it cannot, and does not, explain why the Attorney General has the authority to decide what constitutes an underlying violation of the CSA in the first place. The explanation the Government seems to advance is that the Attorney General's authority to decide whether a physician's actions are inconsistent with the "public interest" provides the basis for the Interpretive Rule.

By this logic, however, the Attorney General claims extraordinary authority. If the Attorney General's argument were correct, his power … would include the greater power to criminalize even the actions of registered physicians, whenever they engage in conduct he deems illegitimate. This power to criminalize… would be unrestrained. It would be anomalous for Congress to have so painstakingly described the Attorney General's limited authority to deregister a single physician or schedule a single drug, but to have given him, just by implication, authority to declare an entire class of activity outside "the course of professional practice," and therefore a criminal violation of the CSA.…

… It is not enough that the terms "public interest," "public health and safety," and "Federal law" are used in the part of the statute over which the Attorney General has authority. The statutory terms "public interest" and "public health" do not call on the Attorney General, or any other Executive official, to make an independent assessment of the meaning of federal law. The Attorney General did not base the Interpretive Rule on an application of the five-factor test generally, or the "public health and safety" factor specifically. Even if he had, it is doubtful the Attorney General could cite the "public interest" or "public health" to deregister a physician simply because he deemed a controversial practice permitted by state law to have an illegitimate medical purpose.…

The limits on the Attorney General's authority to define medical standards for the care and treatment of patients bear also on the proper interpretation of § 871(b). This section allows the Attorney General to best determine how to execute "his functions." It is quite a different matter, however, to say that the Attorney General can define the substantive standards of medical practice as part of his authority. To find a delegation of this extent in *§ 871* would put that part of the statute in considerable tension with the narrowly defined delegation concerning control and registration. It would go, moreover, against the plain language of the text to treat a delegation for the "execution" of his functions as a further delegation to define other functions well beyond the statute's specific grants of authority. When Congress chooses to delegate a power of this extent, it does so not by referring back to the administrator's functions but by giving authority over the provisions of the statute he is to interpret.…

The structure of the CSA… conveys unwillingness to cede medical judgments to an Executive official who lacks medical expertise. In interpreting statutes that divide authority, the Court has recognized: "Because historical familiarity and policymaking expertise account in the first instance for the presumption that Congress delegates interpretive lawmaking power to the agency rather than to the reviewing court, we presume here that Congress intended to invest interpretive power in the administrative actor in the best position to develop these attributes." This presumption works against a conclusion that the Attorney General has authority to make quintessentially medical judgments.

The Government contends the Attorney General's decision here is a legal, not a medical, one. This generality, however, does not suffice. The Attorney General's Interpretive Rule, and the Office of Legal Counsel memo it incorporates, place extensive reliance on medical judgments and the views of the medical community in concluding that assisted suicide is not a "legitimate medical purpose." This confirms that the authority claimed by the Attorney General is both beyond his expertise and incongruous with the statutory purposes and design.

The idea that Congress gave the Attorney General such broad and unusual authority through an implicit delegation in the CSA's registration provision is not sustainable. "Congress, we have held, does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes."…

The importance of the issue of physician-assisted suicide, which has been the subject of an "earnest and

profound debate" across the country ... makes the oblique form of the claimed delegation all the more suspect. Under the Government's theory, moreover, the medical judgments the Attorney General could make are not limited to physician-assisted suicide. Were this argument accepted, he could decide whether any particular drug may be used for any particular purpose, or indeed whether a physician who administers any controversial treatment could be deregistered. This would occur, under the Government's view, despite the statute's express limitation of the Attorney General's authority to registration and control, with attendant restrictions on each of those functions, and despite the statutory purposes to combat drug abuse and prevent illicit drug trafficking.

We need not decide whether *Chevron* deference would be warranted for an interpretation issued by the Attorney General concerning matters closer to his role under the CSA, namely preventing doctors from engaging in illicit drug trafficking. In light of the foregoing, however, the CSA does not give the Attorney General authority to issue the Interpretive Rule as a statement with the force of law....

The Government, in the end, maintains that the prescription requirement delegates to a single Executive officer the power to effect a radical shift of authority from the States to the Federal Government to define general standards of medical practice in every locality. The text and structure of the CSA show that Congress did not have this far-reaching intent to alter the federal-state balance and the congressional role in maintaining it.

The judgment of the Court of Appeals is Affirmed.

### Case Questions

1. What was the Justice Department's argument on behalf of the Attorney General's Interpretive Regulation?
2. According to the Supreme Court majority, what rulemaking powers does the U.S. Attorney General possess?
3. Why did the Supreme Court reject the Justice Department's arguments and affirm the lower courts?

**INTERNET TIP**

Justices Scalia, Roberts, and Thomas dissented in this case. Interested readers can find Justice Scalia's dissent on the textbook's website.

## Investigative Power

Agencies cannot operate without access to facts for intelligent regulation and adjudication. Thus, the **investigative power** is conferred on practically all administrative agencies. As regulation has expanded and intensified, the agencies' quest for facts has gained momentum.

Statutes commonly grant an agency the power to use several methods to carry out its fact-finding functions, such as requiring reports from regulated businesses, conducting inspections, and using judicially enforced subpoenas.

The power to investigate is one of the functions that distinguishes agencies from courts. This power is usually exercised in order to perform another primary function properly. However, some agencies are created primarily to perform the fact-finding or investigative function. Like any other power or function of the government, it must be exercised so as not to violate constitutionally protected rights.

The inspector general of the U.S. Department of Agriculture is statutorily charged with auditing federal programs and exposing fraud and abuse in federal disaster relief programs. In the following case, the inspector general served Ann Glenn and others with subpoenas to turn over specified records, documents, and reports. Glenn and the others, believing that the inspector general did not have the right to subpoena such information, sought relief in the Eleventh Circuit U.S. Court of Appeals.

## Inspector General of U.S. Department of Agriculture v. Glenn

*122 F.3d 1007*
*U.S. Court of Appeals, Eleventh Circuit*
*September 18, 1997*

**Floyd R. Gibson, Senior Circuit Judge**

*1. Background*

In 1993, in response to a hotline complaint alleging questionable disaster program payments to program participants in Mitchell County, Georgia, the United States Department of Agriculture's ("USDA") Inspector General audited the Consolidated Farm Service Agency's ("CFSA") Mitchell County disaster program. The Inspector General sought to determine whether CFSA program participants were complying with regulatory payment limitations. As a result of the audit, the Inspector General determined that $1.3 million in questionable disaster payments were awarded to Mitchell County program participants. As part of the audit, the Inspector General requested various information from appellants to determine their compliance with the payment limitations. When appellants repeatedly refused to provide the requested information, the Inspector General issued subpoenas to require production of the information. The Inspector General sought summary enforcement of the subpoenas in the United States District Court for the Middle District of Georgia. The district court ordered enforcement, and appellants challenge that order on appeal.

*II. Discussion*

Due to a concern that fraud and abuse in federal programs was "reaching epidemic proportions,"… Congress created Offices of Inspectors General in several governmental departments "to more effectively combat fraud, abuse, waste and mismanagement in the programs and operations of those departments and agencies,"… 5 U.S.C. app. §§ 1–12 (1994). The Inspector General Act of 1978,… enables Inspectors General to combat such fraud and abuse by allowing "audits of Federal establishments, organizations, programs, activities, and functions," and by authorizing broad subpoena powers.… We will enforce a subpoena issued by the Inspector General so long as (1) the Inspector General's investigation is within its authority; (2) the subpoena's demand is not too indefinite or overly burdensome; (3) and the information sought is reasonably relevant.… Although appellants recognize that the scope of the Inspector General's subpoena power is broad, they contend that the USDA's Inspector General exceeded the scope of this power when he subpoenaed information as part of a payment limitation review. Appellants argue that a payment limitation review is a "program operating responsibilit[y]" which section 9(a)(2) of the IGA prohibits agencies from transferring to the Inspector General.…

The IGA specifically directs Inspector General to coordinate "activities designed … to prevent and detect abuse" in departmental programs.… To enable the Inspector General to carry out this function, the IGA authorizes the Inspector General to conduct "audits,"… for the purpose of promoting "efficiency" and detecting "fraud and abuse."… The IGA's legislative history suggests that audits are to have three basic areas of inquiry:

> (1) examinations of financial transactions, accounts, and reports and reviews, compliance with applicable laws and regulations,
> (2) reviews of efficiency and to determine whether the audited is giving due consideration to economical and efficiency management, utilization, and conservation of its resources and to minimum expenditure of effort, and
> (3) reviews of program results to determine whether programs or activities meet the objectives established by Congress or the establishment.…

To enable the Inspector General to conduct such audits in an effective manner, the IGA provides the Inspector General with broad subpoena power which is "absolutely essential to the discharge of the Inspector … General's functions," for "[w]ithout the power necessary to conduct a comprehensive audit the Inspector … General could have no serious impact on the way federal funds are expended."…

This case illustrates the necessity of the Inspector General's auditing and subpoena powers. The Inspector General received a hotline complaint regarding questionable payments in the CFSA's Mitchell County disaster program. The Inspector General appropriately began an investigation of the program to detect possible abuse. As part of the audit, the Inspector General requested information from program participants to determine whether the payments they received were

warranted. When appellants, who were program participants, refused to produce the requested information, the Inspector General utilized its subpoena powers to acquire the necessary information. Without this ability to issue subpoenas, the Inspector General would be largely unable to determine whether the program and its benefit recipients were operating in an appropriate manner. Thus, an abuse of the system, which the Inspector General was specifically created to combat, could possibly go undetected, and government waste and abuse could continue unchecked. The subpoena power, which the Inspector General appropriately invoked in this case, is vital to the Inspector General's function of investigating fraud and abuse in federal programs.

Appellants contend that the Inspector General is only authorized to detect fraud and abuse within government programs, and that program administrators are responsible for detecting abuse among program participants. While we agree that IGA's main function is to detect abuse within agencies themselves, the IGA's legislative history indicates that Inspectors General are permitted and expected to investigate public involvement with the programs in certain situations. Congressman Levitas, a co-sponsor of the IGA, stated that the Inspector General's "public contact would only be for the beneficial and needed purpose of receiving complaints about problems with agency administration and in the investigation of fraud and abuse by those persons who are misusing or stealing taxpayer dollars." … From this statement, we conclude that the Inspector General's public contact in this case was appropriate because it occurred during the course of an investigation into alleged misuse of taxpayer dollars. In sum, we conclude that the subpoenas issued by the Inspector General did not exceed the statutory authority granted under the IGA.

Appellants also claim that the subpoenas were too indefinite and were unduly burdensome. CFSA regulations require participants to retain records for a period of two years following the close of the program year.… Appellants argue that the Inspector General cannot subpoena records which predate the required retention period. We do not agree with appellants' argument. While appellants are not required to retain records beyond the two-year period, no indication exists that records created prior to the retention period should be free from the Inspector General's subpoena powers.

Appellants further contend that the subpoenas are unduly burdensome because the 1990 and 1991 records sought by the Inspector General "were maintained and controlled by [appellant] J. C. Griffin, Sr., who had no mental capacity to explain the record-keeping system utilized in 1990 and 1991 in his dealings with the USDA during [that] time period."… We do not believe that Mr. Griffin's mental incapacity has any bearing on the enforceability of the Inspector General's subpoenas. At this stage, the Inspector General is merely requesting information from appellants as part of a large investigation involving many program participants in Mitchell County. The Inspector General has not requested that Griffin explain the contents of his records or his system for maintaining them. Consequently, we are unable to conclude that subpoenas create an undue burden upon Griffin or any of the other appellants.…

*III. Conclusion*

For the reasons set forth in this opinion we AFFIRM the district court's decision to enforce the Inspector General's subpoenas.

### Case Questions

1. What argument did Glenn make to the appellate court regarding the Inspector General's statutory authority?
2. How did the appeals court rule, and why?
3. Why do you think that the appellants were unsuccessful with their claims that the subpoenas were both indefinite and unduly burdensome?

## Adjudicative Power

When an agency's action involves the rulemaking function, it need not make use of judicial procedures. The **adjudicative power** delegated to administrative agencies, however, requires it to make determinations of a targeted person's legal rights, duties, and obligations and for this reason adjudicatory hearings resemble a court's decision-making process. Thus,

when an agency is intent on obtaining a binding determination or adjudication that affects the legal rights of an individual or individuals, it must use some of the procedures that have traditionally been associated with the judicial process.

Before sanctions can be imposed, an alleged violator is entitled to an administrative hearing that is conducted according to APA procedures (or other procedures specified in the enabling act) and that complies with the due process requirements of the Fifth and Fourteenth Amendments. This means that the accused has to receive notice and a fair and open hearing before an impartial and competent tribunal. Parties affected by the agency action must be given the opportunity to confront any adverse witnesses and present oral and written evidence on their own behalf. An agency may confine cross-examination to the essentials, thus avoiding the discursive and repetitive questioning common to courtroom cross-examinations.

Administrative agencies employ **administrative law judges (ALJs)** to conduct adjudicatory hearings. Like judges, ALJs decide both questions of fact and issues of law, and they are limited to the evidence that is established on the record. ALJs are authorized to issue subpoenas, administer oaths, make evidentiary rulings, and conduct hearings. ALJs are not, however, members of the federal judiciary. They perceive their function as that of implementing and administering a legislative purpose rather than as judges impartially deciding between two litigants. In some agencies, ALJs are quite active in questioning witnesses, so a thorough record of the proceedings is developed for the benefit of the agency's administrator or board.

However, administrative law judges *are* empowered to make findings of fact and to recommend a decision. The recommendation is sent to the board of final review in the administrative agency, which ultimately decides whether the agency will retain the power to adopt, alter, or reverse it.

In theory, the decision of an administrative law judge is thoroughly reviewed before the agency's board of final review adopts it as its opinion. In reality, however, because of a board's heavy workload, the review may be delegated to members of its staff, and board members may never even read the administrative law judge's opinion. Although this has been challenged as a lack of due process for the defendant, the courts often permit delegation of review to agency staff members. The courts require only that the board members make decisions and understand the positions taken by the agency.

## JUDICIAL REVIEW

Judicial review is a relatively minor aspect of administrative law. In part, this is because judges lack expertise in the very technical and specialized subject area that is subject to agency regulation. The sheer volume of agency adjudications also makes it unrealistic to expect the judiciary to review more than a small percentage of such decisions. Third, the expense of obtaining judicial review is a barrier to many potential appellants.

Courts and administrative agencies are collaborators in the task of safeguarding the public interest. Thus, unless exceptional circumstances exist, courts are reluctant to interfere with the operation of a program administered by an agency. As the courts' respect of the administrative process increases, judicial self-restraint also increases.

The petitioner in the next case, the National Mining Association, asked the U.S. Court of Appeals to review a final rule promulgated by the Federal Mine Safety and Health Administration. The rule came into being after two fatal incidents occurred in West Virginia coal mines in 2006. The Association objected to procedural and substantive provisions of the rule, which had been adopted to help miners survive mining disasters.

## National Mining Ass'n v. Mine Safety and Health Admn.

*512 F.3d 696*
*United States Court of Appeals, District of Columbia Circuit*
*January 11, 2008.*

**Randolph, Circuit Judge:**

Two fatal accidents at West Virginia coal mines in January 2006 prompted the Mine Safety and Health Administration—MSHA—to adopt emergency safety measures.... MSHA, an agency within the Department of Labor, concluded that the West Virginia miners might have survived if there had been portable oxygen devices ... in the escapeways to protect them from toxic fumes for at least an hour. Acting quickly, MSHA issued an emergency temporary standard requiring mine operators to place such rescue devices, one for each miner, in the primary and emergency escapeways of the mine.... This petition for judicial review, brought by the National Mining Association, seeks to set aside the final rule that replaced the temporary standard.

The Mine Act authorizes MSHA to issue the temporary rules without notice and comment in response to emergencies.... In this case, in order to make its temporary standard permanent, MSHA engaged in notice-and-comment rulemaking, with the published temporary standard serving as the proposed rule.... The resulting product—the final emergency mine evacuation rule ... altered the temporary standard with respect to rescue devices.... The final rule required either that one additional device be provided for each miner in each emergency escapeway or that one additional device be provided in a "hardened room" cache located between two adjacent emergency escapeways and accessible from both.... A "hardened room" is a reinforced room built to the "same explosion force criteria as seals" and serviced by an independent, positive pressure source of ventilation from the surface.... The National Mining Association urges us to set the final rule aside. One of its objections is that MSHA failed to give adequate notice of the hardened room option.

The objection rests on § 101(a)(2) of the Mine Act. 30 U.S.C. § 811(a)(2). This section requires MSHA, in putting out proposed rules for notice and comment, to publish "the text of such rules proposed in their entirety" in the Federal Register.... Because MSHA never published the hardened room option in the Federal Register before issuing the final rule, National Mining concludes that this aspect of the final rule is invalid.

That the final rule differed from the one MSHA proposed is hardly unusual. An agency's final rules are frequently different from the ones it published as proposals. The reason is obvious. Agencies often "adjust or abandon their proposals in light of public comments or internal agency reconsideration."... Whether in such instances the agency should have issued additional notice and received additional comment on the revised proposal "depends, according to our precedent, on whether the final rule is a `logical outgrowth' of the proposed rule."... While we often apply the doctrine simply by comparing the final rule to the one proposed, we have also taken into account the comments, statements and proposals made during the notice-and-comment period.... In *South Terminal Corp. v. EPA,* the case that gave birth to the "logical outgrowth" formulation, the court did the same ... (1st Cir. 1974). The court held that the final rule was "a logical outgrowth"—not simply of the proposed rule—but "of the hearing and related procedures" during the notice and comment period....

