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SECTION OF LABOR AND EMPLOYMENT LAW
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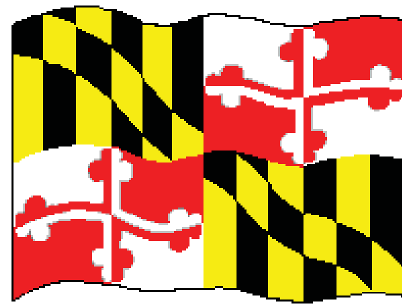

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FROM THE CHAIR

By Thomas J. Gagliardo

It isn't often that the Labor and Employment Section Council will take a position for or against a bill before the Maryland General Assembly. That's not a surprise given that some of us represent employers and others employees. If you think domestic relations law results in many a pitched battle, take a look at what happens in employment litigation. But unlike DR practitioners, who can be expected to represent both husbands and wives, most of us are likely to represent only bosses or only workers. This year, however, the L&E Council has overcome the usual impasse and endorsed companion tax relief bills, to be introduced by Delegate Tom Hucker and Senator Jamie Raskin.

If passed, compensatory damages recovered in discrimination cases, will once again be excluded from taxable income. Such damages are typically not the result of physical injury, but (in the language of 42 U.S.C. 1981a) compensate a person for "emotional pain, suffering, inconvenience, mental anguish, loss of enjoyment of life, and other nonpecuniary losses".

Until the mid-1980's all compensatory damages, regardless of the underlying injury, were excluded from taxable income. But Congress changed the Internal Revenue Code so that only compensatory damages for mental anguish and the like resulting in physical injury would thereafter be deductable in determining one's adjusted gross income. Maryland taxpayers use their federal adjusted gross incomes when calculating what they owe the State. So, since that time, Marylanders who by suit or settlement recover compensatory damages because of the indignity, humiliation and disruption of their lives associated with losing a job have paid taxes, often after landing in a higher tax bracket as a result of recovering those damages.

Here's one example of the inequity this abandonment of a long established tax provision has created -- a woman who obtains an award of compensatory damages after being phys-

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EDITOR'S CORNER

By Albert Palewicz

With this issue the Section of Labor & Employment Law begins its sixteenth year of publication. What is more, we begin it in the best way possible, with the first two issues being sponsored by groups that have never before done so.

This issue has been prepared by members of the Employment Law Group of Washington, DC. Their focus is the representation of plaintiffs who have claims against employers under the many wage and employment laws, as well as those with claims of discrimination for whistle blowing activities. The material presented by them in this issue emphasizes recent development in statutory or case law in their areas of focus. Our next issue (Spring 2011) will by sponsored by Ogletree Deakins of Washington, DC, with Robert Niccolini as coordinator.

As this issue is being prepared for publication, the hue and cry from our neighbor to the southwest may be heard even on the streets of Baltimore. The new U.S. Congress will be seated today, and already the rhetoric on both sides fills the air, real and virtual. Let us hope something good for the country will come out of all the fuss we will have to live through over the next months, and years.

Whatever happens, though, we can be certain there will be effects on the practices of every one of the Section's members. We number over 750 now, and represent all phases of the employment and labor relationship. The Section exists to help all of us weather the storms of an ever changing legal landscape, and the Newsletter is aimed at providing us with a tool to find our way along as things change. Beginning our 16th year of publication, we hope to continue the now well established practice of finding, reporting, and clarifying new developments in our field(s).

Thanks to all who have written for the Newsletter in the past, and welcome to the dozens and dozens who will do so over the next 15 years.

FROM THE CHAIR (continued)

ically assaulted pays no taxes on the award, while a woman who obtains compensatory damages because she had been sexually harassed and humiliated pays often at a higher marginal rate.

So where is the common ground for employees, employers and the attorneys who represent them? As we all know, more taxes equal less net gain, which makes settlement more expensive and, therefore, more difficult to achieve. In a letter supporting similar changes to the federal tax code, advocates across the spectrum said restoring the previous nontaxable status of compensatory damages "will significantly reduce the costs of employment- and civil rights-related litigation for American businesses. More cases will be settled before trial, and it will be less expensive for employers to settle them because employers will not have to pay as much to resolve meritorious claims."

This recognition of shared interest is why unlikely allies such as the National Employment Lawyers Association (composed solely of plaintiff-side lawyers) and the Society for Human Resources Management have joined forces. And it is why the L&E Council has endorsed the effort to bring tax equity to Maryland.

On a related note: while the Council is unlikely to take a position for or against a given bill, we are ready, willing and able to provide advice and technical assistance, whether it is informing legislative sponsors and advocates about judicial interpretation of existing laws or commenting on the likely affect of proposed language.

The Council selected Keith Zimmerman to serve as our designated coordinator, and you should feel free to contact him if you or a member of the General Assembly with whom you are working feels we can be of assistance.

This Maryland State Bar Association Newsletter is not intended to provide legal advice, but rather to provide information concerning recent developments in the field of labor and employment law. Questions concerning individual problems or claims should be addressed to legal counsel. Any opinions expressed herein are solely those of the authors, and are not those of the Maryland State Bar Association. Finally, the articles contained herein are copyrighted, all rights reserved by the respective authors and/or their law firms, companies or organizations.