Here MSHA's proposed rule—the emergency temporary standard—required that a rescue device be provided for each miner in both the primary and the alternative escapeways. That proposal left open several questions. Where in the escapeways should the devices be stored? How should they be made available to the miners? When the two escapeways are close together, will it suffice to have one common cache of devices rather than two separate caches? Given these considerations, interested persons must have been alerted to the possibility of a hardened room option. And the record shows that they were so alerted. Mine operators inquired about the potential of using a common cache of rescue devices located between adjacent emergency escapeways. They submitted questions, to MSHA about whether such a common cache would suffice. Four public meetings were held as part of the rulemaking. At each, the MSHA official's opening statement addressed the possibility of a hardened room alternative directly and sought comments from interested parties. A representative of the National Mining Association attended the Washington, D.C.,

meeting and indicated that his organization would respond to the opening statement by the end of the comment period. The Mining Association never submitted comments, but several interested parties did—including several of the Mining Association's members. MSHA later extended the comment period by thirty days so that "interested parties could adequately address issues contained in MSHA's opening statements."…

The hardened room option was thus a logical outgrowth of the proposed rule, or put differently, the Mining Association had adequate notice. Even if we were less than certain about this conclusion, the actual notice the Mining Association received would have cured any inadequacy….

The Mining Association alleges that the hardened room option—as opposed to an option allowing a common cache with less stringent safeguards—is arbitrary and capricious because MSHA did not sufficiently explain its decision.

The Mine Act incorporates the rulemaking requirements of the APA. 30 U.S.C. § 811(a)… Under the APA, an agency must "incorporate in the rules adopted a concise general statement of their basis and purpose."… This requirement is not meant to be particularly onerous…. It is enough if the agency's statement identifies the major policy issues raised in the rulemaking and coherently explains why the agency resolved the issues as it did… MSHA's statement did just that. As to the hardened room option, the main controversy was about whether less stringent common storage measures could be used instead…. The claim was that these less stringent requirements would provide incremental safety benefits over placing the rescue devices in the escapeways and that the options would be cheaper than the hardened room alternative, making common caches feasible for more mines.

MSHA referred to those comments in the preamble to its final rule, … It explained that its primary concern with approving a common cache of devices was that the cache needed to be "secured against damage from explosions in either escapeway."… Underlying MSHA's analysis is the apparent belief that the redundancy provided by having separate sets of devices results in an increased likelihood that at least one set would survive an explosion. Thus, in order to justify collapsing the two sets into one, additional steps are required to ensure that an explosion would not destroy the devices in a common cache. Hardened rooms achieve this end because they are built to more rigorous specifications…. While other options might be cheaper, the hardened room meets the primary concern MSHA identified.

Though MSHA's explanation of its decision is short, it adequately addresses the major policy concerns raised and demonstrates a course of reasoned decision making. The final rule, including the hardened room option, is not arbitrary and capricious.

*IV.*

The Mining Association argues that MSHA failed to comply with the Regulatory Flexibility Act … because it did not analyze the economic impact of the hardened room option. When promulgating a rule, an agency must perform an analysis of the impact of the rule on small businesses, or certify, with support, that the regulation will not have a significant economic impact on them…. When it published the temporary standard, MSHA certified that the primary method of compliance—placing a separate set of rescue devices in each emergency escapeway—would not have a significant economic impact on small businesses…. The Mining Association does not challenge the sufficiency of that certification. Since the primary method of compliance did not create a significant economic burden on small businesses, there was no reason for MSHA to undertake an economic analysis of the alternative. If the hardened room option is considerably more expensive, small businesses can simply refuse to choose it. *Compare Envtl. Def. Ctr., Inc. v. EPA, 344 F.3d 832, 879 (9th Cir. 2003)* (noting that the creation of cheaper alternative methods of compliance is one way to minimize the impact on small businesses).

For the foregoing reasons, the petition for review is denied.

*So ordered.*

## Case Questions

1. What were the Association's objections to the final rule?
2. Why did the court deny the petition and sustain the final rule?

**INTERNET TIP**

The case of *Chao v. Occupational Safety Health Review Commission* has been included in the Chapter XIII materials found on the textbook's website. In that case, the Secretary of the Department of Labor challenged a final ruling made by the Occupational Safety and Health Review Commission. The Commission had overturned three OSHA citations issued to a bridge painting contractor who was removing lead paint from the bridge. OSHA inspectors had issued the citations after inspecting the worksite and discovering problems with the protective scaffolding installed at that location. The Secretary asked the Court of Appeals to reverse the Review Commission's decision with respect to these citations. In this case, the court had to determine whether to defer to a statutory interpretation made by the administrative agency.

## Timing of Review

Parties must address their complaints to administrative tribunals and explore every possibility for obtaining relief through administrative channels **(exhaust administrative remedies)** before appealing to the courts. The courts will generally not interrupt an agency's procedure until the agency has issued a final decision, because if the administrative power has not been finally exercised, no irreparable harm has occurred; therefore, the controversy is not ripe.

The courts will hear a case before a final agency decision if the aggrieved party can prove that failure to interrupt the administrative process would be unfair. To determine the extent of fairness, the court will consider (1) the possibility of injury if the case is not heard, (2) the degree of doubt of the agency's jurisdiction, and (3) the requirement of the agency's specialized knowledge.

The requirements of exhaustion of administrative remedies and ripeness are concerned with the timing of judicial review of administrative action, but the two requirements are not the same. Finality and exhaustion focus on whether the administrative position being challenged has crystallized and is, in fact, an institutional decision. Ripeness asks whether the issues presented are appropriate for judicial resolution. Although each doctrine has a separate and distinct aim, they frequently overlap.

**INTERNET TIP**

Interested readers can find the case of *Sturm, Ruger & Company v. Chao* in the Internet materials for Chapter XIII on the textbook's website. Sturm, Ruger attempted to litigate claims against the Occupational Safety and Health Administration without having first exhausted all of their administrative remedies. The company was unsuccessful in the U.S. District Court, which dismissed their complaint. The company then appealed to the U.S. Court of Appeals for the District of Columbia Circuit. You can read that court's opinion online.

## Judicial Deference and the Scope of Judicial Review

In general, courts are willing to show **deference** to an agency's competence. Courts will uphold administrative findings if they are satisfied that the agency has examined the issues, reached its decision within the appropriate standards, and followed the required procedures.

It is impossible for a reviewing court to consider more than the highlights of the questions actually argued before an administrative agency since the fact situations are often complex and technical, and the time available for argument short. Instead, courts rely on an agency's expertise. Even when a court holds an original determination invalid, it usually remands the case for further consideration by the agency, rather than making its own final decision.

The courts have established standards as to the scope of judicial review. In general, questions of law are ultimately determined by courts and questions of fact are considered only to a very limited extent. Questions of law must be reserved for the courts because the power of final decision on judicial matters involving private rights cannot constitutionally be taken from the judiciary. However, this does not mean that courts will review every issue of law involved in an administrative determination.

Agency findings with respect to questions of fact, if supported by substantial evidence on the

record considered as a whole, are conclusive. Substantial evidence exists when the agency's conclusion is reasonably supported by the facts of record. Legal conclusions are judicially reversed only because of arbitrariness, capriciousness, an abuse of discretion, or a denial of due process.

**INTERNET TIP**

Students may wish to read a case involving the judicial review of a final decision by the Occupational Safety and Health Review Commission to issue citations to one of the contractors involved in the "Big Dig" project in downtown Boston. This case includes discussions of many of the topics addressed in this chapter in the context of an actual dispute. The case is *Modern Continental Construction Co. Inc v. Occupational Safety and Health Review Comm.*, and it can be found on the textbook's website.

## Introduction to *Ahmed v. Sebelius*

Dr. Ahmed, a Massachusetts dermatologist, was prosecuted in federal court in conjunction with a Medicare fraud investigation. The prosecution alleged that the doctor had fraudulently falsified and backdated patient documents. Prosecutors claimed that Ahmed intentionally misled CMS, the governmental agency administering Medicare, into paying him for treating patients afflicted with a disease called pemphigoid, a malady not covered by Medicare. Ahmed was accused of falsely reporting that some of the pemphigoid patients were also afflicted with a Medicare-authorized disease called "pemphigus." Ahmed entered a plea of guilty to one count of a fifteen-count indictment and was convicted of feloniously obstructing a health care investigation. Shortly after his conviction and sentencing, Dr. Ahmed's billing privileges were revoked by Medicare.

Dr. Ahmed decided to challenge the billing revocation decision via administrative proceedings. The first step in the review process involved asking NHIC, the Medicare contractor that had issued the revocation, to reconsider. A hearing officer reviewed the matter and affirmed the revocation decision. The next step was to request that the Department of Health and Human Services conduct an administrative hearing before an administrative law judge (ALJ). The ALJ also sustained the revocation order. The third step was an appeal from the ALJ's decision to the Health and Human Services Department Appeals Board (DAB), which would be the last administrative step. The DAB made the final decision on behalf of the Department and reaffirmed the revocation decision. Having exhausted all administrative remedies, Dr. Ahmed was entitled to seek judicial review, in this case to the U.S. District Court for Massachusetts.

Dr. Ahmed alleged in his complaint that Secretary Sebelius's Department of Health and Human Services had violated the Administrative Procedures Act, the Medicare Act, and the Fifth Amendment's Due Process Clause.

**Abdul Razzaque Ahmed v. Kathleen Sebelius**
*9-CV-11441-DPW*
*United States District Court, District of Massachusetts.*
*May 10, 2010*

**MEMORANDUM AND ORDER**
**Douglas Woodlock, District Judge**

*I. BACKGROUND*

…Ahmed is a Massachusetts dermatologist who specializes in the diagnosis and treatment of autoimmune skin blistering diseases. Prior to the commencement of the administrative action in this case, Ahmed was an approved Medicare supplier … treated Medicare patients, and received reimbursements from Medicare for those treatments. A. The Medicare Program The Medicare program provides health insurance benefits to individuals over age sixty-five and to certain disabled persons…. Medicare is administered by the Centers for Medicare and Medicaid Services ("CMS"), an agency of HHS. Congress has granted the Secretary broad authority to issue regulations relating to the administration of Medicare pursuant to Sections 1102 and 1871 of the Social Security Act…. (authorizing the

Secretary to "make and publish such rules and regulations … as may be necessary to the efficient administration of the functions" of Medicare); … [and] § 1395 … ("The Secretary shall prescribe such regulations as may be necessary to carry out the administration of the [Medicare] insurance programs."…). A physician wishing to participate in Medicare must first enroll in the program to receive Medicare billing privileges and a billing number….

To maintain billing privileges, physicians must complete the applicable enrollment application and revalidate their Medicare enrollment information every five years…. The application requires the physician to list any "final adverse actions" including any felony convictions…. CMS also may perform "off cycle revalidations."… In addition, CMS has regulatory authority to revoke a physician's Medicare enrollment and billing privileges in certain instances…. Relevant to this case is the regulation permitting revocation if, "within the 10 years preceding enrollment or revalidation of enrollment," the physician "was convicted of a Federal or State felony offense that CMS has determined to be detrimental to the best interests of the [Medicare] program and its beneficiaries."…

*II. STANDARD OF REVIEW*

Any Medicare provider or supplier whose billing privileges are revoked may have a hearing and judicial review under… 42 U.S.C. § 1395cc(j). …

Under the review provision, the district court has the "power to enter, upon the pleadings and transcript of the record, a judgment affirming, modifying, or reversing the decision of the [Secretary], with or without remanding the cause for a rehearing." The Secretary's findings "as to any fact, if supported by substantial evidence, shall be conclusive,"… and must be upheld "if a reasonable mind, reviewing the evidence in the record as a whole, could accept it as adequate to support his conclusion."… Questions of law, however, are reviewed de novo….

*III. DISCUSSION*

In order for the Secretary to revoke Ahmed's billing privileges properly … two conditions must be satisfied: first, the supplier must have been convicted of a designated federal or state felony offense that CMS has determined to be detrimental to the best interests of the Medicare program and its beneficiaries, and second, the conviction must have occurred within the ten years preceding enrollment or revalidation of enrollment. Ahmed challenges the Secretary's decision to revoke his Medicare billing privileges on the grounds that neither condition was met, and that the decision violated his due process rights. I review the Secretary's decision against this challenge and assess whether it is supported by substantial evidence and is legally correct.

***A. Relevant Criminal Conduct***

*1. The Designated Crimes*

Ahmed argues that CMS improperly revoked his Medicare enrollment and billing privileges based on the "erroneous conclusion" that his conviction for obstruction constituted a "financial crime" under 42 C.F.R. § 424.535…. That regulation designates "[f]inancial crimes, such as extortion, embezzlement, income tax evasion, insurance fraud and other similar crimes" as offenses that "CMS has determined to be detrimental to the best interests of the [Medicare] program and its beneficiaries."… Obstruction of a criminal investigation of a health care offense, he suggests, is not such an offense. Ahmed attempts to distinguish his felony conviction for obstruction of the criminal investigation of a health care offense from the four financial crimes listed in the regulation, each of which purportedly requires a showing of actual or intended financial harm to another. I agree with the Secretary, however, that the regulation should not be interpreted so narrowly…. The regulation uses nonexclusive, illustrative language to enumerate the various felony convictions that permit revocation of Medicare privileges: "[o]ffenses *include* … [f]inancial crimes, *such as* extortion, embezzlement, income tax evasion, insurance fraud *and other similar crimes.*"… The DAB [Department Appeals Board] concluded—in my view, correctly—that Ahmed's conviction under § 1518 was "similar" to the listed financial crimes, specifically insurance fraud. The obstruction charge for which Ahmed was convicted is a criminal offense that bears the DNA of insurance fraud in the health care setting. Ahmed created and submitted false documents that could support claims for Medicare coverage of his patients' IVIg treatments. The DAB properly concluded that this conduct, as does insurance fraud, "involves a false statement or misrepresentation in connection with a claim or application for insurance or insurance benefits." Moreover, as recited in the DAB decision, Ahmed stated in briefing to the ALJ [administrative law judge] that he had "placed false letters and immunopathology reports into his patients' files to bolster the reimbursements he received from Medicare." The offense involves the cover up (sic) dimension of criminal conduct striking at the essential financial integrity of the Medicare insurance program…. Ahmed sought to throw investigators off the

scent in their pursuit of a core financial fraud. It is not merely similar to insurance fraud; it is of a piece with it.

*2. Regulatory Revocation Versus Statutory Exclusion*
Ahmed also relies on the separate Medicare participation exclusion statute to distinguish obstruction from financial crimes…. The "mandatory exclusion" provision requires the Secretary to exclude individuals who were convicted of certain crimes, including "*a felony relating to fraud,* theft, embezzlement, breach of fiduciary responsibility, *or other financial misconduct*," from participation in Medicare…. Under the "permissive exclusion" provision, by contrast, the Secretary *may* exclude individuals who have been "convicted, under Federal or State law, in connection with the interference with or *obstruction of any investigation* into" certain criminal offenses, including health care fraud…. Ahmed contends that "Congress's deliberate, separate treatment of obstruction of justice demonstrates that NHIC may not view Dr. Ahmed's actions as falling into the category of 'financial crimes' set forth in 42 CFR § 424.535 … and should not automatically revoke his privileges on that basis."

I reject Ahmed's argument because, as the DAB correctly explained, the regulatory revocation … and the statutory exclusion … are "distinct remedial tools, each with its own set of prerequisites and consequences."… Under the revocation provision, the physician is barred from participating in Medicare from the effective date of the revocation until the end of the re-enrollment bar, which ranges between one and three years depending on the severity of the basis for revocation…. To re-enroll after revocation, the physician must complete and submit a new enrollment application and applicable documentation as a new supplier for validation by CMS….

The exclusion of a physician from participation in Medicare also has a finite time period, but the duration of exclusion differs depending on the crime committed. For mandatory exclusion … based on a felony conviction relating to health care fraud, the minimum period of exclusion is not less than five years…. For permissive exclusion … for a conviction relating to obstruction of an investigation, the exclusion period is three years, "unless the Secretary determines in accordance with published regulations that a shorter period is appropriate because of mitigating circumstances or that a longer period is appropriate because of aggravating circumstances."… At the end of the exclusion period, the physician may apply to the Secretary for termination of the exclusion, or the Secretary may terminate the exclusion in certain instances….

Although there are a variety of differences in details, a primary difference between revocation and exclusion appears to be in the collateral consequences. Revocation bars a supplier from participation in the Medicare program…. Exclusion extends beyond Medicare to Medicaid and all other federal health care programs…. "Federal health care program" is defined as "any plan or program providing health care benefits, whether directly through insurance or otherwise, that is funded directly, in whole or part, by the United States Government … or any State health care program."…

*3. Detrimental to the Best Interests of Medicare*
In the final analysis, even if Ahmed's felony conviction is somehow conceived as not expressly financial in nature, I am persuaded that his admitted obstruction of a criminal investigation of a health care offense here is the type of similar felony that CMS would properly consider "to be detrimental to the best interests" of Medicare and its beneficiaries because of its financial implications….

I therefore conclude … that substantial evidence supports the Secretary's determination that Ahmed's conviction … fell within the scope of relevant financial crimes detrimental to the best interests of Medicare and that the Secretary applied the correct construction of her regulations in reaching this conclusion.

***B. Revalidation***
Ahmed next argues that even if the Secretary properly determined that he committed a relevant crime, she should not have revoked his Medicare privileges without first engaging in some sort of revalidation process. To revoke Ahmed's Medicare billing privileges, his felony conviction must have occurred "within the 10 years preceding enrollment or revalidation of enrollment."… Neither party disputes that Ahmed's initial enrollment in Medicare occurred over ten years before his felony conviction. Therefore, the issue is whether revalidation occurred.

Section 424.515 outlines two types of revalidations. First, a provider or supplier "must resubmit and recertify the accuracy of its enrollment information every 5 years," and they "are required to complete the applicable enrollment application." … Second, "CMS reserves the right to perform off cycle revalidations in addition to the regular 5-year revalidations and may request that a provider or supplier recertify the accuracy of the enrollment information when warranted to assess and confirm the validity of the enrollment information maintained by CMS." …

… Specifically, Ahmed objects to the conclusion that "even the passive act of receiving information that a physician was convicted of a felony can constitute revalidation" because that "nonsensical" reading would render the revalidation requirement meaningless. I find, to the contrary, that § 424.515 expressly provides for event-triggered revalidation: "[o]ff cycle revalidations may be triggered as a result of random checks, information indicating local health care fraud problems, national initiatives, complaints, or other reasons that cause CMS to question the compliance of the provider or supplier with Medicare enrollment requirements."… That is precisely what happened here and it made a great deal of sense. Ahmed's conviction triggered an off-cycle revalidation in November 2007, when CMS and/or NHIC acquired or reviewed information that Ahmed had pled guilty to a felony related to health care reimbursement. The deliberative process did not end there because the felony conviction did not automatically require revocation; rather the regulation *permits*, but does not require, revocation if a physician is convicted of specified felonies…. The revocation based on Ahmed's felony conviction was assessed by three successive layers of administrative decision makers before reaching finality with the DAB decision. Ahmed was afforded the opportunity to submit materials he believed to bear upon the decision. Given the circumstances, those decision makers understandably did not consider Ahmed's several arguments against revocation compelling. I therefore conclude that the revocation of Ahmed's privileges was well within the Secretary's authority as a procedural matter.

***C. Due Process***

More broadly, Ahmed contends that his due process rights were violated because a revalidation process did not occur *before* CMS and/or NHIC made the revocation decision. He insists that revalidation is "an important procedural safeguard that provides Medicare participants and their patients with notice and an opportunity to be heard before a provider's billing privileges are revoked." Ahmed claims that if given that opportunity, he would have clarified "the true circumstances of his crime" and demonstrated "that his Medicare patients had access to few, if any, comparable treatment sources." The constitutional right to due process requires notice and a meaningful opportunity to respond…. Both of these requirements were met in this case. With respect to notice, Ahmed received a letter from NHIC on November 8, 2007 before his billing privileges were revoked on December 9, 2007. That letter also detailed an opportunity for Ahmed to obtain "an independent review" by requesting "an on-the-record reconsideration." With respect to a meaningful opportunity to respond, the Supreme Court "has recognized, on many occasions, that… where it would be impractical to provide predeprivation process, postdeprivation process satisfies the requirements of the Due Process Clause."… *Gilbert v. Homar*,… (1997) …"An important government interest, accompanied by a substantial assurance that the deprivation is not baseless or unwarranted, may in limited cases demanding prompt action justify postponing the opportunity to be heard until after the initial deprivation." *FDIC v. Mallen* … (1988)…. Once Ahmed was convicted of a crime manifesting an intent to manipulate the Medicare reimbursement system and to obstruct the criminal justice system which polices it, there was more than adequate need for prompt action to revoke his privileges to participate in the system. An elaborate pre-revocation process before the initiation of a felony-based revocation is not required for those convicted, as Ahmed was, of any felony within the terms of § 424.535(a)(3)…. [T]he regulation expressly rejects pre-revocation process for physicians, like Ahmed, whose billing privileges are revoked due to a felony conviction…. The sole remedies are post-revocation administrative and judicial review, which have been pursued vigorously by Ahmed through all their layers and fully satisfy his constitutional right to due process.

*IV. Conclusion*

For the reasons set forth more fully above, I GRANT the Defendant's motion … for judgment on the pleadings, or in the alternative, for summary judgment. I DENY the Plaintiff's cross-motion for judgment on the pleadings.

## Case Questions

1. Why did Ahmed believe his billing privileges should not have been revoked?
2. Why did the U.S. District Court reject Ahmed's arguments?

## ADMINISTRATIVE AGENCIES AND THE REGULATION OF BUSINESS

Congress has neither the time nor the expertise to regulate business. Congress has also decided that the judicial process is not well suited to the task. Instead it has entrusted the day-to-day responsibility for regulating business to administrative agencies. The following material focuses on two administrative agencies and how they perform this function.

### Occupational Safety and Health Administration

Historically, the common law provided an employee injured on the job with little recourse against an employer who could use the assumption-of-risk and contributory-negligence defenses or who invoked the fellow servant doctrine. With little incentive for employers to reduce employment-related injuries, the number of industrial injuries increased as manufacturing processes became more complex. Legislation was passed to improve job safety for coal miners during the late 1800s, and most states had enacted job safety legislation by 1920. Maryland and New York were the first states to establish workers' compensation laws, which have now been adopted in all fifty states. Although these laws modified the common law to enable injured employees to recover, they didn't change the practices that caused the dangerous conditions. Furthermore, state legislatures were reluctant to establish strict safety regulations, fearing that such actions would cause industry to move to other, less restrictive states.

In response to the problem, in 1970 Congress passed the Occupational Safety and Health Act to improve employees' safety and working conditions. The act established the National Institute of Occupational Safety and Health to conduct research in the area of employee health and safety. The act also created an administrative agency, called the **Occupational Health and Safety Administration (OSHA),** to set and enforce environmental standards within the workplace.

An employee who suspects that there is a safety violation at his or her place of work can contact the local OSHA office. An OSHA inspector makes an unannounced visit to the premises and conducts an inspection. If the inspection reveals violations, appropriate citations—either civil or criminal—are issued.

For civil citations, OSHA may impose fines up to $70,000 for each willful and repeated violation and $7,000 for less serious violations. As we saw earlier in this chapter in the case of *Sturm, Ruger & Co., Inc. v. Elaine Chao, Sec., U.S. Dept. of Labor*, an employer may contest an OSHA citation at a hearing before an administrative law judge. The ALJ's decision is appealable to the Occupational Health Review Commission, whose decision is appealable to the U.S. Court of Appeals.

Criminal prosecutions for OSHA violations are rare; however, when brought they are tried in federal district court. Convicted offenders can be fined up to $500,000 for each count and sentenced to a maximum of six months in prison.

OSHA inspectors also have the right to post a job site as imminently dangerous and obtain injunctions where necessary to shut down a work site because of the existence of dangerous working conditions.

### Federal Trade Commission and Consumer Credit Protection

The first multiuse credit cards, Visa and MasterCard, came into existence only in 1959. Initially, businesses that extended credit to consumers were subject to few regulations. They often imposed unduly high interest charges, failed to disclose their interest rates and associated credit charges, and mailed unsolicited credit cards to potential users. Because debt collection practices were unregulated, consumers were often harassed and threatened at home and at work. As a result, in 1968 Congress passed the **Consumer Credit Protection Act (CCPA).**

Designed to promote the disclosure of credit terms and to establish the rights and responsibilities of both creditors and consumers, the CCPA is much more protective of the consumer than was the common law. Although several agencies share authority for enforcing and controlling the CCPA, the Federal

Trade Commission bears primary responsibility for the CCPA enforcement.

Under the CCPA, many early credit card and loan practices became illegal. Issuers of credit cards, for example, were no longer permitted to mail unsolicited cards. Many of the questions about the apportionment of duties between the merchants who accepted credit cards and the card-issuing banks were clarified. For example, under the CCPA, a bank may not withdraw funds from a cardholder's savings or checking accounts to cover a credit card charge without the cardholder's authorization. Also, under the CCPA a cardholder's liability for unauthorized charges is limited to $50 in most cases.

The CCPA is extremely lengthy and complex and is better known under its various subsections. Title 1 of the CCPA is known as the Truth in Lending Act. The Fair Credit Reporting Act was added in 1970, the Equal Credit Opportunity Act in 1974, the Fair Credit Billing Act in 1975, and the Fair Debt Collection Practices Act in 1977.

The Truth in Lending Simplification and Reform Act was signed into law in 1980. It primarily regulates the disclosure of credit terms and conditions in conjunction with household purchases and common real estate transactions. Congress intended to make it easier for consumers to shop for credit. Before the passage of this act, many lenders did not disclose interest rates, finance charges, or other charges in ways that could be easily compared with those of their business competitors. Under the Truth in Lending Act, creditors must disclose information about interest rates and other finance charges in a highly regulated and uniform manner. A knowing and willful violator of the Truth in Lending Act may be criminally prosecuted and penalized with fines and incarceration. However, the most effective and most commonly used method of enforcing this act is through private suit. A successful plaintiff can recover a fine, an award of compensatory damages, and an order that the creditor pay the consumer's attorney fees.

The Fair Credit Reporting Act of 1970 (FCRA) is designed to ensure that consumers are treated fairly by credit reporting agencies and medical information businesses. Prior to its enactment, agencies that investigated individuals in order to provide companies with credit, insurance, employment, or other consumer reports were subject to few restraints. Individuals not only had no right to know the contents of the report, but businesses had no duty to disclose the fact that a report even existed. Hence, many individuals were denied credit, employment, or other benefits without knowing that an investigation had been made. Consumers now have the right to know the contents of any adverse report used by a business, the name of the agency that compiled the report, and when such information has resulted in an adverse decision that has been made based on such a report. Consumers may also require compiling agencies to investigate disputed facts, correct the report, or include a consumer's own explanation of disputed facts as part of its report. Investigating agencies must follow "reasonable procedures" in compiling the report, and comply with provisions intended to protect the consumer's privacy.

The Fair Credit Billing Act (FCBA) provides that a credit cardholder is financially responsible only for the first $50 of unauthorized charges. Many credit card issuers, as a matter of company policy, will even waive a bona fide customer's obligation to make this payment. The FCBA also addresses a cardholder's rights vis-à-vis a creditor where the cardholder has discovered that items purchased with a credit card were received in damaged condition or were of poor quality. In general (and there are exceptions), the FCBA provides a cardholder with the same remedies against the creditor as exist under state law in the cardholder's state (which will frequently include the right to withhold payment) if certain requirements are met. First, the credit card purchase must have cost more than $50; second, the purchase must have been made either in the cardholder's own state or within 100 miles of his or her home; third, the cardholder must have attempted to resolve the dispute with the merchant; and fourth, the cardholder must have given the credit card issuer a detailed written explanation of the facts within sixty days of receiving the credit card bill containing the disputed charge.

The **Equal Credit Opportunity Act (ECOA)** of 1974 is designed to eradicate discrimination in the granting of credit when the decision to grant it or refuse it is based on an individual's sex, marital status, race, color, age, religion, national origin, or receipt of public assistance. The major effect of this act had been to eliminate sex discrimination. Under the ECOA, a married woman can now obtain credit in her own name. A prospective creditor may not ask about an individual's marital status, childbearing plans, spouse or former spouse, or other similar criteria. Questions regarding alimony and child support are proper only if the applicant will rely on those sums to repay the obligation.

Because the ECOA is modeled after the Equal Employment Opportunity Act, facially neutral practices that have the effect of discriminating against a protected class are also prohibited.

The ECOA requires creditors to notify consumers of any decision about the extension or denial of credit, along with the creditor's reasons or a statement indicating that the individual is entitled to know the reasons. An individual may bring suit against a creditor for noncompliance with the ECOA to recover actual and punitive damages.

As previously stated, the Federal Trade Commission bears primary responsibility for the CCPA enforcement. We see an example of the FTC attempting to enforce one of the various consumer protection acts for which it is responsible in the following case. Trans Union, the appellant, is one of the nation's largest credit reporting companies. What follows is its appeal of an FTC determination that the Fair Credit Reporting Act prohibits credit reporting agencies from compiling and selling certain types of information that have been collected for purposes of credit-worthiness determinations to marketing firms who deal directly with consumers.

**Trans Union Corporation v. Federal Trade Commission**
*245 F.3d 809*
*U.S. Court of Appeals, District of Columbia Circuit*
*April 13, 2001*

**Tatel, Circuit Judge**

Petitioner, a consumer reporting agency, sells lists of names and addresses to target marketers—companies and organizations that contact consumers with offers of products and services. The Federal Trade Commission determined that these lists were "consumer reports" under the Fair Credit Reporting Act and thus could no longer be sold for target marketing purposes. Challenging this determination, petitioner argues that the Commission's decision is unsupported by substantial evidence and that the Act itself is unconstitutional....

*I*

Petitioner Trans Union sells two types of products. First, as a credit reporting agency, it compiles credit reports about individual consumers from credit information it collects from banks, credit card companies, and other lenders. It then sells these credit reports to lenders, employers, and insurance companies. Trans Union receives credit information from lenders in the form of "tradelines." A tradeline typically includes a customer's name, address, date of birth, telephone number, Social Security number, account type, opening date of account, credit limit, account status, and payment history. Trans Union receives 1.4 to 1.6 billion records per month. The company's credit database contains information on 190 million adults.

Trans Union's second set of products—those at issue in this case—are known as target marketing products. These consist of lists of names and addresses of individuals who meet specific criteria such as possession of an auto loan, a department store credit card, or two or more mortgages. Marketers purchase these lists, then contact the individuals by mail or telephone to offer them goods and services. To create its target marketing lists, Trans Union maintains a database known as MasterFile, a subset of its consumer credit database. MasterFile consists of information about every consumer in the company's credit database who has (A) at least two tradelines with activity during the previous six months, or (B) one tradeline with activity during the previous six months plus an address confirmed by an outside source. The company compiles target marketing lists by extracting from MasterFile the names and addresses of individuals with

characteristics chosen by list purchasers. For example, a department store might buy a list of all individuals in a particular area code who have both a mortgage and a credit card with a $10,000 limit. Although target marketing lists contain only names and addresses, purchasers know that every person on a list has the characteristics they requested because Trans Union uses those characteristics as criteria for culling individual files from its database. Purchasers also know that every individual on a target marketing list satisfies the criteria for inclusion in MasterFile.

The Fair Credit Reporting Act of 1970 ("FCRA"),... regulates consumer reporting agencies like Trans Union, imposing various obligations to protect the privacy and accuracy of credit information. The Federal Trade Commission, acting pursuant to its authority to enforce the FCRA ... determined that Trans Union's target marketing lists were "consumer reports" subject to the Act's limitations....

... Finding that the information Trans Union sold was "collected in whole or in part by [Trans Union] with the expectation that it would be used by credit grantors for the purpose of serving as a factor in establishing the consumer's eligibility for one of the transactions set forth in the FCRA," and concluding that target marketing is not an authorized use of consumer reports ... the Commission ordered Trans Union to stop selling target marketing lists....

Trans Union petitioned for review. In *Trans Union Corp. v. FTC*,... (D.C. Cir. 1996) ("*Trans Union I*"), we agreed with the Commission that selling consumer reports for target marketing violates the Act.... We nevertheless set aside the Commission's determination that Trans Union's target marketing lists amounted to consumer reports.... The Commission, we held, failed to justify its finding that Trans Union's lists, by conveying the mere fact that consumers had a tradeline, were communicating information collected for the purpose of determining credit eligibility. We found that the Commission had failed to provide evidence to support the proposition that "the mere existence of a tradeline, as distinguished from payment history organized there-under," was used for credit-granting decisions or was intended or expected to be used for such decisions....

On remand, following extensive discovery, more than a month of trial proceedings, and an initial decision by an Administrative Law Judge, the Commission found that Trans Union's target marketing lists contain information that credit grantors use as factors in granting credit. Accordingly, the Commission concluded, the lists are "consumer reports" that Trans Union may not sell for target marketing purposes.... The Commission also rejected Trans Union's argument that such a restriction would violate its First Amendment rights. Applying intermediate scrutiny, the Commission found that the government has a substantial interest in protecting private credit information, that the FCRA directly advances that interest, and that the Act's restrictions on speech are narrowly tailored.... The Commission thus ordered Trans Union to "cease and desist from distributing or selling consumer reports, including those in the form of target marketing lists, to any person unless [the company] has reason to believe that such person intends to use the consumer report for purposes authorized under Section [1681b] of the Fair Credit Reporting Act." *In re Trans Union Corp.*, Final Order, No. 9255 (Feb. 10, 2000). Trans Union again petitions for review.

*II*

As we pointed out in *Trans Union I*, the first element of the FCRA's definition of consumer report—"bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living," 15 U.S.C. §§ 1681a(d)(1)—"does not seem very demanding," for almost any information about consumers arguably bears on their personal characteristics or mode of living.... Instead, Trans Union does not challenge the Commission's conclusion that the information contained in its lists meets this prong of the definition of consumer report.

Whether the company's target marketing lists qualify as consumer reports thus turns on whether information they contain "is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer's eligibility for [credit]." ... According to the Commission, "a factor in establishing the consumer's eligibility for [credit]," *id.*, includes any type of information credit grantors use in their criteria for "prescreening" or in "credit scoring models." ... "Prescreening" involves selecting individuals for guaranteed offers of credit or insurance.... "Credit scoring models" are statistical models for predicting credit performance that are developed by observing the historical credit performance of a number of consumers and identifying the consumer characteristics that correlate with good and bad credit performance.... Applying its prescreening/credit scoring model standard, the Commission found that Trans Union's lists contain the type of information "'used' and/or 'expected to be used'... as a factor in establishing a consumer's eligibility for credit." ...

Trans Union urges us to reject the Commission's interpretation of the Act in order to avoid what the company calls "serious constitutional questions."... But as we demonstrate in Section III, *infra*, Trans Union's constitutional arguments are without merit, so we

have no basis for rejecting the Commission's statutory interpretation on that ground.

Nor has Trans Union offered a basis for questioning the Commission's statutory interpretation on other grounds....

We have the same reaction to the brief's occasional suggestions that the Commission's decision was arbitrary and capricious.... [T]he list of issues presented for review neither mentions the arbitrary and capricious standard nor otherwise questions the reasonableness of the Commission's decision.

We thus turn to the one non-constitutional argument that Trans Union clearly mounts: that the Commission's decision is unsupported by substantial evidence....

Instead of challenging the Commission's findings regarding specific target marketing products, Trans Union points to evidence relating to the general question of whether the information in its target marketing lists is used to determine credit worthiness. This is not the question before us. As we indicate above, the Commission interprets "factors in establishing the consumer's eligibility for credit,"... to include any information considered by lenders in prescreening, which, as two witnesses testified, can involve consideration of criteria other than credit worthiness, e.g., whether a given consumer is likely to respond to an offer of credit. Because Trans Union has not challenged the Commission's interpretation of the statute, its argument that the information the company sells is not actually used to determine credit worthiness is beside the point. Moreover, Trans Union cites no testimony refuting the Commission's finding that the information in its target marketing lists is used in prescreening.