ARTICLES

Court of Appeals Clarifies the Scope of Protected Conduct Under Maryland Health Care Worker Whistleblower Protection Act, Provides Insight into Maryland Public Policy

By R. Scott Oswald, Esq.
The Law Employment Group

On May 13, 2010, the Court of Appeals of Maryland held in *Lark v. Montgomery Hospice, Inc.*,[1] that an employee does not need to make an external disclosure in order to be protected under the Maryland Health Care Worker Whistleblower Protection Act, Md. Code, Health Occ. §§ 1-501 to -506 (the "Act"). In its discussion of the Act, the court cites numerous cases from other jurisdictions favoring the protection of whistleblowers making only an internal disclosure, and in gratis dictum indicates that an employee need not make an external disclosure in order to be protected under the Maryland common law tort of wrongful discharge.[2]

Susan Lark was as a nurse at Montgomery Hospice Inc. (Montgomery).[3] Starting in 2004, Lark noticed what she thought were abnormalities and potential violations of generally accepted professional standards of nursing practice. A few years later, Lark learned that her co-workers were distributing narcotics in an unsafe and potentially illegal manner. Some of the practices which Lark alleges include the distribution of narcotics to non-patients, providing adult doses to children, improper documentation of the distribution of narcotics, distribution of narcotics to patients without a physician's order, and failure to use safety precautions with a patient that had a high risk of hemorrhage.

From September 2006 to April 2007, Lark complained to management about the alleged violations in an attempt to comply with her legal and ethical responsibilities. Some of her complaints were in the form of emails to her supervisor and the Vice-President of Clinical Services. On April 14, 2007 Lark met with her supervisor, the Vice-President of Clinical Services, and the Vice-President of Medical Services. During the meeting, Lark was given a memo alleging that she engaged in "practices [that] are frequently outside the acceptable and safe standards of nursing practice" and she was terminated.[4]

Lark filed a complaint alleging *inter alia* that her discharge was in violation of public policy and the Maryland Health Care Worker Whistleblower Protection Act, Md. Code, Health Occ. §§ 1-501 to -506. Lark's suit appears to be the first reported action ever brought under the 8 year old Act which prohibits employers retaliating against an employee because the employee:

> (1) Discloses or threatens to disclose to a supervisor or board an activity, policy, or practice of the employer that is in violation of a law, rule, or regulation; (2) Provides information to or testifies before any public body conducting an investigation, hearing, or inquiry into any violation of a law, rule, or regulation by the employer; or (3) Objects to or refuses to participate in any activity, policy, or practice in violation of a law, rule, or regulation.
>
> Md. Code, Health Occ. § 1-502.

Section 503 of the Act narrows the scope of protected conduct and provides that an employee is only protected if:

> (1) The employee has a reasonable, good faith belief that the employer has, or still is, engaged in an activity, policy, or practice that is in violation of a law, rule, or regulation; (2) The employer's activity, policy, or practice that is the subject of the employee's disclosure poses a substantial and specific danger to the public health or safety; and (3) Before reporting to the board: (i) The employee has reported the activity, policy, or practice to a supervisor or administrator of the employer in writing and afforded the employer a reasonable opportunity to correct the activity, policy, or practice; or (ii) If the employer has a corporate compliance plan specifying who to notify of an alleged violation of a rule, law, or regulation, the employee has followed the plan.
>
> Md. Code, Health Occ. § 1-503.

Montgomery filed a motion to dismiss, arguing that Lark's claims should be dismissed because "(1) the wrongdoing she complains of was committed by her fellow employees and not [Appellee]; and (2) she never reported any perceived wrongdoing to the appropriate external board or other authority as required for the Act to apply."[5] The trial court, treating Montgomery's motion to dismiss as a motion for summary judgment, granted the motion on all counts. Lark appealed only her claim under the Act and the Court of Appeals issued a writ of certiorari on its own initiative.

Public Policy Favors Protection of Employees Who Make Internal Disclosures

Montgomery argued that Lark is not protected under the Act because she "never reported any perceived wrongdoing to the appropriate external board or other authority as required for the Act to apply."[6] According to Montgomery, section 503(3) of the Act "necessarily implies that reporting to the board is a man-

datory prerequisite to coverage under the Act," and any other reading would cause "this particular clause [to be] stripped of all meaning and . . . rendered surplusage."[7] Montgomery made a similar argument regarding Lark's wrongful discharge claim, claiming that because the state law underlying Lark's public policy argument require disclosure of suspected violations to the Board of Nursing, such external disclosures are "a necessary prerequisite for any claim of wrongful discharge under Maryland law."[8,9]

While these arguments may have presented the best chance of success in the instant case, they were by no means in the best interest of Montgomery or other employers in the state of Maryland. Had Montgomery prevailed, employees would no longer have any incentive use internal channels when reporting illegal, unethical, or dangerous behavior. Instead, employees would be forced into making potentially costly and embarrassing external disclosures. Such encouragement would undermine compliance and internal reporting programs, and consequently drive up costs for employers and increase the likelihood of litigation.

The court rejected, correctly, Montgomery's position. First addressing Montgomery's statutory interpretation argument, the court observed that the Act is a remedial statute and should be "construed liberally in favor of claimants to suppress the evil and advance the remedy."[10] The court then concluded:

> § 1-503(3) was not enacted to protect an employer against a legitimate Whistleblower action asserted by a former employee who was fired before he or she made an external report, provided that the former employee actually 'reported the activity, policy, or practice [that poses a substantial and specific danger to the public health or safety] to a supervisor or administrator of the employer in writing[.]' . . . Because the Act expressly protects an employee who 'threatens to disclose' as well as an employee who actually discloses, we reject the argument that a report to the Board of Nursing was an essential condition precedent to the action asserted in the case at bar.[11]

The court next turned its attention to the issue of whether public policy supports the protection of employees who make only an internal disclosure under the Act. Here the court in gratis dictum addresses not only whether an internal disclosure is sufficient to trigger protection under the Act but also whether an internal disclosure alone is sufficient to trigger protection under the common law claim of wrongful discharge in violation of public policy.

The court begins a ten page survey of the law by quoting and agreeing with a leading treatise stating: "'the viability of a public policy tort claim by a discharged whistleblower does not depend on whether or not the violations or illegal activities were reported to outside authorities.'"[12] The court then recites eleven cases from nine states and the District of Columbia, in support of this proposition.[13] Of the eleven cases, all but two were based on common law wrongful discharge in violation of public policy. The court also emphasized a quote from *Sullivan v. Mass. Mut. Life Ins. Co.*,[14] a wrongful discharge and breach of contract case:

> **A rule that would permit the employer to fire a whistleblower with impunity before the employee contacted the authorities would encourage employers promptly to discharge employees who bring complaints to their attention, and would give employees with complaints an incentive to bypass management and go directly to the authorities.**[15]

While only dictum, the court's lengthy discussion of common law wrongful discharge signals an unmistakable departure from the external reporting requirement first articulated in *Wholey v. Sears Roebuck*[16] and an expansion of protected conduct. In the wake of Lark, prudent employers should consider internal disclosures to be protected activities under both the Act and Maryland common law.

Endnotes:

[1] Lark, 414 Md. 215, 994 A.2d 968 (2010).
[2] The Maryland tort of wrongful discharge is commonly referred to as an Adler claim. See Adler v. Am. Standard Corp., 432 A.2d 464 (Md. 1981).
[3] See Lark v. Montgomery Hospice, Inc., 414 Md. 215, 994 A.2d 968 (2010) (all facts in this article are based upon the Court of Appeal's opinion in Lark unless otherwise indicated).
[4] Lark, 414 Md. at 221, 994 A.2d at 971 (alteration in original).
[5] Lark, 414 Md. at 223, 994 A.2d at 972 (alteration in the original).
[6] Id.
[7] Lark, 414 Md. at 224, 994 A.2d at 973. Montgomery continued, "'[w]henever possible, a statute should be read so that no word, clause, sentence or phrase is rendered superfluous or nugatory.'" (quoting Chesapeake & Potomac Tel. Co. of Md. v. Dir. of Fin. for Baltimore, 343 Md. 567, 579, 683 A.2d 512, 517 (1996)).
[8] Lark, 414 Md. at 223, 994 A.2d at 973.
[9] Montgomery also argued that Lark's statutory and common law claims should be dismissed "because . . . the wrongdoing she complains of was committed by her fellow employees and not [Appellee]." Lark, 414 Md. at 223, 994 A.2d at 972 (alteration in original). The Court rejected this argument without much discussion.
[10] Lark, 414 Md. at 228, 994 A.2d at 976 (internal quotation and citation omitted).
[11] Lark, 414 Md. at 231-32, 994 A.2d at 977-78 (alteration in the original).
[12] Lark, 414 Md. at 232, 994 A.2d at 978 (quoting Paul H. Tobias, Litigating Wrongful Discharge Claims § 5.13 (1987 & Supp. 2009-10)).
[13] See Lark, 414 Md. at 232-42, 994 A.2d 978-84 (quoting and discussing cases from AZ, CA, CT, IL, MA, NH, OK, OR, RI, and DC).
[14] Sullivan, 802 F. Supp. 716, 724-25 (D. Conn. 1992) (former employee alleged he was terminated in breach of contract and violation of public policy)

(citing Norris v. Lumbermen's Mass Mut. Co., 881 F.2d 1144, 1153 (1st Cir. 1989) (wrongful discharge in violation of public policy)).
[15] Lark, 414 Md. at 236, 994 A.2d at 980 (quoting Sullivan, 802 F. Supp. at 723) (emphasis in original)
[16] Wholey, 370 Md. 38, 62, 803 A.2d 482, 496 (2002) ("To qualify for the public policy exception to at-will employment, the employee must report the suspected criminal activity to the appropriate law enforcement or judicial official, not merely investigate suspected wrong-doing and discuss that investigation with co-employees or supervisors.").

The Maryland False Health Care Claims Act of 2010

By Jason Zuckerman
The Law Employment Group

In April 2010, the Maryland False Health Care Claims Act of 2010 (SB 279) (MD FCA),[1] was signed by Governor O'Malley. The Act prohibits a person from knowingly presenting or causing to be presented a false or fraudulent claim for payment or approval to a State health plan or program. Violators of the Act may be liable for treble damages and fined $10,000 per violation. Similar to the Federal False Claims Act,[2] an individual, known as a relator, may file a civil action under seal against an alleged violator on behalf of the State. The State is then given an opportunity to intervene in the action. If the action is successful, the relator may be awarded between 15 and 25 percent of the amount recouped.

The Act also prohibits retaliation against employees, contractors, and grantees who act in furtherance of an action under the Act, make disclosures that are reasonably believed to evidence a violation of the Act, or object to or refuse to participate in any activity that is reasonably believed to be a violation of the Act.