...Trans Union [has] thus failed to mount a proper substantial evidence challenge to the Commission's finding that lenders take list information into account in credit models and prescreening, but we have no doubt that the decision does find support in the record. Consider, for example, Trans Union's "MasterFile/Selects" product line, which allows marketers to request lists based on any of five categories of information: (1) credit limits (e.g., consumers with credit cards with credit limits over $10,000), (2) open dates of loans (e.g., consumers who took out loans in the last six months), (3) number of tradelines, (4) type of tradeline (e.g., auto loan or mortgage), and (5) existence of a tradeline. The Commission cites testimony and other record evidence that support its finding that lenders consider each of these five categories of information in prescreening or credit scoring models.... To support its finding that information about the number of tradelines in a consumer's credit file is a consumer report, the Commission cites the testimony of a vice president in charge of direct mail processing for a bank's credit card department who explained that, in its credit making decisions, her bank considers the number of tradelines consumers possess.... The Commission also points to record evidence demonstrating that Trans Union itself uses the number of tradelines as a predictive characteristic in its credit scoring models.... As to the type of tradeline, the Commission cites the testimony of representatives of companies that design credit models who explained that some credit scoring models, including two used by Trans Union, take into account possession of a bank card.... One witness testified that Trans Union scoring models also consider possession of a finance company loan to be a predictive characteristic. Another witness, this one representing a credit card company, testified that his company's scoring models assign points for possession of a mortgage, retail tradeline, or bank card....

The record also contains sufficient evidence to support the Commission's resolution of the issue remanded by *Trans Union I*: whether mere existence of a tradeline is "a factor in credit-granting decisions." ... An employee of a bank that issues credit cards testified that to be eligible for credit, an individual must have at least one tradeline.... The vice president of credit scoring at another credit card issuer testified that the very first question her company asks in prescreening is whether the consumer has a tradeline that has been open for at least a year. Challenging the implications of this testimony, Trans Union argues that banks ask whether consumers have tradelines not because the existence of a tradeline is itself a factor in determining credit eligibility, but because banks want to determine whether there is enough information in consumer files to make credit eligibility determinations. This may be true. But as we explain above, our task is limited to determining whether substantial record evidence supports the Commission's finding that banks consider the existence of a tradeline as a factor in prescreening or credit models. Because the record contains such evidence, we have no basis for questioning the Commission's decision....

*III*

Trans Union's constitutional challenge consists of two arguments. It claims first that the FCRA is vague, thus running afoul of the due process guarantee of the Fifth Amendment. Trans Union also argues that the statute violates the free speech guarantee of the First Amendment because it restricts its ability to disseminate information.

Beginning with the Fifth Amendment challenge, we are guided by *Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc.*... (1982). "Laws," the

Court said, must not only "give the person of ordinary intelligence a reasonable opportunity to know what is prohibited," but in order to prevent "arbitrary and discriminatory enforcement," they must also "provide explicit standards for those who apply them."… Emphasizing that these principles should not "be mechanically applied," the Court held that "economic regulation is subject to a less strict vagueness test because its subject matter is often more narrow, and because businesses, which face economic demands to plan behavior carefully, can be expected to consult relevant legislation in advance of action."… The "regulated enterprise," the Court added, "may have the ability to clarify the meaning of the regulation by its own inquiry, or by resort to an administrative process." … Finally, "the consequences of imprecision are qualitatively less severe" when laws have "scienter requirements" and "civil rather than criminal penalties."…

Applying this standard, we see no merit in Trans Union's vagueness argument. To begin with, because the FCRA's regulation of consumer reporting agencies is economic, it is subject to "a less strict vagueness test."… Moreover, Trans Union has "the ability to clarify the meaning of the [FCRA]"… through the Commission's advisory opinion procedures. *See* 16 C.F.R. §§ 1.1–1.4 (establishing general procedures for obtaining advisory opinions); *id.* §§ 2.41(d) (establishing procedures for obtaining guidance regarding compliance with FTC orders)….

Trans Union's First Amendment challenge fares no better. Banning the sale of target marketing lists, the company says, amounts to a restriction on its speech subject to strict scrutiny. Again, Trans Union misunderstands our standard of review. In *Dun & Bradstreet, Inc. v. Greenmoss Builders, Inc*.… (1985), the Supreme Court held that a consumer reporting agency's credit report warranted reduced constitutional protection because it concerned "no public issue." … "The protection to be accorded a particular credit report," the Court explained, "depends on whether the report's 'content, form, and context' indicate that it concerns a public matter."… Like the credit report in *Dun & Bradstreet*, which the Supreme Court found "was speech solely in the interest of the speaker and its specific business audience,"… the information about individual consumers and their credit performance communicated by Trans Union target marketing lists is solely of interest to the company and its business customers and relates to no matter of public concern. Trans Union target marketing lists thus warrant "reduced constitutional protection."…

We turn then to the specifics of Trans Union's First Amendment argument. The company first claims that neither the FCRA nor the Commission's Order advances a substantial government interest. The "Congressional findings and statement of purpose" at the beginning of the FCRA state: "There is a need to insure that consumer reporting agencies exercise their grave responsibilities with … respect for the consumer's right to privacy."… Contrary to the company's assertions, we have no doubt that this interest—protecting the privacy of consumer credit information—is substantial.

Trans Union next argues that Congress should have chosen a "less burdensome alternative," i.e., allowing consumer reporting agencies to sell credit information as long as they notify consumers and give them the ability to "opt out."… Because the FCRA is not subject to strict First Amendment scrutiny, however, Congress had no obligation to choose the least restrictive means of accomplishing its goal.

Finally, Trans Union argues that the FCRA is underinclusive because it applies only to consumer reporting agencies and not to other companies that sell consumer information. But given consumer reporting agencies' unique "access to a broad range of continually-updated, detailed information about millions of consumers' personal credit histories,"… we think it not at all inappropriate for Congress to have singled out consumer reporting agencies for regulation.… To survive a First Amendment underinclusiveness challenge … "neither a perfect nor even the best available fit between means and ends is required." … The FCRA easily satisfies this standard.…

*IV*

Having considered and rejected Trans Union's other arguments, we deny the petition for review.

*So Ordered.*

## Case Questions

1. What consumer interest was the FTC seeking to protect in ruling as it did vis-à-vis Trans Union?
2. Why did the appeals court uphold the agency's determination that Trans Union's actions were contrary to the requirements of the Fair Credit Reporting Act?

## CHAPTER SUMMARY

The chapter began with a historical overview of the evolution of federal administrative agencies and why they came into being. This was followed with a discussion of the ways federal agencies are organized and how agencies are legally delegated rulemaking, investigative, and adjudicative powers in an enabling act. Explanations as to how each of these delegated powers is exercised were then followed by an overview of the judiciary's limited role in reviewing agency decisions. The chapter concluded with a look at how two federal agencies regulate business activity.

## CHAPTER QUESTIONS

1. The Secretary of Commerce, pursuant to rulemaking authority contained in the Atlantic Tunas Convention Act of 1975 (the "ATCA"), adopted regulations regarding the use of "spotter aircraft" by fishing permit holders. The purposes of the ATCA included preventing the overfishing of the Atlantic Bluefin Tuna (ABT), setting quotas on the ABT catch per country, and increasing ABT scientific research. The regulations prohibited persons holding "general" category fishing permits from using "spotter" aircraft to locate Atlantic Bluefin Tuna (ABT), but permitted the use of such planes by persons licensed to catch ABT with harpoons or seine nets. The ABT is a very valuable fish, each one being worth up to $50,000. The Atlantic Fish Spotters Association brought suit, maintaining that this regulation should be overturned. What standard will the plaintiffs have to meet to persuade the U.S. District Court to overturn the regulation? What type of evidence will the plaintiffs need to produce to be successful?

   *Atlantic Fish Spotters Association v. Dailey, 8 F. Supp.2d 113 (1998)*

2. Faustino Ramos, Michael Beal, and Francisco Marila were employees of Mavo Leasing, Inc. Mavo and the Production Workers Union (PWU) of Chicago were parties to a collective bargaining agreement that required that all employees pay union dues to the PWU. Mavo discharged the above-named employees for not paying their union dues in accordance with a clause in the collective bargaining agreement. The three employees claimed that the union had not given them notice of their right to challenge certain union expenditures that were not made in furtherance of collective bargaining. They argued that they did not have to pay dues for nonrepresentation expenses. The employees complained about this lack of notice to the National Labor Relations Board (NLRB). An ALJ heard the complaint and ruled that the union did not have an affirmative obligation to provide the employees with the requested notice. An NLRB three-member appeals panel ruled in favor of the employees and interpreted the National Labor Relations Act as requiring the union to affirmatively provide the employees with notice of the right to object to paying dues to fund nonrepresentation expenditures, prior to discharge from employment for nonpayment of union dues. The issue was appealed to the U.S. Court of Appeals for the Seventh Circuit. How should the Court decide this appeal, and why?

   *Production Workers Union of Chicago v. N.L.R.B., 161 F.3d 1047 (1998)*

3. The Fertilizer Institute (TFI) is a trade organization that represents members of the fertilizer industry. TFI filed suit in U.S. District Court against the EPA, contesting the agency's decision to list nitrate compounds on the toxic release inventory that is compiled by the EPA pursuant to the "Emergency Planning and Community Right to Know Act of 1986."

The EPA listed these compounds because there was evidence that they posed a chronic health threat to human infants. TFI argued that the record did not support the EPA's decision. What evidence would the trial court need to conclude that the EPA had acted arbitrarily in reaching its decision? Why?

*Fertilizer Industry v. Browner, 163 F.3d 774 (1998)*

4. New York's Aid to Families with Dependent Children (AFDC) program, stressing "close contact" with beneficiaries, requires home visits by caseworkers as a condition for assistance "in order that any treatment or service tending to restore [beneficiaries] to a condition of self-support and to relieve their distress may be rendered and … that assistance or care may be given only in such amount and as long as necessary." Visitation with a beneficiary, who is the primary source of information to welfare authorities about eligibility for assistance, is not permitted outside working hours, and forcible entry and snooping are prohibited. The appellee was a beneficiary under the AFDC program. Although she had received several days' advance notice, she refused to permit a caseworker to visit her home. Following a hearing and advice that assistance would consequently be terminated, she brought suit for injunctive and declaratory relief, contending that home visitation is a search and, when not consented to or supported by a warrant based on probable cause, would violate her Fourth and Fourteenth Amendment rights. The district upheld the appellee's constitutional claim. Was the district court correct? Why or why not?

*Wyman v. James, 400 U.S. 309 (1971)*

5. Columbia East, Inc., the owner of 34.3 acres of farmland, wanted its zoning changed so it could develop a mobile home park. The board of zoning appeals granted a preliminary approval of the application for a special exception to develop a mobile home park in an area zoned as agricultural. Final approval by the board of zoning appeals could only be granted after the plans and specifications for the development of the proposed trailer court had been completed and approved by the appropriate agencies. Neighboring landowners filed a suit in court challenging the board's preliminary approval, claiming the decision was made without adequate provision for sewage treatment. What should the court decide?

*Downing v. Board of Zoning Appeals, 274 N.E.2d 542 (Ind. 1971)*

6. The Occupational Safety and Health Act empowers agents of the Secretary of Labor to search the work area of any employment facility within the act's jurisdiction. No search warrant or other process is expressly required under the act. An OSHA inspector entered the customer service area of Barlow's, Inc., an electrical and plumbing installation business, and stated that he wished to conduct a search of the working areas of the business. Barlow, the president and general manager, asked the inspector whether he had received any complaints about the working conditions and whether he had a search warrant. The inspector answered both questions in the negative. The inspector was denied entry into the working areas. Marshall, Secretary of Labor, argued that warrantless inspections to enforce OSHA regulations are reasonable within the meaning of the Fourth Amendment, and relied on the act, which authorizes inspection of business premises without a warrant. Should the court accept Marshall's argument?

*Marshall v. Barlow's, Inc., 436 U.S. 307 (1978)*

7. Under the U.S. Community Health Centers Act, the secretary of the Department of Health, Education, and Welfare was empowered to award monetary grants to health centers that complied with federal regulations. Temple University received funds under the act and was therefore required to meet the federal regulations. In addition, the Pennsylvania Department of Public Welfare and the County Mental Health and Retardation Board were charged with the responsibility of administering county health programs. In 1970, the Temple

University Mental Health Center was required to cut back services and impose strict security measures because of campus riots. Members of the surrounding community brought suit against Temple University, charging that the center was not providing required services and that members of the community were deprived of access to the facility. What should the court's decision be?

*North Philadelphia Community Board v. Temple University, 330 F.Supp. 1107 (1971)*

## NOTES

1. *Federal Regulatory Directory* (Washington, D.C.: Congressional Quarterly, Inc., 1990), p. 621.
2. Ibid., p. 687.
3. Ibid., p. 2.
4. Ibid., p. 3.

# XIV

# Alternative Dispute Resolution

## CHAPTER OBJECTIVES

1. *Understand the rationale supporting the use of ADR methods as a substitute for litigation.*
2. *Explain the differences between voluntary and court-annexed arbitration.*
3. *Describe the key features of arbitration, mediation, minitrials, summary jury trials, and private trials.*

Litigation is not the only mechanism available for the resolution of a dispute. Disputants who are unable to negotiate a solution to a pending conflict but who wish to avoid a public court trial can choose what is currently called **alternative dispute resolution (ADR).** ADR has gained in popularity largely because many people are dissatisfied with the workings of the traditional legal system. This dissatisfaction has many origins. Plaintiffs, in particular, dislike litigation's snail-like pace and complain about the volume of cases clogging up the court system and producing gridlock.[1] In federal district courts, for example, 276,397 civil cases were filed in the twelve-month period ending September 30, 2009, up from 244,343 filings in 2006.[2] Dissatisfaction also results when lawyers adopt a strategy of winning by exhausting an opponent's financial resources. Although case preparation generally will not compensate for a weak case, sometimes a weak case can be won if the client has vastly superior resources. An attorney may take such a case to trial in order to drag out the proceedings, dramatically increase the opponent's litigation expenses, and force the opponent to settle the case on unfavorable terms.

As a factual matter, a very small percentage of cases filed actually go to trial. The data from federal courts are illustrative. Of the 263,049 civil cases terminated in U.S. district courts during the twelve-month period ending September 30, 2009, only 1.2 percent actually went to trial. The percentage of federal cases reaching trial was 1.3 percent in 2006 and 2.2 percent in 2000.[3]

Many attorneys, while acknowledging that few cases are actually resolved at trial, continue to prepare each case as if it will be. They overprepare for a variety of professional and strategic reasons. Because litigation is an adversarial process, lawyers assume that opponents will resort to every legal device to win. Attorneys anticipate a continuing series of battles with the opponent at the pretrial, trial, and appellate stages of a process that can take years to determine an ultimate winner. They know that there are many ways to lose a case, and they worry about malpractice claims. Trial victories require more than good facts and sound legal arguments; they result from careful preparation and thorough discovery. Discovery also consumes large amounts of an attorney's time, which often translates into billable hours paid by the client.

The fact that lawyers become heavily involved in preparing attacks upon their client's opponent often means that they avoid looking at possible weaknesses in their own cases until just before trial. Lawyers often view themselves as their client's champion, and they frequently engage in posturing and puffery. Some refuse to initiate settlement discussions with the opponents because they fear that this might be interpreted by their clients, as well as their client's opponents, as a sign of weakness. If settlement discussions do occur, neither side is likely to be candid and reveal the amount that would be accepted in settlement of the case. Further, a tactical advantage can be gained by responding to an opponent's proposal rather than being the first to suggest a settlement figure. This game-like approach to litigation only compounds costs in money and time as the parties prepare for a trial that statistically is unlikely to occur.

Many litigants often find the judicial system's traditional "winner-take-all" approach unsatisfactory because it produces a costly victory. Both parties can lose when the disputants have an ongoing relationship, as in business, labor–management, or child custody cases, and one party clobbers the other in court. Because ADR methods can often resolve disputes more satisfactorily than trials—at less expense and in less time—some lawyers are required to explain the existence of options to litigation to their clients.[4]

Businesses have been looking for ways to resolve disputes that avoid class action lawsuits and jury trials, which expose them to the possibility of high damage awards. Congress's enactment of the Alternative Dispute Resolution Act (ADRA) in 1998) has increased judicial interest in ADR. In the ADRA, Congress explicitly required the federal district courts and courts of appeals to implement ADR procedures. Its reasoning is clearly explained in the excerpt found in Figure 14.1.

State courts also have been looking for cost-efficient ways to reduce the length of their burgeoning dockets, given the low percentage of their civil cases that are actually tried. California, Florida, and Texas, for example, have established statewide ADR systems. Other states permit local jurisdictions to experiment with ADR if they wish to do so. Some jurisdictions offer a menu of ADR options; others focus on a preferred procedure, such as mediation or arbitration.[5]

Thus, many disputants participate in ADR either because they have been required to do so by legislation or court rule **(court-annexed ADR)**.

## VOLUNTARY ADR

When parties to a dispute decide to avoid the negative aspects of a court trial, they may voluntarily choose to resort to ADR, because it can often produce a fair result faster and at less cost than a public court trial involves. In fact, several major corporations will contract only with vendors who agree to participate in ADR. Disputants often prefer ADR

**Sec. 651. Authorization of alternative dispute resolution**

(a) Definition.—For purposes of this chapter, an alternative dispute resolution process includes any process or procedure, other than an adjudication by a presiding judge, in which a neutral third party participates to assist in the resolution of issues in controversy, through processes such as early neutral evaluation, mediation, minitrial, and arbitration as provided in sections 654 through 658.

(b) Authority.—Each United States district court shall authorize, by local rule adopted under section 2071(a), the use of alternative dispute resolution processes in all civil actions, including adversary proceedings in bankruptcy, in accordance with this chapter, except that the use of arbitration may be authorized only as provided in section 654. Each United States district court shall devise and implement its own alternative dispute resolution program, by local rule adopted under section 2071(a), to encourage and promote the use of alternative dispute resolution in its district.

(c) Existing Alternative Dispute Resolution Programs.—In those courts where an alternative dispute resolution program is in place on the date of the enactment of the Alternative Dispute Resolution Act of 1998, the court shall examine the effectiveness of that program and adopt such improvements to the program as are consistent with the provisions and purposes of this chapter.

(d) Administration of Alternative Dispute Resolution Programs.—Each United States district court shall designate an employee, or a judicial officer, who is knowledgeable in alternative dispute resolution practices and processes to implement, administer, oversee, and evaluate the court's alternative dispute resolution program. Such person may also be responsible for recruiting, screening, and training attorneys to serve as neutrals and arbitrators in the court's alternative dispute resolution program. . . .