Prohibited False Claims

The Act applies to State health plans and programs including "[t]he State Medical Assistance Plan established in accordance with the federal Social Security Act of 1939," any medical assistance plan established by the state, the Medical Assistance Program, and any other program or plan,[3] provided the State provides a portion of the money or property requested or will reimburse another party for any portion of the money or property requested in the false claim.[4] The Act prohibits both direct false claims and reverse false claims.[5] A reverse false claim is made when a person has "possession, custody, or control of money or other property used by or on behalf of the State under a State health plan [or program] and knowingly deliver[s] or cause[s] to be delivered to the State less than all of that money or other property."[6] The Act does not have a presentiment requirement and claims made to a contractor, grantee, or other recipient are actionable.[7]

Violators of the act are subject to a civil fine of up to $10,000 per violation and up to three times the damages sustained by the state, as well as the relator's attorneys' fees and costs.[8] The factors that a court will consider in determining the appropriate fines and damages include:

- "The number, nature, and severity of the violations" and the "[t]he number, nature, and severity of any previous violations;"
- "Whether the person has a compliance program in place;"
- Remedial steps taken since the defendant learned of the violation;
- "[H]arm or detriment to patents or consumers of the State health plan or State health program;" and
- "Whether the person self-reported the violation, the timeliness of the self-reporting, the extent to which the person otherwise cooperat[ed]" and any "prior knowledge of an investigation or other action relating to the violation."[9]

Limited Qui Tam Provision

Similar to the Federal False Claims Act,[10] a private person, known as a relator, may file a civil action on behalf of themselves and the State against "a person who has acted or is action in violation of section § 2-602(a)."[11] Such a complaint must be filed in camera and remains under seal for 60 days.[12] The complaint should be accompanied with "a written disclosure of substantially all material evidence and information the person posses.[13] The defendant is not served until the court unseals the complaint and orders service.[14] Within 60 days, the State will investigate the claim and must decide whether to intervene.[15] If the State believes that "the act, transaction, or occurrence that gave rise to the alleged violation . . . is likely to be continuing, the State shall notify the defendant as soon as possible without jeopardizing the course and conduct of the State's or federal government's investigation."[16]

If the State elects to intervene in a case, it takes on the primary responsibility for prosecuting the claim and is not bound by any actions of the relator.[17] The State may elect to pursue alternative remedies[18] or settle the claims notwithstanding any objections by the relator.[19] Both the State and defendant may seek to limit the relator's involvement in the proceedings if it is shown that the relator's unrestricted participation would interfere with the State's case or "harass the defendant or cause the defendant undue burden or unnecessary expense."[20] If at any time the state withdraws as a party to the action, the court must dismiss the action.[21] In contrast to the Federal False Claims Act, a relator cannot pursue an action under the Act without government intervention.

Public Disclosure Bar and Original Source Rule

The Act contains several limitations on who may bring and action and when. A relator may not bring an action that is based on "allegations or transactions" that are the basis of another proceeding to which the state is a party.[22] Similar to the Federal False Claims Act,[23] the Act contains a public disclosure bar prohibiting courts from exercising jurisdiction over any action "based on the public disclosure of allegations" in: 1) a criminal, civil, or administrative hearing; 2) a legislative or administrative hearing, audit, or investigation; or 3) the news media,[24] unless the relator is an "original source" of the information.

A relator is an original source of information if she has "direct and independent knowledge" of the information on which the allegations are based and has voluntarily provided such information to the State before commencing the action.[25] There has been substantial litigation about the definition of an original source under the federal False Claims Act, and Maryland courts will likely look to this body of law to define an original source. Federal case law holds that an original source must have "direct and independent knowledge" of the information underlying the allegations in the lawsuit, rather than information that was the basis for prior public disclosure.[26] In other words, the relator must have gained the information through his own experience or investigation.[27] For example, a relator cannot pursue a qui tam action against a hospital for an alleged "kickback scheme" based on information obtained from patient complaints and informal discussions in lounges and staff meetings. [28]

The Act prohibits public employees from filing an action if the information that the action is based upon was obtained through the performance of that employee's duties, or if that employee had a duty to investigate the conduct of the defendant.[29]

Relator's Reward

If the State prevails in an action under the Act, the relator shall be awarded 15 to 25 percent of the proceeds.[30] The amount is "[p]roportional to the amount of time and effort that the person contributed to the final resolution of the civil action."[31] However, if the court finds that the action is based primarily on publicly disclosed information, the relator's reward is limited to no more than 10%.[32] A prevailing relator may be awarded reasonable attorneys' fees and costs.[33] If the court finds that the relator initiated, planned, or deliberately participated in the violation on which the action was based, the court may reduce the share of the proceeds.[34]

If the relator is convicted of a crime arising from participation in the violation on which the action was based, the relator: 1) must be dismissed from the action and 2) will be denied any reward.[35] If the conviction is subsequent to the reward, the reward must be forfeited.[36] Regardless of any wrongdoing on the part of the relator, the State may still pursue the action.[37] If the defendant prevails and the court finds that the relator brought the claim to harass the defendant or in bad faith, the court may order the relator to pay the defendant's attorneys' fees and expenses.[38]

Robust Anti-Retaliation Provision

Similar to the federal False Claims Act, the Maryland Act prohibits retaliation against an employee, contractor, or grantee who acts in furtherance of an action under the act.[39,40] Protected conduct under the Act includes:

- Participating in an action filed or about to be filed under the Act;
- Disclosing or threatening to disclose information that the whistleblower reasonably believes shows a violation of the Act to a supervisor or public body; and
- Objecting to or refusing to participate in any activity, policy, or practice that the whistleblower reasonably believes to be a violation of the Act.[41]

A whistleblower suffering unlawful retaliation can file a civil action seeking an injunction against further retaliation; reinstatement to full seniority with all fringe benefits; two times the amount of lost wages, benefits, other remuneration, including interest; attorneys' costs and fees; punitive damages; and the assessment of a civil penalty of up to $5,000 and any other compensatory damages necessary to make the whistleblower whole.[42]

Effective Date and Statute of Limitations

The Act took effect on October 1, 2010 but applies retroactively.[43] The statute of limitations is six years from the date on which the alleged false claim was made or three years from when the facts material to the right of action are known or should have been known by the relator, State's Inspector General, or the Director of the State's Medicaid Fraud Control Unit.[44] In no event may an action be filed more than 10 years after the date on which the underlying false claim was made.

Commentary

The Act, called a "strong blow to those who have defrauded taxpayers out of millions of dollars through false and fraudulent Medicaid claims" by Lt. Governor Brown,[45] has been criticized as not going far enough to combat contractor fraud. The primary criticism of the Act is that it does not appear to meet the minimum requirements of the federal Deficit Reduction Act of 2005 (DRA) which would allow Maryland to receive an additional 10% share of Medicaid funds recovered by state and federal false claims act actions.[46] Under the federal False Claims Act, "[a]ny recovery of damages to the State Medicaid program will be shared with the State in the same proportion as the State's share of the costs of the Medicaid program."[47] Similarly, "if a State obtains a recovery

as the result of a State action relating to false or fraudulent claims submitted to its Medicaid program, it must share the damages recovered with the Federal Government in the same proportion as the Federal Government's share in the cost of the State Medicaid program."[48] If a state has a DRA qualified false claims act, the federal government will lower its mandated share of recovered Medicaid funds by 10 percent, in turn increasing the state's recovery by 10 percent.[49] For example, if $100 million is recovered in a state with a 50-50 Medicaid split and that state has a DRA qualified false claims act, the state is entitled to keep 60% or an extra $10 million.

Under the DRA, a state false claims act qualifies for the 10 percent increase if:

> (1) The law establishes liability to the State for false or fraudulent claims described in section 3729 of Title 31, with respect to any expenditure described in section 1396b(a) of this title. (2) The law contains provisions that are at least as effective in rewarding and facilitating qui tam actions for false or fraudulent claims as those described in sections 3730 through 3732 of Title 31. (3) The law contains a requirement for filing an action under seal for 60 days with review by the State Attorney General. (4) The law contains a civil penalty that is not less than the amount of the civil penalty authorized under section 3729 of Title 31.[50]

The DRA requires the Inspector General of the Department of Health and Human Resources (IG) to consult with the U.S. Attorney General to determine whether a state False Claims Act qualifies for the 10 percent reward[51] and in 2006, the IG published guidelines for making such a determination in the federal register.[52]

According to the Revised Fiscal and Policy Note for the Act, published by the Maryland Department of Legislative Services, the Act will likely not qualify under the DRA because it prohibits a private individual from pursuing a qui tam action if the State declines to intervene or withdraws and because the Act does not set a minimum penalty per violation.[53]

In sum, while the Act is not as robust as most state false claims acts, it provides a substantial incentive for employees to blow the whistle on health care fraud and provides robust protection against retaliation.

Endnotes:

[1] The Maryland False Health Care Claim Act of 2010 is codified at Health—General Section 2-601 through 2-611 under the new subtitle "Subtitle 6. False Claims Against State Health Plans and State Health Programs."
[2] 31 U.S.C. §§ 3729-3733.
[3] § 2-601(l)(1)-(m).
[4] § 2-601(a).
[5] § 2-602(a)(4).
[6] Id.
[7] § 2-601(b)(ii).
[8] § 2-602(b)(1)(i)-(ii).
[9] § 2-602(c)(1).
[10] See 31 U.S.C. § 3730(b)(1) ("A person may bring a civil action for a violation of section 3729 for the person and for the United States Government.").
[11] § 2-604(a)(1)(i) (section 2-602(a) prohibits the making of false claims).
[12] § 2-604(a)(3)(ii).
[13] § 2-604(a)(3)(i).
[14] § 2-604(a)(3)(ii)(2).
[15] § 2-604(a)(3)(ii)(3).
[16] § 2-604(a)(5)(iii).
[17] § 2-604(b)(1)(i)-(ii).
[18] § 2-604(c)(1).
[19] § 2-604(b)(4).
[20] § 2-604(b)(5)(i)-(ii).
[21] § 2-604(b)(3)(i)-(ii).
[22] § 2-606(c).
[23] See 31 U.S.C. § 3730(e).
[24] §2-606(d)(1).
[25] § 2-606(d)(2).
[26] Rockwell Int'l Corp. v. U.S., 549 U.S. 457, 470-71 (2007).
[27] United States ex rel. Hansen v. Cargill, Inc., 107 F. Supp. 2d 1172 (N.D. Cal. 2000) (finding relator was not original source where relator was not witness to facts upon which allegations were based and did not have firsthand knowledge).
[28] United States ex rel. Lam v. Tenet Healthcare Corp. 287 Fed. Appx. 396, 401 (5th Cir. 2008).
[29] § 2-606(b)(1)-(2).
[30] § 2-605(a)(1)(i).
[31] § 2-605(a)(1)(ii).
[32] § 2-605(a)(2)(i-ii).
[33] § 2-605(a)(4)(i).
[34] § 2-605(b)(1).
[35] § 2-605(b)(3)(i)-(ii).
[36] § 2-605(b)(4).
[37] § 2-605(b)(4).
[38] § 2-605(c).
[39] See generally § 2-607.
[40] State employees are not protected under the Act. See § 2-607(c)-(d)(2).
[41] § 2-607(a).
[42] § 2-607(b)(2).
[43] §2-609(b).
[44] § 2-609(a).
[45] Press Release, Maryland False Health Claims Act of 2010 Passes Final Vote in Maryland General Assembly (Apr. 9, 2010) available at, www.governor.maryland.gov/ltgovernor/pressreleases/100409.asp (last visited Nov. 29, 2010).
[46] See 42 U.S.C. § 1396h.
[47] Publication of OIG's Guidelines for Evaluating State False Claims Acts, 71 Fed. Reg. 48552 (Aug. 21, 2006).