**FIGURE 14.1** Excerpt from the Alternative Dispute Resolution Act of 1998
*Source:* Public Law 105-315, 105th Congress.

because they can choose the procedure that seems most appropriate to their needs. They may also like having their dispute resolved by a person or persons who have particular expertise in that subject area.

When parties voluntarily participate in ADR, they negotiate a contract that sets forth the rules that will govern the proceedings. There are several agencies to which they can turn for model ADR rules and procedures. This is helpful because attorneys who are inexperienced with ADR are sometimes reluctant to negotiate an ADR agreement with a more seasoned opponent. Model rules are evenhanded, and their terms provide either side with an advantage. They establish reasonable and simplified discovery rules and simplified rules of evidence that allow the parties to introduce documents that might otherwise be inadmissible hearsay. The rules also can provide for confidentiality: Businesses and individuals often would prefer to deny competitors, the general public, and the news media access to private and potentially embarrassing information that would be revealed in conjunction with public court litigation.[6]

Traditional ADR practitioners and firms often advertise in trade publications and list themselves in many metropolitan-area telephone directories under "arbitration." To attract customers, increasing numbers of automobile manufacturers, local home contractors, businesses, and professionals advertise that they participate in ADR. The American Arbitration Association and the Federal Conciliation and Mediation Service are prominent

examples of institutions that maintain panels of arbitrators and impartial third parties (called neutrals) who can be engaged to provide ADR services. National dispute resolution firms have offices in major cities, have employed hundreds of retired judges (even state supreme court justices), and have annual revenues exceeding $40 million.[7]

## ONLINE DISPUTE RESOLUTION

In recent years, the Internet explosion and advances in computer hardware and software have contributed to the expansion of online dispute resolution (ODR). Well-known organizations such as the American Arbitration Association and the Better Business Bureau now provide ODR services, as do private companies such as Square Trade and Cybersettle. The speed, flexibility, and relatively low costs of ODR are especially appealing to online retailers seeking another option for handling customer disputes that cannot be easily resolved by customer service representatives.

**INTERNET TIP**

The American Arbitration Association has a wonderful website explaining both traditional ADR and the expanding ODR options.

## COURT-ANNEXED ADR

Participation in ADR is legislatively or judicially authorized in many jurisdictions. As mentioned above, the federal Alternative Dispute Resolution Act, for example, provides for ADR programs in the U.S. District Courts as well as the U.S. Courts of Appeals.

Where federal and state judges claim authority to compel ADR participation, they usually promulgate court rules. Such rules are justified as being necessary and an appropriate exercise of a court's inherent power to manage its docket. Local rules often require that parties participate in nonbinding, court-annexed ADR programs before they are permitted access to a jury trial. Such programs encourage settlements, reduce court dockets, and lessen the financial burdens on taxpayers, who pay for the operation of the public judicial systems. The Alternative Dispute Resolution Act requires every federal district court to adopt at least one ADR method by local rule.

Most ADR methods are undertaken in the expectation that such programs will result in reducing the number of cases that are tried to juries. Any proposals to deny plaintiffs pursuing common law relief access to a trial by jury will clearly collide with the traditional right to a jury trial enshrined in the Seventh Amendment to the U.S. Constitution. The scope of the Seventh Amendment's jury trial right is deeply rooted in our history. Under our law, the right to a jury trial is recognized for all actions that were tried by English juries at the time of the Constitution's ratification and for other actions that are closely related to common law claims. There is no jury trial right for litigants who seek equitable relief or for actions that were unknown to the common law. Compulsory ADR has been structured so that there is no infringement of the right to a jury trial. Litigants are required to participate in pretrial ADR, but they can reject ADR solutions and then proceed to a trial by jury.

In the following case, the petitioner, Atlantic Pipe Corporation (APC), petitioned for a writ of prohibition from the district court's ruling that APC was required to participate in, and share in the cost of, court-annexed mediation conducted by a neutral appointed by the court.

## In re Atlantic Pipe Corporation

*304 F.3d 135*
*U.S. Court of Appeals, First Circuit*
*September 18, 2002*

**Selya, Circuit Judge**

…January 1996, Thames-Dick Superaqueduct Partners (Thames-Dick) entered into a master agreement with the Puerto Rico Aqueduct and Sewer Authority (PRASA) to construct, operate, and maintain the North Coast Superaqueduct Project (the Project). Thames-Dick granted subcontracts for various portions of the work, including a subcontract for construction management to Dick Corp. of Puerto Rico (Dick-PR), a subcontract for the operation and maintenance of the Project to Thames Water International, Ltd. (Thames Water), and a subcontract for the fabrication of pipe to Atlantic Pipe Corp. (APC). After the Project had been built, a segment of the pipeline burst. Thames-Dick incurred significant costs in repairing the damage. Not surprisingly, it sought to recover those costs from other parties. In response, one of PRASA's insurers filed a declaratory judgment action in a local court to determine whether Thames-Dick's claims were covered under its policy. The litigation ballooned, soon involving a number of parties and a myriad of issues above and beyond insurance coverage….

…Thames-Dick asked that the case be referred to mediation and suggested Professor Eric Green as a suitable mediator. The district court granted the motion over APC's objection and ordered non-binding mediation to proceed before Professor Green…. The court also stated that if mediation failed to produce a global settlement, the case would proceed to trial.

After moving unsuccessfully for reconsideration of the mediation order, APC … alleged that the district court did not have the authority to require mediation … and, in all events, could not force APC to pay a share of the expenses of the mediation. We invited the other parties and the district judge to respond…. Several entities … opposed the petition. Two others … filed a brief in support of APC. We assigned the case to the oral argument calendar and stayed the contemplated mediation pending our review….

*The Merits*

There are four potential sources of judicial authority for ordering mandatory non-binding mediation of pending cases, namely, (a) the court's local rules, (b) an applicable statute, (c) the Federal Rules of Civil Procedure, and (d) the court's inherent powers. Because the district court did not identify the basis of its assumed authority, we consider each of these sources.

*A. The Local Rules*

A district court's local rules may provide an appropriate source of authority for ordering parties to participate in mediation…. In Puerto Rico, however, the local rules contain only a single reference to any form of alternative dispute resolution (ADR). That reference is embodied in the district court's Amended Civil Justice Expense and Delay Reduction Plan (CJR Plan)….

The district court adopted the CJR Plan on June 14, 1993, in response to the directive contained in the Civil Justice Reform Act of 1990 (CJRA),… Rule V of the CJR Plan states:

> Pursuant to 28 U.S.C. §§ 473(b)(4), this Court shall adopt a method of Alternative Dispute Resolution ("ADR") through mediation by a judicial officer. Such a program would allow litigants to obtain from an impartial third party—the judicial officer as mediator—a flexible non-binding, dispute resolution process to facilitate negotiations among the parties to help them reach settlement.

… In addition to specifying who may act as a mediator, Rule V also limns the proper procedure for mediation sessions and assures confidentiality….

The respondents concede that the mediation order in this case falls outside the boundaries of the mediation program envisioned by Rule V… because it involves mediation before a private mediator, not a judicial officer…. APC argues that the … court exceeded its authority… by issuing a non-conforming mediation order (i.e., one that contemplates the intervention of a private mediator). The respondents counter by arguing that the rule does not bind the district court because, notwithstanding the unambiguous promise of the CJR Plan (which declares that the district court "shall adopt a method of Alternative Dispute Resolution"), no such program has been adopted to date.

This is a powerful argument. APC does not contradict the respondents' assurance that the relevant portion of the CJR Plan has remained unimplemented…. Because that is so, we conclude that the District of Puerto Rico has no local rule in force that dictates

the permissible characteristics of mediation orders. Consequently, APC's argument founders….

*B. The ADR Act*

There is only one potential source of statutory authority for ordering mandatory non-binding mediation here: the Alternative Dispute Resolution Act of 1998 (ADR Act), 28 U.S.C. §§ 651–658. Congress passed the ADR Act to promote the utilization of alternative dispute resolution methods in the federal courts and to set appropriate guidelines for their use. The Act lists mediation as an appropriate ADR process…. Moreover, it sanctions the participation of "professional neutrals from the private sector" as mediators …. Finally, the Act requires district courts to obtain litigants' consent only when they order arbitration … not when they order the use of other ADR mechanisms (such as non-binding mediation).

Despite the broad sweep of these provisions, the Act is quite clear that some form of the ADR procedures it endorses must be adopted in each judicial district by local rule…. (directing each district court to "devise and implement its own alternative dispute resolution program, by local rule adopted under [28 U.S.C.] section 2071(a), to encourage and promote the use of alternative dispute resolution in its district"). In the absence of such local rules, the ADR Act itself does not authorize any specific court to use a particular ADR mechanism. Because the District of Puerto Rico has not yet complied with the Act's mandate, the mediation order here at issue cannot be justified under the ADR Act….

Although the ADR Act was designed to promote the use of ADR techniques, Congress chose a very well-defined path: it granted each judicial district, rather than each individual judge, the authority to craft an appropriate ADR program. In other words, Congress permitted experimentation, but only within the disciplining format of district-wide local rules adopted with notice and a full opportunity for public comment…. To say that the Act authorized each district judge to disregard a district-wide ADR plan (or the absence of one) and fashion innovative procedures for use in specific cases is simply too much of a stretch….

We add, however, that … we know of nothing in either the ADR Act or the policies that undergird it that can be said to restrict the district courts' authority to engage in the case-by-case deployment of ADR procedures. Hence, we conclude that where, as here, there are no implementing local rules, the ADR Act neither authorizes nor prohibits the entry of a mandatory mediation order.

*C. The Civil Rules*

The respondents next argue that the district court possessed the authority to require mediation by virtue of the Federal Rules of Civil Procedure. They concentrate their attention on Fed. R. Civ. P. 16, which states in pertinent part that "the court may take appropriate action with respect to … (9) settlement and the use of special procedures to assist in resolving the dispute when authorized by statute or local rule…."… Because there is no statute or local rule authorizing mandatory private mediation in the District of Puerto Rico … Rule 16(c)(9) does not assist the respondents' cause….

*D. Inherent Powers*

…[D]istrict courts have substantial inherent power to manage and control their calendars…. This inherent power takes many forms…. By way of illustration, a district court may use its inherent power to compel represented clients to attend pretrial settlement conferences, even though such a practice is not specifically authorized in the Civil Rules….

Although many federal district courts have forestalled … debate by adopting local rules that authorize specific ADR procedures and outlaw others … [because] the District of Puerto Rico is not among them … we have no choice but to address the question head-on.

We begin our inquiry by examining the case law. In *Strandell v. Jackson County* … (7th Cir. 1987), the Seventh Circuit held that a district court does not possess inherent power to compel participation in a summary jury trial…. In the court's view, Fed. R. Civ. P. 16… prevented a district court from forcing "an unwilling litigant [to] be sidetracked from the normal course of litigation…." But the group that spearheaded the subsequent revision of Rule 16 explicitly rejected that interpretation…. Thus, we do not find *Strandell* persuasive on this point….

… [T]he Sixth Circuit also has found that district courts do not possess inherent power to compel participation in summary jury-trials…. The court thought the value of a summary jury trial questionable when parties do not engage in the process voluntarily, and it worried that "too broad an interpretation of the federal courts' inherent power to regulate their procedure … encourages judicial high-handedness…."

The concerns articulated by these two respected courts plainly apply to mandatory mediation orders. When mediation is forced upon unwilling litigants, it stands to reason that the likelihood of settlement is diminished. Requiring parties to invest substantial

amounts of time and money in mediation under such circumstances may well be inefficient….

The fact remains, however, that none of these considerations establishes that mandatory mediation is always inappropriate. There may well be specific cases in which such a protocol is likely to conserve judicial resources without significantly burdening the objectors" rights to a full, fair, and speedy trial. Much depends on the idiosyncrasies of the particular case and the details of the mediation order.

In some cases, a court may be warranted in believing that compulsory mediation could yield significant benefits even if one or more parties object. After all … negotiations could well produce a beneficial outcome, at reduced cost and greater speed, than would a trial. While the possibility that parties will fail to reach agreement remains ever present, the boon of settlement can be worth the risk.

This is particularly true in complex cases involving multiple claims and parties. The fair and expeditious resolution of such cases often is helped along by creative solutions—solutions that simply are not available in the binary framework of traditional adversarial litigation. Mediation with the assistance of a skilled facilitator gives parties an opportunity to explore a much wider range of options, including those that go beyond conventional zero-sum resolutions. Mindful of these potential advantages, we hold that it is within a district court's inherent power to order non-consensual mediation in those cases in which that step seems reasonably likely to serve the interests of justice….

*E. The Mediation Order*

Our determination that the district courts have inherent power to refer cases to non-binding mediation is made with a recognition that any such order must be crafted in a manner that preserves procedural fairness and shields objecting parties from undue burdens. We thus turn to the specifics of the mediation order entered in this case….

As an initial matter, we agree with the lower court that the complexity of this case militates in favor of ordering mediation. At last count, the suit involves twelve parties, asserting a welter of claims, counterclaims, cross-claims, and third-party claims predicated on a wide variety of theories. The pendency of nearly parallel litigation in the Puerto Rican courts, which features a slightly different cast of characters and claims that are related to but not completely congruent with those asserted here, further complicates the matter. Untangling the intricate web of relationships among the parties, along with the difficult and fact-intensive arguments made by each, will be time-consuming and will impose significant costs on the parties and the court. Against this backdrop, mediation holds out the dual prospect of advantaging the litigants and conserving scarce judicial resources.

In an effort to parry this thrust, APC raises a series of objections…. APC posits that the appointment of a private mediator proposed by one of the parties is per se improper (and, thus, invalidates the order). We do not agree. The district court has inherent power to "appoint persons unconnected with the court to aid judges in the performance of specific judicial duties…." In the context of non-binding mediation, the mediator does not decide the merits of the case and has no authority to coerce settlement. Thus, in the absence of a contrary statute or rule, it is perfectly acceptable for the district court to appoint a qualified and neutral private party as a mediator. The mere fact that the mediator was proposed by one of the parties is insufficient to establish bias in favor of that party….

We hasten to add that the litigants are free to challenge the qualifications or neutrality of any suggested mediator (whether or not nominated by a party to the case). APC, for example, had a full opportunity to present its views about the suggested mediator both in its opposition to the motion for mediation and in its motion for reconsideration of the mediation order. Despite these opportunities, APC offered no convincing reason to spark a belief that Professor Green, a nationally recognized mediator with significant experience in sprawling cases, is an unacceptable choice. When a court enters a mediation order, it necessarily makes an independent determination that the mediator it appoints is both qualified and neutral. Because the court made that implicit determination here in a manner that was procedurally fair (if not ideal), we find no abuse of discretion in its selection of Professor Green….

APC also grouses that it should not be forced to share the costs of an unwanted mediation. We have held, however, that courts have the power under Fed. R. Civ. P. 26(f) to issue pretrial cost-sharing orders in complex litigation….

The short of the matter is that, without default cost-sharing rules, the use of valuable ADR techniques (like mediation) becomes hostage to the parties" ability to agree on the concomitant financial arrangements. This means that the district court's inherent power to order private mediation in appropriate cases would be rendered nugatory absent the corollary power to order the sharing of reasonable mediation costs. To avoid this pitfall, we hold that the district court, in an appropriate case, is empowered to order the sharing of reasonable costs and expenses associated with mandatory non-binding mediation.

….[A] mediation order [,] [however,] must contain procedural and substantive safeguards to ensure fairness to all parties involved. The mediation order in this case does not quite meet that test. In particular, the order does not set limits on the duration of the mediation or the expense associated therewith….

… As entered, the order … does not set forth either a timetable for the mediation or a cap on the fees that the mediator may charge. The figures that have been bandied about in the briefs—$900 per hour or $9,000 per mediation day—are quite large and should not be left to the mediator's whim. Relatedly, because the mediator is to be paid an hourly rate, the court should have set an outside limit on the number of hours to be devoted to mediation. Equally as important, it is trite but often true that justice delayed is justice denied. An unsuccessful mediation will postpone the ultimate resolution of the case—indeed, the district court has stayed all discovery pending the completion of the mediation—and, thus, prolong the litigation. For these reasons, the district court should have set a definite time frame for the mediation….

To recapitulate, we rule that a mandatory mediation order issued under the district court's inherent power is valid in an appropriate case. We also rule that this is an appropriate case. We hold, however, that the district court's failure to set reasonable limits on the duration of the mediation and on the mediator's fees dooms the decree.

*IV. Conclusion*

We admire the district court's pragmatic and innovative approach to this massive litigation. Our core holding—that ordering mandatory mediation is a proper exercise of a district court's inherent power, subject, however, to a variety of terms and conditions—validates that approach. We are mindful that this holding is in tension with the opinions of the Sixth and Seventh Circuits in NLO and Strandell, respectively, but we believe it is justified by the important goal of promoting flexibility and creative problem-solving in the handling of complex litigation.

That said, the need of the district judge in this case to construct his own mediation regime ad hoc underscores the greater need of the district court as an institution to adopt an ADR program and memorialize it in its local rules. In the ADR Act, Congress directed that "each United States district court shall authorize, by local rule under section 2071(a), the use of alternative dispute resolution processes in all civil actions…." 28 U.S.C. §§ 651(b). While Congress did not set a firm deadline for compliance with this directive, the statute was enacted four years ago. This omission having been noted, we are confident that the district court will move expediently to bring the District of Puerto Rico into compliance.

We need go no further. For the reasons set forth above, we vacate the district court's mediation order and remand for further proceedings consistent with this opinion. The district court is free to order mediation if it continues to believe that such a course is advisable or, in the alternative, to proceed with discovery and trial.

Vacated and remanded….

### Case Questions

1. Should a court have the power to compel litigants to participate in (and pay for) mediation before permitting a jury trial? Isn't this a waste of time and money?
2. Did reading this case expose any problems with the Alternative Dispute Resolution Act?
3. What exactly did the Sixth Circuit Court of Appeals decide in this case? How did the court justify its decision?

## ADR TECHNIQUES

The demand for trial-avoidance methods to resolve disputes has resulted in increasing reliance on settlement conferences, arbitration, and mediation—three of the oldest and the most popular ADR options—as well as the development of newer techniques such as private trials, minitrials, and summary jury trials.