[48] Id. at 48553.
[49] 42 U.S.C. § 1396h(a).
[50] 42 U.S.C. § 1396h(b).
[51] Id.
[52] See Publication of OIG's Guidelines for Evaluating State False Claims Acts, 71 Fed. Reg. 48552-554 (Aug. 21, 2006).
[53] Amy A. Devadas, Fiscal and Policy Note Revised SB 279, Dep't. of Legis. Servs., Md. Gen. Assemb. 2010, at 10 (2010). The federal False Claims Act permits a private qui tam action regardless of intervention and imposes a minimum civil fine of $5,000. See 31 U.S.C. §§ 3730(b), 3729(a)(1)(G).

Maryland Workplace Fraud Act and the Misclassification of Construction and Landscaping Employees

By Nicholas Woodfield, Esq.
The Law Employment Group

On May 7, 2009, Governor Martin O'Malley signed the Maryland Workplace Fraud Act ("MDWFA") into law, providing construction and landscaping employees who are misclassified as independent contractors by their employer with the right to bring a private action in court. Additionally, the MDWFA grants the Maryland Commissioner of Labor and Industry new powers to investigate and punish employers who misclassify their employees as independent contractors or do not classify them at all. The MDWFA took effect on October 1, 2009, and it is intended to protect and empower Maryland workers while also leveling the playing field for those employers who play by the rules.

The Incentive for Employers to Misclassify

Employers often intentionally misclassify employees as independent contractors for a host of reasons. An employer who intentionally misclassifies an employee as an independent contractor does so attempting to avoid, inter alia, the following costs associated with employment:

- paying minimum wages;
- paying overtime;
- paying the payroll tax;
- paying worker's compensation;
- paying unemployment;
- paying social security;
- offering or subsidizing employee health benefits;
- offering paid leave; and
- offering Federal Family and Medical Leave Act (FMLA) unpaid leave.

By misclassifying employees as independent contractors, employers reduce their Federal Insurance Contributions Act (FICA) costs, unemployment contributions, workers' compensation insurance costs, and benefits contributions. As the result, misclassified employees are wrongly denied access to unemployment insurance, workers' compensation, and other protections, and Maryland taxpayers are deprived of millions of dollars to the Unemployment Insurance Trust fund and the State General Fund.

A Misclassification Gamble

Employers also often misclassify to avoid paying employees overtime wages at the rate of time and a half. If an employer is caught misclassifying employees, the litigation costs and other penalties can far outweigh any temporary cost savings to the employer. For instance, under the federal Fair Labor Standards Act of June 25, 1938, Chapter 676, 52 Stat. 1069, 29 U.S.C. § 201, et seq. (FLSA), employees may file a private action against employers who fail to pay them properly. Employees who prevail under the FLSA are entitled to liquidated damages of an additional amount equivalent to the unpaid wages due to the employee. For example, if an employee is awarded $10,000 in unpaid wages, he or she may be entitled to an additional $10,000 of liquidated damages, bringing the total recovery to $20,000. These damages are awarded instead of interest.

An employer can avoid paying liquidated damages only if it shows that it acted in good faith and that it had a reasonable basis to believe its practices complied with the MDWFA. "Good faith" has a special meaning under the FLSA, and it requires that employers have made a specific investigation into the application of the FLSA to the particular situation. A prevailing employee is also entitled to an award of reasonable attorney's fees and costs, which can far exceed the unpaid wages awarded to the employee. Moreover, the IRS may assess penalties for employee misclassification stemming from an employer's nonpayment of federal employment taxes and failure to withhold income taxes.

In addition to the foregoing federal remedies, the MDWFA grants construction and landscaping employees even further remedies against employers who misclassify their employees, as a prevailing employee can recover not only their unpaid wage differential, but also, inter alia, an additional amount up to three times the "economic damages" if the employer knowingly misclassified the individual.

In fact, the MDWFA grants individuals a private right of action

to file suit in court to challenge their classification if a final order has not been issued by another court or administrative unit. The action must be filed within three years after the date the cause of action accrues. The court may award a prevailing misclassified employee the following:

(1) "Economic damages" including unpaid wages and benefits;
(2) An additional amount up to three times the "economic damages" if the employer knowingly misclassified the individual;
(3) Reasonable attorneys' fees and litigation costs; and
(4) "Any other appropriate relief."

The amount of an award under the MDWFA could be thus be quite substantial, because it includes the cost of litigation and potentially the costs of the unemployment benefit if the employer laid off the employee.

§ 3-903: The Employer-Employee Test

Under section 3-903 of MDWFA, it is illegal for an employer to improperly classify an individual. Whether or not the employee agreed to work as an independent contractor does not factor into the test.

The MDWFA presumes an individual is an employee unless the employer demonstrates that:

(1) the individual is free from the control and direction of the employer;
(2) the individual is engaged in an independent business or occupation;
(3) the work is "outside the usual course of business" for the employer; and
(4) the work is performed outside the employer's place of business (not including worksites).

Work is "outside the usual course of business" if it is performed offsite, does not integrate into the employer's operation, or is entirely unrelated to the employer's business.

The MDWFA also defines a special class of "exempt" individuals who are not presumed to be employees. "Exempt" individuals:

(1) perform services in a personal capacity employing no one else other than their children, spouse, or parents;
(2) perform services free from the direction or control of the employer;
(3) furnish their own tools and equipment;
(4) operate complete control over the management and operation of their business; and
(5) may work for other entities at the individual's sole choice and discretion.

The test in this statute, while not identical, is very similar to federal tests for the employer-employee relationship.

§ 3-904: Bad Faith Misclassification of Employees

The MDWFA contains stiffer penalties for employers who act in bad faith. Under section 3-904 of the MDWFA, it is illegal for an employer to knowingly misclassify an individual. The statute defines "knowingly" as having actual knowledge, acting in deliberate ignorance, or acting in reckless disregard of the truth. Furthermore, the statute lists what is "strong evidence" that an employer did not know it was misclassifying employees:

(1) the employer sought evidence that the individual is exempt;
(2) the employer sought evidence that the individual is an independent contractor who withholds and reports payroll taxes, pays unemployment insurance taxes, and maintains workers' compensation insurance;
(3) the employer provided the individual with a section 3-914 written notification of the individual's classification; or
(4) the employer classifies as independent contractors all workers performing substantially the same work as the individual, reports those workers' income to the IRS, and has received a determination from the IRS that the individual is an independent contractor.

The IRS will give an opinion on the classification of an individual if asked either by the employer or, alternatively, by the individual. Exercising this degree of due diligence is strong evidence that the employer did not know it was misclassifying employees. Additionally, under section 3-914 of the MDWFA, the employer is required to provide each individual classified as an exempt person or independent contractor with notice of that classification (written in both English and Spanish) explaining the implications of that individual's classification. For up to three years, the employer must maintain records of the individual's classification, evidence supporting the classification, and the individual's occupation, rate of pay, hours, and other information. The employer who inadvertently misclassifies an employee can avoid stiffer penalties by showing it had acted in good faith.

§ 3-912: Anti-retaliation Protections

It is also illegal for the employer to discriminate or take an adverse employment action against any individual who:

(1) Files a complaint with the employer or the Commissioner alleging violations under this statute;
(2) Brings an action in court under this statute; or
(3) Testifies in an authorized action under this statute.

Adverse employment actions likely include termination, suspension, demotion, reduced hours, threatened adverse employment actions, harassment, or any conduct that would dissuade a reasonable employee from reporting violations. The employee must file his or her complaint with the Commissioner within 180 days of the retaliation. The Commissioner may then investigate and file a complaint in circuit court on the employee's behalf to re-

instate the employee with back pay and "other appropriate damages or relief."

§ 3-916: Claims Filed in Bad Faith

The Commissioner must also investigate any allegations that a person is acting in bad faith when they make an allegation of workplace fraud. Under section 3-916, a person may not:

(1) Make or cause to be made a groundless or malicious complaint;
(2) In bad faith, bring an action under this statute; or
(3) In bad faith, testify in an action under this statute.

The Commissioner must issue violators a citation with the option for a hearing. Violators are subject to a civil penalty not exceeding $1,000, and the prevailing employer may be entitled to recover attorney's fees. Additionally, if the violator is alleged to be employed by the employer, the Commissioner must report the identity of the violator to the employer.

The Commissioner's New Powers

The Commissioner of Labor and Industry is charged with enforcing Subtitle 9 of the MDWFA and may investigate potential violations on his or her own initiative. The Commissioner may:

(1) Conduct confidential investigations;
(2) Enter an employer's place of business or worksite to observe work being performed, interview individuals, and copy records;
(3) Require an employer to produce records related to their classification of employees; and
(4) Issue a subpoena for testimony or the production of records.

Investigations must be confidential, and the Commissioner must issue a citation to any employer he or she determined has violated the statute. Additionally, the Commissioner must generate an annual report detailing his or her enforcement efforts under this statute.

Citation Administrative Procedures

At the close of an investigation, the Commissioner must issue a citation to any employer the Commissioner determines has violated the MDWFA. The Commissioner must also provide notice of the citation to other state agencies to which the employer may now owe taxes. If the employer is engaged in a contract with a "public body," the Commissioner must promptly notify the "public body" of the citation. The "public body" must then withhold an amount that is sufficient to pay restitution to each employee for the full amount of wages due and to pay any benefits, taxes, or other contributions that are required by law to be paid on behalf of the employee.

Within fifteen days of receiving notice of the citation, an employer may request a hearing before an Administrative Law Judge. The ALJ's decision is a final order of the Commissioner, but either party may be appeal and seek judicial review in court.

§§ 3-908 and 3-909: Civil Penalties

The MDWFA includes potentially stiff penalties to deter employers from acting in bad faith when classifying workers. A penalty is only assessed if – by a final order of a court or administrative unit – the employer is found to have misclassified employees. If the employer is found to have unknowingly misclassified employees, the employer will be assessed a penalty up to $1,000 for each misclassified employee only if the employer fails to come into compliance in a timely manner. Alternatively, if the employer is found to have knowingly misclassified employees, the employer will be assessed a penalty up to $5,000 for each misclassified employee. On the employer's second offence, the employer will be assessed a penalty up to $10,000 for each misclassified employee and on further offenses the employer will be assessed a penalty up to $20,000 for each misclassified employee. The court or administrative unit considers the following factors when deciding the amount of the penalty:

(1) The gravity of the violation;
(2) The size of the employer;
(3) Whether the employer acted in good faith;
(4) The employer's history of violations;
(5) Whether the employer has deprived the employee of rights the employee is entitled to under state labor law; and
(6) Whether the employer has made restitution and come into compliance with state laws.