### Settlement Conferences

Rule 1 of the Federal Rules of Civil Procedure states that judges are expected to promote "the just, speedy, and inexpensive determination of every action." This very general charge gives judges considerable flexibility in determining how they will achieve this goal. Many judges use **settlement conferences,** which are a traditional step in the

litigation process, as an informal method for resolving a dispute without a trial.[8]

A judge who is willing to be assertive can help parties explore a lawsuit's settlement potential. The judge can initiate the process or respond to a request for assistance from one or more of the parties. This intervention can be helpful when neither of the opposing attorneys is willing to make the first move toward a settlement. The parties, however, often leap at an opportunity to discuss settlement if the judge broaches the subject. An assertive judge may personally convene a settlement conference, carefully review the case, and emphasize each side's weaknesses and strengths. This is important because the evidence is frequently inconclusive. A judge who is knowledgeable about the relevant law can be very influential. He or she can point out the costs of going to trial and emphasize the risks each side incurs by trying the matter to an unpredictable jury.[9] The judge may know about recent verdicts in similar cases that went to trial and may suggest ADR options that could help each side avoid the necessity of a trial. Some judges, if requested by the parties, will propose a settlement figure. Judges who have the time, skill, and interest to function as mediators may meet privately with each side. They may even request that the clients meet without their attorneys being present. The judge's participation is the key ingredient. It is one thing for an attorney to engage in puffery with a client or an opponent. It is another matter to refuse to acknowledge the weaknesses of one's case to an experienced trial judge. Many judges, however, don't define their role in this way, believing that settlement is a matter to be decided solely by the parties without judicial involvement.

Serious issues arise regarding the judge's proper role in the settlement conference. Many lawyers are concerned that a party who refuses to settle may encounter bias if the matter is subsequently set for trial before the settlement judge. They fear that the judge might rule against the "uncooperative" party on motions and evidence admissibility at trial. One solution to this problem is to make sure that the judge conducting the settlement conference does not sit as the trial judge. Another is to use a lawyer–mediator instead of the judge at the settlement conference.

**INTERNET TIP**

In *Estate of John Skalka v. Mark Skalka,* the Indiana Court of Appeals has to decide whether a state trial judge acted improperly when conducting a settlement conference. Interested readers will find this case included with the Chapter XIV materials on the textbook's website.

## Arbitration

**Arbitration** is the most used form of ADR[10] and was in existence long before the emergence of the English common law.[11] It was well known in the eighteenth century, and George Washington's will even contained an arbitration clause in the event that disputes arose between his heirs.[12]

American courts traditionally opposed arbitration because the parties were in effect thumbing their noses at the judicial system. Many judges believed that people who chose arbitration over the judicial system should not be entitled to come to the judiciary for enforcement of nonjudicial decisions. In the 1925 **Federal Arbitration Act** (FAA), however, Congress established a national policy favoring the arbitration of commercial transactions. In the act, Congress provided that arbitration contracts "shall be valid, irrevocable, and enforceable save upon such grounds as exist at law or equity for the revocation of any contract" and required that courts enforce most arbitration awards.[13] Congress subsequently amended the FAA in 1947, 1954, 1970, and 1990 to recognize and enforce arbitration awards involving commercial arbitration agreements between Americans and citizens of other countries. Congress also enacted the **Labor–Management Relations Act** in 1947, which extended the use of arbitration to disputes arising out of collective bargaining. The U.S. Supreme Court has generally gone along with Congress and the executive branch in supporting the expansion of this and other forms of ADR.[14]

Some disputants end up in arbitration because it is required by a court-annexed program or Is a condition of being employed. In other instances, parties contract to submit their disputes to an arbitrator for resolution.

**INTERNET TIP**

The plaintiff in *Linda James v. McDonald's Corporation* challenged McDonald's claim that by participating in that company's "Who Wants to Be a Millionaire" promotion she had contracted to resolve any dispute with the company via arbitration and could not litigate her claim. The U.S. Court of Appeals for the Seventh Circuit's opinion in this 2005 case can be found on the textbook's website.

## Voluntary Arbitration

Voluntary arbitration is increasingly used to resolve business disputes because it provides prompt decisions at a reasonable cost. The voluntary arbitration process is very different from the judicial process. In voluntary arbitrations, for example, the arbitrator makes a binding decision on the merits of the dispute and can base his or her decision on a lay or business sense of justice rather than on the rules of law that would be applied in court. A private arbitration proceeds pursuant to a contract in which the parties promise to bind themselves to arbitrate their controversy and abide by the arbitrator's decision (which is called an **award**). Because a person who chooses to arbitrate waives the right to a jury trial, arbitration agreements must be in writing to be enforceable in court. Some parties agree to arbitrate their agreements prior to the existence of any dispute.[15] Contracts between unions and management, investors and stockbrokers,[16] and banks and their customers[17] often include arbitration clauses. Many major corporations routinely include arbitration clauses in contracts they make with their suppliers. Arbitration agreements can also be negotiated after a controversy has arisen.

Arbitrators are selected by agreement of the parties. The nonprofit American Arbitration Association has been a supplier of arbitrators since 1926.[18] Arbitrators in business disputes are often chosen because of their expertise in a specific field. This better enables them to render a reasonable and proper decision. This should be contrasted with the trial decisions that are made by a randomly selected judge and jury. The parties can choose a person who they believe will conduct the proceedings fairly and with integrity. However, the legal continuity of the judicial system is not necessarily present in a voluntary arbitration. Arbitrators, for example, do not have to follow precedent in their decision-making process, nor do they have to prepare written explanations for their award (although they often do both).

Each arbitration hearing is convened for the sole purpose of deciding a particular dispute. Arbitration hearings are often conducted in hotels, motels, and offices and, unlike court trials, are generally not open to the public. Although the formalities of a court proceeding need not be followed, arbitration hearings usually follow the sequence of opening statements by the opposing parties, direct and cross-examination of the witnesses, introduction of exhibits, and closing arguments. Arbitrators base their decisions on the evidence and the arguments made before them. However, they are generally not bound by the rules of evidence used in litigation.

Although the parties to an arbitration usually comply with the terms of the arbitrator's award, judicial enforcement action can be taken against a party who reneges.

In the next case, Shelly Sullivan, the plaintiff at trial, sought to litigate rather than arbitrate her claims against a pest control company. The company contended that Sullivan had contractually agreed to arbitrate any claims she might have and thus the lawsuit should be abated.

## Sears Authorized Termite and Pest Control, Inc. v. Shelly J. Sullivan

*816 So. 2d 603*
*Supreme Court of Florida*
*May 2, 2002*

**Wells, C. J**

We have for review the … issue of whether a provision requiring arbitration in an agreement to provide exterminating services for pests, including spiders, includes claims for personal injury allegedly caused by being bitten by spiders which were to be eradicated in the performance of the agreement….

In this case, petitioner Sears Authorized Termite & Pest Control, Inc. (Sears) and respondent Shelly Sullivan (Sullivan) executed a pest control agreement in which Sears agreed to provide services for the control of various pests, including spiders. Sullivan filed suit, essentially alleging in her complaint that Sears treated and retreated for spiders but failed to control the population of spiders at her residence. The failure to control the population of spiders resulted in Sullivan being bitten by spiders, causing her personal injuries and damages. Sears responded by moving to abate and compel arbitration based upon the following arbitration provision in the pest control agreement:

> Arbitration
>
> The purchaser and … Sears Authorized Termite & Pest Control agree that any controversy or claim between them arising out of or related to the interpretation, performance or breach of any provision of this agreement shall be settled exclusively by arbitration. This contract/agreement is subject to arbitration pursuant to the Uniform Arbitration Act of the American Arbitration Association. The arbitration award may be entered in any court having jurisdiction. In no event shall either party be liable to the other for indirect, special or consequential damages or loss of anticipated profits.

The trial judge held a hearing and entered an order granting Sears' motion. In his order the trial judge stated:

> The key case seems to be *Seifert v. U.S. Home Corporation*…. The two closest cases to the present case are *Terminix International Company v. Michaels* … (Fla. 4th DCA 1996), and *Terminix International Company v. Ponzio* … (Fla. 5th DCA 1997).
>
> The present case hinges on an arbitration provision in a pest control customer agreement. The Court's view of the pertinent portion of the agreement is that: regarding any provision of this contract for which a controversy exists concerning its interpretation, performance or breach, arbitration is required. The Court analyzes the pertinent provisions of the contract to require the pest control company to provide necessary service for the control of spiders. The allegations in this complaint are essentially that the pest control company treated and retreated for spiders but failed to control the spiders. The counts are counts for breach of warranty which are clearly contractual counts and counts for negligence, fraud in the inducement, fraud, and negligent misrepresentation.
>
> This case differs from *Michaels* in that *Michaels* had to do with the use of ultra hazardous chemicals. A general duty is imposed on the producer and distributor of hazardous chemicals which is independent of and unrelated to any contractual obligations. Personal injuries claimed in that case were the result of poisoning from these ultra hazardous chemicals. In the present case the cause of action is based on the inability of the pest control services to effectively poison the spiders. In *Michaels* the duty to avoid poisoning persons with ultra hazardous chemicals existed whether or not there was a contract between the parties.
>
> *Ponzio* is factually like the present case in that it was a lawsuit on a pest control contract for failure to eradicate brown recluse spiders, the same spiders in the present case. Like *Ponzio*… the allegations of the present complaint are that the pest control service had a duty to control certain pests and that it failed to do so resulting in bodily injury. There is no assertion of strict liability or of a failure to warn and the claims and controversy herein derive from the contract.
>
> *Seifert* is the most important case. It involves an inherently dangerous design of an air conditioning system so that carbon monoxide gas from a vehicle in the garage circulated through the house and killed Mr. Seifert. The court held that the tort claim related to duties wholly independent of the agreement by the builder to construct the house. *Seifert* recognized that carbon monoxide poisoning was not related to any of the contemplated terms of the contract. In the

present case the contemplated terms of the contract call for the control of spiders. The issue is whether the spiders were properly controlled or not. This at least, raises some issue, the resolution of which requires a reference to or construction of a portion of the contract, namely the portion that obligates the pest control service to control the pests. It involves a disagreement or a controversy relating to the performance or breach of this requirement of the contract as well as the interpretation of how much treatment was necessary in order to effectuate control of the pests.

Unlike an ultra hazardous chemical, or a latent fatally dangerous condition in a home, the present condition is not one imposed by general law or public policy but arises from the contract in question. The obligation is based on a new duty that did not exist without the contract. The tort claims are therefore directly related to the contract. The contract explicitly refers to the control of spiders. It is not necessary to stretch the scope of the arbitration clause in order to encompass these claims. Consequently the arbitration clause is not interfering with a right to jury trial since arbitration clauses are enforceable and favored when the disagreement falls within the scope of the arbitration agreement....

... [T]he... Court of Appeal... reversed.... [It]... found that *Seifert* and *Michaels* should be read to mean that Sullivan's claim for personal injuries and damages resulting from the spider bites were not covered by the arbitration provision....

In this case, it is clear that the intent of the agreement was to "control" spiders, among other "pests." Thus, Sullivan's cause of action rests upon the failure to perform the agreement. The plain language of this arbitration clause covers the "performance" of the agreement. This clearly is distinct from *Seifert*, in which we specifically held: "The tort claim filed in this case neither relies on the agreement nor refers to any provision within the agreement. Rather, the petitioner's tort claim relates to duties wholly independent from the agreement..." We likewise find this case to be distinguishable from the Fourth District Court of Appeal's decision in *Michaels*, in which the factual allegation was based on the use of ultra-hazardous chemicals.... Rather, we find this case to be similar to the Fifth District Court of Appeal's decision in *Ponzio*.

Accordingly, we quash the Fourth District Court of Appeal's decision in *Sullivan*, approve *Ponzio* to the extent it is consistent with this opinion, and remand this case with instructions that the trial court's order compelling arbitration be affirmed.

It is so ordered.

**Case Questions**

1. Why does the Florida Supreme Court reverse the Court of Appeals?
2. How were the *Seifert* and *Michaels* cases distinguished on their facts from the facts of the Sullivan case?

## Judicial Review of Arbitration Awards

Either party to an arbitration may institute a court action seeking confirmation (judicial enforcement) or modification of the award. Federal and state laws provide for jurisdiction in specified courts to (1) recognize and enforce arbitration, (2) provide standards of conduct for arbitration hearings, (3) make arbitration agreements irrevocable, and (4) provide that court action cannot be initiated until the arbitration has concluded.

States differ about the powers judges reviewing arbitration awards should possess. Most state courts and the federal courts will usually confirm an arbitration award unless the arbitrator violated the terms of the arbitration contract, the arbitration procedures offended fundamental due process, or the award violated public policy. Even the traditional rule prohibiting appellate courts from reviewing an arbitrator's findings of fact is subject to reconsideration, as we will see in the following precedent-setting case.

## Cable Connection, Inc. v. DIRECTV, Inc.

*190 P.3d 586*
*California Supreme Court*
*August 25, 2008*

**Corrigan, J.**

This case presents two questions regarding arbitration agreements. (1) May the parties structure their agreement to allow for judicial review of legal error in the arbitration award? (2) Is classwide arbitration available under an agreement that is silent on the matter? …

Defendant DIRECTV, Inc. broadcasts television programming nationwide, via satellite. It contracts with retail dealers to provide customers with equipment needed to receive its satellite signal. In 1996, DIRECTV employed a "residential dealer agreement" for this purpose. A new "sales agency agreement" was used in 1998. Both agreements included arbitration clauses; neither mentioned classwide arbitration.

In 2001, dealers from four states filed suit in Oklahoma, asserting on behalf of a nationwide class that DIRECTV had wrongfully withheld commissions and assessed improper charges. DIRECTV moved to compel arbitration. As the Oklahoma court was considering whether the arbitration could be conducted on a classwide basis, the United States Supreme Court decided *Green Tree Financial Corp. v. Bazzle* (2003)…. A plurality in *Bazzle* held that the arbitrator must decide whether class arbitration is authorized by the parties' contract…. Accordingly, the Oklahoma court directed the parties to submit the matter to arbitration in Los Angeles as provided in the sales agency agreement….

After the dealers presented a statement of claim and demand for class arbitration in March 2004, a panel of three AAA [American Arbitration Association] arbitrators was selected. Following the procedure adopted by the AAA in response to *Bazzle,* the panel first addressed whether the parties' agreement permitted the arbitration to proceed on a classwide basis.

After briefing and argument, a majority of the panel decided that even though "the contract is silent and manifests no intent on this issue," arbitration on a classwide basis was authorized…. The award emphasized that class arbitration was not necessarily required in this case; it was merely permitted by the contract. Whether the arbitration would actually be maintained on a classwide basis would be the subject of a future hearing….

DIRECTV petitioned to vacate the award, contending (1) the majority had exceeded its authority by substituting its discretion for the parties' intent regarding class arbitration; (2) the majority had improperly ignored extrinsic evidence of contractual intent; and (3) even if the majority had not exceeded the authority generally granted to arbitrators, the award reflected errors of law that the arbitration clause placed beyond their powers and made subject to judicial review…. The trial court vacated the award, essentially accepting all of DIRECTV's arguments.

The Court of Appeal reversed, holding that the trial court exceeded its jurisdiction by reviewing the merits of the arbitrators' decision….

We granted DIRECTV's petition for review.

*II. DISCUSSION*

*A. Contract Provisions for Judicial Review of Arbitration Awards*

***1. The CAA, the FAA, and Prior Case Law***

> "In most important respects, the California statutory scheme on enforcement of private arbitration agreements is similar to the FAA [Federal Arbitration Act]; the similarity is not surprising, as the two share origins in the earlier statutes of New York and New Jersey….

Consistent with that purpose, the CAA [California Arbitration Act] and the FAA provide only limited grounds for judicial review of an arbitration award. Under both statutes, courts are authorized to vacate an award if it was (1) procured by corruption, fraud, or undue means; (2) issued by corrupt arbitrators; (3) affected by prejudicial misconduct on the part of the arbitrators; or (4) in excess of the arbitrators' powers…. An award may be corrected for (1) evident miscalculation or mistake; (2) excess of the arbitrators' powers; or (3) imperfection in form…..

…[I]n *Moncharsh* [*v. Heily & Bliss* (1992] we declared that "in the absence of some limiting clause in the arbitration agreement, the merits of the award, either on questions of fact or of law, may not be reviewed except as provided in the statute."… In the years following the *Moncharsh* decision, our Courts of Appeal have rejected claims that review of the merits was authorized inferentially, by contract clauses stating that "the award will be in the form of a statement of decision"… In each of these cases, however, the courts noted that an expanded scope of review *would* be available under a clause specifically tailored for that purpose…

Nevertheless, when the issue has been squarely presented, no Court of Appeal has enforced a contract clause calling for judicial review of an arbitration award on its merits.... In *Crowell* [*v. Downey Community Hospital Foundation* (2002)] ... the parties' contract included an arbitration clause requiring the arbitrator to make written findings and conclusions "supported by law and substantial evidence."... The award was to be "final, binding and enforceable ..., except that upon the petition of any party to the arbitration, a court shall have the authority to review the transcript of the arbitration proceedings and the arbitrator's award and shall have the authority to vacate the arbitrator's award, in whole or in part, on the basis that the award is not supported by substantial evidence or is based upon an error of law."...

The *Crowell* court, in a split decision, decided the statutory bases for vacating and correcting arbitration awards are exclusive, and permitting the parties to expand those grounds by agreement would undermine the purpose of reducing expense and delay....

***2. Hall Street and the Question of Preemption***

The *Hall Street* case arose from an arbitration agreement negotiated during litigation, to resolve an indemnification claim. The agreement was approved and entered as an order by the trial court. It provided:

> "The Court shall vacate, modify or correct any award: (i) where the arbitrator's findings of facts are not supported by substantial evidence, or (ii) where the arbitrator's conclusions of law are erroneous...."

The trial court vacated the arbitrator's award and remanded for further consideration; at the time, the Ninth Circuit approved of contract provisions for expanded judicial review.... After the arbitrator ruled a second time, both parties sought modification, and both appealed from the trial court's judgment modifying the award. By that time, the Ninth Circuit had changed its view on the enforceability of judicial review provisions.... It reversed the judgment....

... [T]he Supreme Court granted certiorari. A majority of the court agreed with the Ninth Circuit that the grounds for vacatur and modification provided by sections 10 and 11 of the FAA are exclusive. ... First, the majority rejected the argument that the nonstatutory "manifest disregard of the law" standard of review recognized by some federal courts supports the enforceability of contract provisions for additional grounds to vacate or modify an arbitration award. ....

Next, the *Hall Street* majority disposed of the contention that allowing parties to contract for an expanded scope of review is consistent with the FAA's primary goal of ensuring the enforcement of arbitration agreements. ... The majority ... characterized the statutory grounds for review as remedies for "egregious departures from the parties' agreed-upon arbitration," such as corruption and fraud.... It viewed the directive in section 9 of the FAA, that the court "must grant" confirmation "unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11," as a mandatory provision leaving no room for the parties to agree otherwise....

Despite this strict reading of the FAA, the *Hall Street* majority left the door ajar for alternate routes to an expanded scope of review...."... [H]ere we speak only to the scope of the expeditious judicial review under §§ 9, 10, and 11, deciding nothing about other possible avenues for judicial enforcement of arbitration awards...."

Furthermore, the *Hall Street* majority recognized that the trial court's case management authority under rule 16 of the Federal Rules of Civil Procedure might support its order adopting the parties' agreement to review of the merits. However, it remanded for further proceedings on this point, concluding that it was "in no position to address the question now, beyond noting the claim of relevant case management authority independent of the FAA...."

The dealers in this case urge us to follow the rationale of the *Hall Street* majority. They contend that any other construction of the CAA would result in its preemption by the FAA. Alternatively, they argue that *Hall Street* provides a persuasive analysis of the FAA that should be applied to the similar CAA provisions governing judicial review....

We conclude that the *Hall Street* holding is restricted to proceedings to review arbitration awards under the FAA, and does not require state law to conform with its limitations. Furthermore, a reading of the CAA that permits the enforcement of agreements for merits review is fully consistent with the FAA "policy guaranteeing the enforcement of private contractual arrangements"...

***3. Moncharsh and the California Rule***

In *Moncharsh* ... [w]e reaffirmed "the general rule that an arbitrator's decision is not ordinarily reviewable for error by either the trial or appellate courts"... and held that the statutory grounds for review were intended to implement that rule.... To that extent, our conclusions were consistent with those of the *Hall Street* majority. However, in several respects *Moncharsh* reflects a very different view of arbitration agreements and the arbitration statutes, as applied to the scope of judicial review. Therefore, we disagree with the dealers' argument that *Hall Street* is persuasive authority for a

restrictive interpretation of the review provisions in the CAA.

*Moncharsh* began from the premise that "[t]he scope of arbitration is … a matter of agreement between the parties' [citation], and "[t]he powers of an arbitrator are limited and circumscribed by the agreement or stipulation of submission."…

> "The policy of the law in recognizing arbitration agreements and in providing by statute for their enforcement is to encourage persons who wish to avoid delays incident to a civil action to obtain an adjustment of their differences by a tribunal of their own choosing… "Because the decision to arbitrate grievances evinces the parties' intent to bypass the judicial system and thus avoid potential delays at the trial and appellate levels, arbitral finality is a core component of the parties' agreement to submit to arbitration. Thus, an arbitration decision is final and conclusive *because the parties have agreed that it be so.* By ensuring that an arbitrator's decision is final and binding, courts simply assure that the parties receive the benefit of their bargain…."
>
> "Thus, both because it vindicates the intentions of the parties that the award be final, and because an arbitrator is not ordinarily constrained to decide according to the rule of law, it is the general rule that, "The merits of the controversy between the parties are not subject to judicial review…."

Our reasoning in *Moncharsh* centered not on statutory restriction of the parties' contractual options, but on the parties' intent and the powers of the arbitrators as defined in the agreement. These factors support the enforcement of agreements for an expanded scope of review. If the parties constrain the arbitrators' authority by requiring a dispute to be decided according to the rule of law, *and* make plain their intention that the award is reviewable for legal error, the general rule of limited review has been displaced by the parties' agreement. Their expectation is not that the result of the arbitration will be final and conclusive, but rather that it will be reviewed on the merits at the request of either party. …

We have consistently recognized that "[a]n exception to the general rule assigning broad powers to the arbitrators arises when the parties have, in either the contract or an agreed submission to arbitration, explicitly and unambiguously limited those powers…. Our review in *Moncharsh* of the CAA's legislative history confirms that while the statutory grounds for correction and vacation of arbitration awards do not ordinarily include errors of law, contractual limitations on the arbitrators' powers can alter the usual scope of review.

The current version of the CAA was enacted following a study by the California Law Revision Commission, undertaken at the Legislature's direction….

> "The Arbitration Study emphasized that arbitration should be the end of the dispute and that 'the ordinary concepts of judicial appeal and review are not applicable to arbitration awards. Settled case law is based on this assumption….' After surveying the state of the law, the report concluded that although the California statutes do not 'attempt to express the exact limits of court review of arbitration awards, … no good reason exists to codify into the California statute the case law as it presently exists.' … Further, the report recommended that the 'present grounds for vacating an award should be left substantially unchanged.' … Considering the nature of the revisions incorporated in the CAA, this court concluded that the Legislature intended to "adopt the position taken in case law and endorsed in the Arbitration Study, that is, 'that in the absence of some limiting clause in the arbitration agreement, the merits of the award, either on questions of fact or of law, may not be reviewed except as provided in the statute."' … (*Moncharsh* … quoting *Crofoot* …)

The *Crofoot* rule does not suggest that review of the merits must rest on a nonstatutory basis. As discussed below, *Crofoot's* reference to a limiting clause in the agreement pertains to limits on the arbitrators' powers. Thus, the merits of an award may come within the ambit of the statutory grounds of review for excess of the arbitrators' powers. (§§ 1286.2, subd. (a)(4); 1286.6, subd. (b).) However, absent such a limitation, the scope of review provided by statute is quite limited. In *Moncharsh,* we noted that section 1286.2 includes no provision for review of the merits like that found in section 1296, governing public construction contract arbitrations…. The *Crowell* court, and the Court of Appeal below, considered section 1296 an indication that the Legislature did not intend to permit review of the merits by agreement…. This view is mistaken. In *Moncharsh* we inferred from section 1296 that "the Legislature did not intend to confer traditional judicial review in private arbitration cases…." However, the failure to provide for that scope of review *by statute* does not mean the parties themselves may not do so *by contract*…. Our holding in *Moncharsh* that the CAA incorporates the *Crofoot* rule is irreconcilable with the notion that the parties are barred from agreeing to limit the arbitrators' authority

by subjecting their award to review on the merits. The history of the FAA, as reviewed by the *Hall Street* majority, includes no similar indication that Congress intended the statutory grounds for review to operate as default provisions, providing only limited review unless the parties agree otherwise…. Therefore, *Hall Street's* FAA analysis is inapposite.

In California, the policy favoring arbitration without the complications of traditional judicial review is based on the parties' expectations as embodied in their agreement, and the CAA rests on the same foundation. "Accordingly, policies favoring the efficiency of private arbitration as a means of dispute resolution must sometimes yield to its fundamentally contractual nature, and to the attendant requirement that arbitration shall proceed *as the parties themselves have agreed.*" … The scope of judicial review is not invariably limited by statute; rather, "the parties, simply by agreeing to arbitrate, are deemed to accept limited judicial review *by implication*…" It follows that they may expressly agree to accept a broader scope of review…

The Arbitration Study discussed in *Moncharsh* includes a similar observation. Regarding the statutory ground of review for excess of the arbitrators' powers, the study stated: "Arbitrators may base their decision upon broad principles of justice and equity, but if the submission agreement specifically requires an arbitrator to act in conformity with rules of law, the arbitrator exceeds his authority if his decision is not based on rules of law."…

A provision requiring arbitrators to apply the law leaves open the possibility that they are empowered to apply it "wrongly as well as rightly." … As we recently observed: "When parties contract to resolve their disputes by private arbitration, their agreement ordinarily contemplates that the arbitrator will have the power to decide any question of contract interpretation, historical fact or general law necessary, in the arbitrator's understanding of the case, to reach a decision…. Inherent in that power is the possibility the arbitrator may err in deciding some aspect of the case. Arbitrators do not ordinarily exceed their contractually created powers simply by reaching an erroneous conclusion on a contested issue of law or fact, and arbitral awards may not ordinarily be vacated because of such error, for "[t]he arbitrator's resolution of these issues is what the parties bargained for in the arbitration agreement."…

Therefore, to take themselves out of the general rule that the merits of the award are not subject to judicial review, the parties must clearly agree that legal errors are an excess of arbitral authority that is reviewable by the courts. Here, the parties expressly so agreed, depriving the arbitrators of the power to commit legal error. They also specifically provided for judicial review of such error…. We do not decide here whether one or the other of these clauses alone, or some different formulation, would be sufficient to confer an expanded scope of review. However, we emphasize that parties seeking to allow judicial review of the merits, and to avoid an additional dispute over the scope of review, would be well advised to provide for that review explicitly and unambiguously….

Review on the merits has been deemed incompatible with the goals of finality and informality that are served by arbitration and protected by the arbitration statutes…. However … those policies draw their strength from the agreement of the parties. It is the parties who are best situated to weigh the advantages of traditional arbitration against the benefits of court review for the correction of legal error….

To the extent the concern with reviewability arises from apprehension that permitting review on the merits would open the door to contracts imposing unfamiliar standards of review, it appears to be unfounded. We have discovered no case where the parties attempted to make the courts apply an unusual standard of review. Instead, as in this case, they have required the arbitrators to apply legal standards, resulting in awards that can be reviewed in traditional fashion….We need not speculate about provisions calling for bizarre modes of decision, but we note that arbitration agreements are "as enforceable as other contracts, but not more so."… Thus, just as the parties to any contract are limited in the constraints they may place on judicial review, an arbitration agreement providing that a "judge would review the award by flipping a coin or studying the entrails of a dead fowl" would be unenforceable….

The benefits of enforcing agreements like the one before us are considerable, for both the parties and the courts. The development of alternative dispute resolution is advanced by enabling private parties to choose procedures with which they are comfortable. Commentators have observed that provisions for expanded judicial review are a product of market forces operating in an increasingly "judicialized" arbitration setting, with many of the attributes of court proceedings. The desire for the protection afforded by review for legal error has evidently developed from the experience of sophisticated parties in high stakes cases, where the arbitrators' awards deviated from the parties' expectations in startling ways….

The judicial system reaps little benefit from forcing parties to choose between the risk of an erroneous arbitration award and the burden of litigating their dispute entirely in court. Enforcing contract provisions

for review of awards on the merits relieves pressure on congested trial court dockets.... Courts are spared not only the burden of conducting a trial, but also the complications of discovery disputes and other pretrial proceedings. Incorporating traditional judicial review by express agreement preserves the utility of arbitration as a way to obtain expert factual determinations without delay, while allowing the parties to protect themselves from perhaps the weakest aspect of the arbitral process, its handling of disputed rules of law....

There are also significant benefits to the development of the common law when arbitration awards are made subject to merits review by the parties' agreement. "[I]f courts are reduced to the function of merely enforcing or denying arbitral awards, without an opportunity to discuss the reasoning for the arbitral decision, the advancement of the law is stalled, as arbitral decisions carry no precedential value.... Thus, expansion of judicial review gives the courts of first instance the opportunity to establish a record, and to include the reasoning of expert arbitrators into the body of the law in the form of written decisions. This procedure better advances the state of the law and facilitates the necessary beneficial input from experts in the field...."

These advantages, obtained with the consent of the parties, are substantial. As explained in *Moncharsh,* the drafters of the CAA established the statutory grounds for judicial review with the expectation that arbitration awards are ordinarily final and subject to a restricted scope of review, but that parties may limit the arbitrators' authority by providing for review of the merits in the arbitration agreement.... The Court of Appeal erred by refusing to enforce the parties' clearly expressed agreement in this case.

*B. The Award Permitting Classwide Arbitration*

Two of the three arbitrators below decided the dealers could pursue arbitration on a classwide basis, although the parties' contract did not mention classwide arbitration. The Court of Appeal agreed with this determination. The contract calls for the arbitrators to apply California substantive law, while following the procedural requirements of AAA rules and the FAA....

The Court of Appeal, and the arbitrators in the majority, viewed the right to pursue classwide arbitration as a substantive one... The court concluded that these cases "give[ ] arbitrators discretion to order classwide arbitration even where the arbitration agreement is silent on that issue, in divergence from the general rules of contract interpretation that terms are not to be inserted into contracts."...

DIRECTV claims that ...the arbitrators in the majority violated a provision of the AAA rules stating: "In construing the applicable arbitration clause, the arbitrator shall not consider the existence of ... AAA rules, to be a factor either in favor of or against permitting the arbitration to proceed on a class basis." ...

DIRECTV appears to be correct.... AAA's class arbitration policy is based on the *Bazzle* decision.... The *Bazzle* plurality declared: "[T]he relevant question here is what *kind of arbitration proceeding* the parties agreed to. That question does not concern a state statute or judicial procedures.... It concerns contract interpretation and arbitration procedures. Arbitrators are well situated to answer that question...." We express no view on whether the terms of this arbitration clause are consistent with conducting arbitration on a classwide basis. Instead of deciding that question, the majority arbitrators misapplied AAA rules and policy as well as the *Keating* rule. Under the circumstances, we deem it appropriate to permit the arbitration panel to reconsider the availability of classwide arbitration as a matter of contract interpretation and AAA arbitration procedure.

*III. DISPOSITION*

We reverse the judgment of the Court of Appeal, with directions to instruct the trial court to vacate the award so that the arbitrators may redetermine whether the arbitration may proceed on a classwide basis.

**Case Question**

Why did the California Supreme Court refuse to adopt the U.S. Supreme Court's reasoning in the Hall Street case?

## Court-Annexed Arbitration

Court-annexed arbitration includes both voluntary and mandatory procedures. Mandatory arbitrations, however, for reasons founded in the right to jury trial contained in both federal and state constitutions, can only produce nonbinding decisions.

The type of cases that can be arbitrated is increasingly determined by statute, but in many jurisdictions this is determined pursuant to local court rules. Traditionally, arbitrations are most common in commercial, personal injury, and property damage cases in which the amount does not exceed a designated sum. That sum, called the jurisdictional amount, varies by jurisdiction.

The rules of arbitration often provide for limited discovery and modified rules of evidence. In brief, trial-like hearings lasting only a few hours, attorneys offer documentary evidence, present witness testimony, and cross-examine opposing witnesses. Arbitrators, who are often retired judges and local attorneys, are selected in various ways. In some courts, the clerk of court randomly assigns arbitrators. In other jurisdictions the parties participate in the selection process.

Arbitrators listen to the presentations, ask questions of the presenters, and determine the liability and damages issues. They generally do not make findings of fact or conclusions of law (as would judges in bench trials). Depending on local practice, the arbitrator may—or may not—attempt to mediate the dispute, critique the parties, or propose settlement terms.

An arbitrator's award becomes a final judgment unless the parties reject it within a prescribed period of time and demand a traditional jury trial (called a **trial de novo**). Unless the trial judgment exceeds the arbitration award, a party demanding a trial de novo often will be penalized and required to pay the arbitration costs.

The following case contains a discussion of the rights of the parties to a court-annexed arbitration proceeding to reject the arbitrator's decision and insist on a trial de novo.

**Allstate Insurance Company v. A. William Mottolese**
*803 A.2d 311*
*Supreme Court of Connecticut*
*August 20, 2002*

**Sullivan, C. J.**
This case is before us on a writ of error brought by the named plaintiff in error, Allstate Insurance Company (plaintiff) … the insurer of the defendant in the underlying action, seeking reversal of an order of the trial court, *Mottolese. J.*, the defendant in error (trial court), imposing sanctions against the plaintiff pursuant to Practice Book §§ 14-13. The dispositive issue in this case is whether a party's proper exercise of its right to a trial de novo … following a nonbinding arbitration proceeding may serve as the grounds for the imposition of sanctions under Practice Book §§ 14-13….

The plaintiff claims that the trial court's order of sanctions against it is void because it is not a party to the underlying action and never consented to the court's personal jurisdiction over it. Further, the plaintiff contends that: (1) the trial court violated its due process rights by failing to give notice that court would be considering whether to impose sanctions upon the plaintiff for its refusal to increase its settlement offer; and (2) the order of sanctions was an improper attempt by the trial court to coerce and intimidate the plaintiff to settle the underlying defendant's case and, as such, violated the underlying defendant's constitutional right of access to the courts. We agree that, under the circumstances of this case, the plaintiff's conduct, which was grounded in its insured's exercise of his right to a trial de novo, cannot serve as the basis for an order of sanctions, and we reverse the order sanctioning the plaintiff.

The record discloses the following relevant facts and procedural history. In December, 1997, Robert Morgan filed the underlying action against David Distasio, the plaintiff's insured, to recover damages for injuries sustained in a December 5, 1995 automobile accident…. After a pretrial conference at which no settlement was reached, the trial court referred the case to nonbinding arbitration… the court annexed arbitration program. In December, 1999, the arbitrator issued a memorandum of decision in which he found… that Distasio negligently had rear-ended Morgan's vehicle, that Morgan had sustained minor physical injuries and property damage, and that judgment should be rendered in favor of Morgan in the amount of $2450. Distasio thereafter timely filed a claim for a

trial de novo … requesting that the trial court vacate the arbitration award and restore the case to the jury trial list.

On April 4, 2001, a pretrial conference was held before the trial court, Mottolese, J. The trial court continued the conference to April 11, 2001, with the instruction that Distasio produce his insurance claims representative on that date. On April 11, 2001, Distasio, Morgan and their respective counsel, along with the claims representative for the plaintiff, Stephen Coppa, appeared before the court in accordance with a written notice of pretrial conference. Coppa acknowledged that the plaintiff had made its initial settlement offer of $2050 to Morgan after evaluating the case, and that, at the time the offer was made, he had told Morgan that the offer was final. After discussion, the trial court found that the plaintiff's refusal "to pay anything more than $2050… is conduct which may fairly be characterized as unfair and in bad faith." The trial court further stated that "this court deems [the plaintiff's] refusal to participate in a resolution of this case in a reasonable manner as the functional equivalent of a failure to attend a pretrial," and that "it's unreasonable for any insurance carrier, any tortfeasor, to require judicial resources to be put in place and for thousands and thousands of taxpayers' money to be expended in order to save you, [the plaintiff], $400.00." The trial court held that the plaintiff's conduct was an "unwarranted imposition upon scarce judicial resources… a gross abuse of the civil justice system; and [that it made] a mockery of Connecticut's court annexed arbitration program." Accordingly, pursuant to Practice Book §§ 14-13 … the trial court awarded Morgan attorney's fees of $250 for the April 4 pretrial conference and $250 for the April 11 hearing.

Distasio moved for articulation, requesting that the trial court clarify whether the ruling on attorney's fees was directed at the plaintiff, Distasio or Distasio's counsel. In response, the trial court appointed H. James Pickerstein, an attorney, "as a special master to conduct discovery on behalf of the court and to assist the court in preparing its articulation." The court ordered that the scope of discovery was to include, but not be limited to, the plaintiff's settlement policies and practices as they related to the underlying case, the extent to which Distasio's counsel had participated in the settlement process, and the policies and practices of the court annexed arbitration program and de novo trials….

…Distasio filed an appeal in the Appellate Court challenging the appointment of the special master.

In the meantime, the plaintiff moved for permission to amend the writ to address the sanction order….

The plaintiff claims that the order of sanctions was an improper attempt to coerce and intimidate it into settling the matter, thereby violating its constitutional right to a trial by jury. Specifically, the plaintiff argues that Distasio's assertion of his statutory right to a trial de novo following the court-ordered nonbinding arbitration proceeding preserved his right to a trial by jury guaranteed by the Connecticut constitution, and that a party's decision not to be bound by an arbitrator's decision regarding settlement cannot be the basis for the imposition of sanctions under Practice Book §§ 14-13.

Conversely, the trial court argues that, because the arbitrator's award of $2450 in damages was a mere $400 more than the plaintiff was originally willing to pay, the plaintiff took a defiant approach to the settlement process that was interpreted by the trial court as being disrespectful to it, harmful to the opposing party and implicitly contemptuous. The trial court further argues that it is within that court's inherent authority to sanction all who appear before it whose actions may be characterized as unfair and in bad faith.

We agree with the plaintiff and conclude that Distasio's exercise of his right to file for a trial de novo after the completion of arbitration proceedings cannot provide the basis for sanctions pursuant to Practice Book §§ 14-13. Accordingly, we conclude that the trial court abused its discretion when it sanctioned the plaintiff….

We begin with a review of the nonbinding arbitration program. Section 52-549u permits the judges of the Superior Court to refer certain civil actions to an arbitrator for nonbinding arbitration. The arbitrator's decision, however, is not binding on the parties and does not limit either party's access to a trial…. Pursuant to §§ 52-549z (d) and Practice Book §§ 23-66(c), a party that participated in nonbinding arbitration may appeal from the arbitrator's decision by requesting a trial de novo, in which case the arbitrator's decision becomes null and void.

The statutory right to a trial de novo has its underpinnings in the Connecticut constitution. "Article IV of the amendments to the constitution of Connecticut provides, inter alia, that the right of trial by jury shall remain inviolate. It is clear that the right to a jury trial may not be abolished as to causes triable to the jury prior to the constitution of 1818, and extant at the time of its adoption…. Nevertheless, such a right may be subjected to reasonable conditions and

regulations…. The provision by the legislature for an alternative means of dispute resolution through the use of arbitrators to hear cases claimed for jury trial was but part of an effort to alleviate court congestion…. The right to a trial by jury in these cases is preserved inviolate by General Statutes §§ 52-549z and Practice Book §§ [23-66]. Each of these sections provides for a claim for a trial de novo within twenty days of the filing of the arbitrator's decision. Once a claim for trial de novo is filed in accordance with the rules, a decision of an arbitrator becomes null and void…."

Although both parties to the arbitration have an inviolable right to a trial de novo, that right is subject to reasonable conditions and regulations…. Attendance at a pretrial hearing is one such condition. Thus, Practice Book §§ 14-13 provides in relevant part that "when a party against whom a claim is made is insured, an insurance adjuster for such insurance company shall be available by telephone at the time of such pretrial session unless the judge… in his or her discretion, requires the attendance of the adjuster at the pretrial. If any person fails to attend or to be available by telephone pursuant to this rule, the judicial authority may make such order as the ends of justice require, which may include the entry of a nonsuit or default against the party failing to comply and an award to the complying party of reasonable attorney's fees…."

We further recognize, as the trial court claimed, that "our courts have long been recognized to have an inherent power, independent of any statute, to hold a defendant in contempt of court…. The purpose of the contempt power is to enable a court to preserve its dignity and to protect its proceedings…." The sanction created by Practice Book §§ 14-13 and relied upon by the trial court in this case, however, was intended to serve a different function, namely to ensure the insurer's presence to assist in the settlement of the case.

Public policy favors and encourages the voluntary settlement of civil suits…. *Krattenstein v. G. Fox & Co.* ... (1967) ("It is a proper exercise of the judicial office to suggest the expediency and practical value of adjusting differences and compromising and settling suits at law. The efficient administration of the courts is subserved by the ending of disputes without the delay and expense of a trial, and the philosophy or ideal of justice is served in the amicable solution of controversies. Our rules specifically provide for the procedure to be followed in pretrial sessions designed to encourage the settlement of cases.") We view with disfavor, however, all pressure tactics, whether employed directly or indirectly, to coerce settlement by litigants, their counsel and their insurers. The failure to concur with what a trial court may consider an appropriate settlement should not result in the imposition of any retributive sanctions upon a litigant, his or her counsel or his or her insurer. As our sister state, New York, has recognized, "the function of courts is to provide litigants with an opportunity to air their differences at an impartial trial according to law…. [The court should not be able] to exert undue pressure on litigants to oblige them to settle their controversies without their day in court."…

We recognize that Practice Book §§ 14-13 grants the trial court the authority to sanction an insurance company for its failure to attend or be available by telephone at a pretrial session. In this case, however, the plaintiff was not unavailable or otherwise absent from the proceedings. Moreover, its actual presence, through its agent,… cannot be transformed into the functional equivalent of an absence, as the trial court ruled,… simply because the insurer decided not to abide by the arbitrator's assessment of damages and to insist, as its insured's agent, on the insured's right to a trial.

Although we sympathize with the trial court's concern that merely attending a pretrial conference while refusing, at the same time, to participate meaningfully in the negotiation or settlement process is not within the spirit of the settlement process, the plaintiff's refusal, on the basis of a validly exercised right to a trial de novo, to abide by the arbitrator's nonbinding decision that the plaintiff should pay $400 more than its original offer does not fall within the parameters of sanctionable behavior under §§ 14-13. To conclude otherwise would undermine the insured's constitutional right to a trial of the claims. Practice Book §§ 14-13 authorizes the court to use its discretion to require an insurer to be present or available because the insurer's presence might assist in the settlement of the case. Under these circumstances, however, the failure to negotiate is not equivalent to the failure to appear in court. Distasio indicated, by requesting a trial de novo, that he wanted his dispute to be resolved by trial. The plaintiff's rejection of the arbitration award evidences the same preference, in accordance with §§ 52-549z (d) and Practice Book §§ 23-66 (c). Accordingly, because Distasio properly exercised his statutory right to a trial de novo and the plaintiff properly complied with the trial court's request to be present at the pretrial hearing, we conclude that the trial court abused its discretion when it imposed sanctions….

The writ of error is granted and the matter is remanded with direction to vacate the order of sanctions….

**Case Questions**

1. What was the arbitrator's decision in this case?
2. Why did Judge Mottolese want to sanction the insurance company in this case for contempt of court?
3. Why did the state supreme court order that the order imposing sanctions be vacated?

## JOINTLY USED ADR METHODS

Mediation, minitrials, and arbitration are used with both court-annexed and voluntary ADR. The following discussion briefly examines each of these methods.

### Mediation

**Mediation** is a technique in which one or more neutral parties, called mediators, help disputants to find ways to settle their dispute.[19] Parties often attempt to resolve their disagreements by mediation before participating in binding arbitration or litigation. Informal, unstructured, and inexpensive, mediation focuses on settlement, not on victory at trial. Mediators have no formal power to make a decision: Their role is that of facilitator, and different mediators use different styles and techniques to help parties come to an agreement. There is no formal hearing in a mediation. Instead, using joint meetings and private caucuses, mediators (1) help the parties identify their real goals, (2) narrow the issues, (3) look for alternatives and options as well as areas of common interest, and (4) prevent the parties from focusing on only one solution.

Court-annexed mediation often involves using trial attorneys as mediators. Mediators in some jurisdictions are paid and in others are volunteers. The theory is that neutral, experienced trial attorneys will be able to persuade litigants to look at their cases realistically and moderate their monetary demands. These are important hurdles that often stand in the way of a settlement.

Court-annexed mediation procedures vary. Lawyer-mediators are used in some jurisdictions and three-person panels in others. In complex cases, the court may appoint a person called a special master to serve as a mediator. Mediators vary in their approaches, but they tend to evaluate each case and predict what would happen if the case went to trial. They also indicate what they believe to be the settlement value of the case. These two determinations serve as a catalyst in starting settlement discussions between the parties.

In some jurisdictions the court refers most cases to mediation. In other jurisdictions, mediation occurs pursuant to stipulation or a suggestion from the court. Mediation is nonbinding, and parties retain their rights to attempt other ADR methods and to go to trial.

There is a big difference between the focus of a trial and that of a mediation. Trials exist to produce a winner and a loser. Mediation exists to help the parties settle their dispute in an amicable and expeditious manner. The objective is to find a solution to the dispute that is more acceptable to each party than going to trial. Mediation is more flexible than a trial and can produce a result that is more attuned to the underlying facts. Another advantage to mediation is that there are fewer enforcement problems. Because mediation produces an agreement between the parties, many problems that result when a judgment creditor attempts to enforce a judgment are avoided.

As states have begun to implement court-annexed mediation, questions have arisen regarding the procedures to be employed when using the ADR method. The following case from Tennessee is illustrative.

## Team Design v. Anthony Gottlieb

*104 S.W.3d 512*
*Court of Appeals of Tennessee*
*July 18, 2002*

**William C. Koch**

This appeal raises important issues regarding the permissible range of court-annexed alternative dispute resolution procedures available under Tenn. S. Ct. R. 31….

Michael J. Bonagura and Kathie Baillie Bonagura perform country music in a group known as "Baillie and the Boys." When the transactions giving rise to this lawsuit arose, they were managed by Anthony Gottlieb, who did business as Morningstar Management. On January 22, 1996, the Bonaguras signed an "Exclusive Artist Agreement" with Intersound Entertainment, Inc. ("Intersound"), a Minnesota corporation whose principal place of business was in Roswell, Georgia. This agreement obligated Intersound to be responsible for the artwork and graphic design for the Baillie and the Boys albums.

With Intersound's knowledge and consent, the Bonaguras hired Harris Graphics, Inc. and Team Design to develop the artwork and graphics for an upcoming album called "Lovin' Every Minute." They believed that Intersound would be responsible for paying for this work. However, unbeknownst to the Bonaguras, Mr. Gottlieb had delivered a letter to Intersound agreeing that the Bonaguras would be responsible for paying for the artwork and graphic design for this album.

When Harris Graphics and Team Design were not paid for their work, they filed suit in the Davidson County General Sessions Court against Intersound and Mr. Gottlieb seeking payment and an injunction against the use of their work until they were paid. The general sessions court later permitted Harris Graphics and Team Design to add the Bonaguras as defendants. Following a hearing, the general sessions court granted Team Design a $4,086.75 judgment against Intersound and the Bonaguras. It also granted Harris Graphics a $2,200 judgment against Inter-sound and a $2,760 judgment against the Bonaguras.

All the parties perfected de novo appeals to the Circuit Court for Davidson County….

The trial was originally set for September 1998 but, at the trial court's initiative, was continued twice to February 16, 1999. Approximately one month before trial, the lawyer representing the Bonaguras requested his fellow lawyers to agree to preserve the Bonaguras' trial testimony by taking their depositions because Cactus Pete's in Jackpot, Nevada had declined to release them from a previous contractual commitment that conflicted with the rescheduled court date. The lawyers agreed, and the Bonaguras' depositions were scheduled for January 19, 1999. However, before the depositions could be taken, Mr. Gottlieb changed his mind and insisted that the Bonaguras be present at the trial. On January 21, 1999, the Bonaguras filed a motion seeking a continuance and an order enforcing the agreement permitting them to present their testimony by deposition. Team Design and Harris Graphics agreed to the use of the depositions at trial but objected to another continuance.

The trial court conducted a hearing on the Bonaguras' motion on February 5, 1999…. After the trial court agreed to the Bonaguras' request for a continuance, the lawyers and the trial court began discussing another trial date. During this discussion, the trial court offered the alternative of "binding mediation" and stated that it would be available to conduct the mediation on March 11, 1999. The record contains no indication that the trial court informed the parties of the specific procedures that would be used for this mediation or the legal consequences of their agreement to participate in the mediation…. The lawyers for all the parties accepted the court's offer, and on February 16, 1999, the trial court entered an order referring the case to "binding mediation before this Court" on March 11, 1999.

Thereafter, the trial court directed the parties to submit confidential statements outlining their respective positions. When the parties returned to court on March 14, 1999,… a clerk explained the procedure the trial court intended to follow which consisted of separate meetings with each of the parties and their lawyers in chambers. Over the next four hours, the trial court met separately with each of the parties and their lawyer. According to one of the lawyers, the trial court "made no attempt to seek a mutual agreement as to a resolution of the issues among the parties, but, after the final interview, announced that she would make a decision and enter an order reflecting her decision." On March 19, 1999, the trial court entered an order awarding Team Design a $4,086.75 judgment against Intersound and awarding Harris Graphics a $5,044.45 judgment against Intersound. The trial court also awarded Intersound a judgment against Mr. Gottlieb for one-third of the total amount of Team Design's and Harris Graphics' judgments to be paid from moneys he received from the "Lovin' Every Minute"

album. Likewise, the trial court awarded Intersound a judgment against the Bonaguras for one-third of the of Team Design's and Harris Graphics' judgments to be paid from the royalties generated from their "Lovin' Every Minute" album.

On March 31, 1999, Intersound filed a … motion based on its lawyer's assertion that he had understood that the "binding mediation" offered by the trial court would be the sort of mediation authorized by Tenn. S. Ct. R. 31 in which he had previously participated in other cases. He also asserted that he never would have agreed to mediation had he understood the procedure that the court planned to follow. Team Design, Harris Graphics, and Mr. Gottlieb opposed the motion. They argued (1) that all the parties had agreed to "binding mediation," (2) that Intersound had not objected to the procedure prior to the entry of the March 19, 1999 order, and (3) that it would be unfair to permit Intersound to object to the proceeding at this point. The trial court entered an order on April 29, 1999, denying Intersound's post-trial motion. Intersound has perfected this appeal.

*II. The Trial Court's Authority to Conduct Binding Mediation*

We turn first to the question of a Tennessee trial court's authority to conduct "binding mediation." Intersound asserts that any sort of mediation conducted by a trial court in Tennessee must be consistent with Tenn. S. Ct. R. 31. In response, Team Design, Harris Graphics, and Mr. Gottlieb assert that the parties and the trial court may, by agreement, agree upon an alternative dispute procedure that does not meet all the requirements of Tenn. S. Ct. R. 31 and that the trial court and the parties did precisely that. We have determined that all court-annexed alternative dispute resolution procedures must be consistent with Tenn. S. Ct. R. 31 and that the "binding mediation" procedure used in this case was not consistent with Tenn. S. Ct. R. 31.

*A.*

Public policy strongly favors resolving disputes between private parties by agreement. Private parties may, of course, decide to submit their disputes to the courts for resolution; however, a broad range of other formal and informal alternatives are available before they resort to litigation. These procedures are, as a practical matter, limited only by the parties' imaginations because the parties themselves may agree on virtually any mutually satisfactory procedure that is not illegal or contrary to public policy. Thus, alternative dispute resolution procedures may range from formal procedures such as arbitration under Tennessee's version of the Uniform Arbitration Act… to far less formal procedures such as "splitting the difference," flipping a coin, or, for that matter, arm wrestling. At least with regard to formal agreements to resolve disputes, the courts will require the parties to follow their agreed-upon dispute resolution procedure as long as they are competent and are dealing at arm's length. When the parties have agreed to be bound by the outcome of their agreed-upon procedure, the courts will require them to accept the result by declining to try their dispute de novo and by limiting the scope of judicial review of the outcome….

The parties' ability to manipulate the contours of the procedure to resolve their disputes narrows considerably once they submit their dispute to the courts for resolution. Judicial proceedings must be conducted in accordance with the ancient common-law rules, applicable constitutional principles, statutes, and court rules.

In Tennessee prior to 1995, traditional litigation was the only procedure available to parties who turned to the courts for resolution of their disputes. The trial courts lacked express authority to provide judicial oversight over pending cases other than the sort of oversight traditionally provided by American judges. They certainly did not have express authority to offer or require the use of alternative dispute resolution procedures. This changed on July 1, 1995, when amendments to Tenn. R. Civ. P. 16 greatly expanded the trial courts' case management authority. For the first time, Tenn. R. Civ. P. 16.03(7) specifically empowered trial courts to discuss "the possibility of settlement or the use of extrajudicial procedures, including alternative dispute resolution, to resolve the dispute." These amendments did not, however, empower trial courts to require the parties to engage in any sort of alternative dispute resolution procedure or to participate in any such procedure themselves. These changes were to come five months later.

On December 18, 1995, the Tennessee Supreme Court filed Tenn. S. Ct. R. 31 establishing procedures for court-annexed alternative dispute resolution in Tennessee's trial courts…. The original version of the rule represented an incremental approach to court-annexed alternative dispute resolution. The procedures… were intended to be alternatives, not replacements, to traditional litigation….

Under the original version of the rule … [ADR] procedures became available only after "all parties are before the court."… At that time, any or all of the parties could request authorization to engage in an alternative dispute resolution procedure…. The rule also permitted the trial court, even without the parties' request or consent but after consultation with the