Each time the employer knowingly violates the statute, the limit on the assessed penalty doubles up to a maximum limit of $20,000 per misclassified employee.

§ 3-915: Use of Business Arrangements

No person may use (or conspire to use) business arrangements, foreign or domestic, to facilitate, or evade detection of, a violation of this statute. The Commissioner must issue violators a citation with the option for a hearing. Violators are subject to a civil penalty not exceeding $20,000, unless the person is a lawyer or CPA performing an act in the ordinary course of his or her license. In such case the Commissioner must instead report lawyers and CPAs to their respective state regulators.

Conclusion

The MDWFA is intended to curb the illegal misclassification of construction and landscaping employees as independent contractors. The MDWFA's penalties are stiffer than the penalties available under other wage nonpayment statutes, and the tenor of the statute evidence that the Maryland General Assembly and Gov-

ernor's Office have come to view workplace fraud as a problem that allows offending employers to undercut competitors who play by the rules, to deny workers critical workplace protections only guaranteed to employees and to deprive taxpayers of critical dollars. By increasing damages awards available to affected employees and by shifting attorney's fees and costs in successful actions to the offending employers, the Maryland General Assembly and Governor's Office have also sent a signal that they want employees and their lawyers to pursue these cases to help eliminate workplace fraud in Maryland.

DMD Extends FLSA's Prohibition of Retaliation to Mistaken but Good Faith Complaints to a State Agency

By Nicholas Woodfield, Esq.
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In Randolph v. ADT Sec. Servs., Inc.,[1] Judge Deborah K. Chasanow held that two commissioned sales representatives engaged in protected conduct under the Fair Labor Standards Act's anti-retaliation provision[2] when they complained to the Maryland Department of Labor, Licensing and Regulation (DLLR) about not receiving overtime pay and proper compensation for their sales even though they were compensated on a commissions-only basis.

When Plaintiffs Sharon Randolph and Tami Thompson were hired by ADT, they were told that they would be paid salary during training and then transition to 100 percent commission. Randolph and Thompson worked a minimum of 48 hours and 6 days per week after completing their training period, and upon receiving their first commission check the Plaintiffs complained to management, believing they were undercompensated for their sales. Management first promised to resolve any discrepancies with their compensation but later failed to follow through. Ultimately management advised Thompson that if she kept complaining, she "might get into trouble."

Approximately two months later, the Plaintiffs realized that they were making less than minimum wage while working over 40 hours per week. The Plaintiffs believed they were entitled to minimum wages and overtime, and so the Plaintiffs complained to DLLR. The Plaintiffs reported that ADT had not paid them all that they were owed for their sales and that it failed to pay overtime. To support their claims, the Plaintiffs provided the DLLR with proof of their hours as well as information and documentation necessary to prove that ADT was not properly compensating them for their sales. The DLLR sent a letter to ADT on April 2, 2009, informing ADT of the complaint and announcing that an investigation was being opened.

On or about April 3, 2009, Thompson received a phone call from her manager and a human resources representative, accusing her of providing privileged information to the DLLR. ADT then suspended Thompson and Randolph. ADT next sent the Plaintiffs letters dated April 10, 2009, stating that they were terminated because they violated a confidentiality agreement by disclosing information about compensation plans, customers' personal information, and confidential company information to the DLLR.

The Plaintiffs filed a complaint in the U.S. District Court for the District of Maryland, alleging that they were wrongfully discharged in violation of public policy[3] and retaliated against in violation of the FLSA.[4] ADT filed a motion to dismiss, setting the court up to answer a question of first impression in the Fourth Circuit: whether employees whose compensation is 100% sales commission based engaged in protected conduct under the FLSA's anti-retaliation provision when they filed a complaint with a state agency based on their reasonable, good faith belief that they were illegally not being paid minimum wages and overtime.

As noted by Judge Chasanow, prior to Randolph, the closest a court in the Fourth Circuit has come this question is Kennedy v. Va. Polytechnic Inst. & State Univ.,[5] where Judge James C. Turk held that an employee engaged in protected conduct under the Equal Pay Act[6] when she complained to the Virginia Human Rights Council and the Equal Employment Opportunity Commission.

According to Judge Chasanow, the Seventh Circuit is the only circuit to address this issue. In Sapperstein v. Hager,[7] an employee complained to the Illinois Department of Labor, alleging that his employer failed to pay overtime and paid minors less than minimum wage in violation of the FLSA. Unbeknownst to the plaintiff, his employer's gross annual sales were actually just below the $500,000 threshold for the FLSA's minimum wage laws.[8] The district court granted the employer's motion to dismiss, ruling that since the employer was not subject to the FLSA, the employee was not protected by the statute's anti-retaliation provision. On appeal, the Seventh Circuit held that an employee is protected whenever he files a good faith complaint with the appropriate authorities, regardless of whether the conduct reported is an actual violation of the FLSA.[9]

The protection of employees' good faith yet mistaken complaints,

as well as complaints to state agencies, is key to the enforcement of the FLSA and integral to carrying out Congress's intent. As the Supreme Court observed in Mitchell v. Robert DeMario Jewelry, Inc.,[10] section 215(a)(3) takes on a central role in the enforcement of the FLSA since the federal government does not directly oversee employers and rather "chose to rely on information and complaints received from employees seeking to vindicate rights claimed to have been denied." Id at 292. With so much importance placed on protecting employees who make good faith complaints, employers should be wary of taking any retaliatory action against an employee and expect that courts will generally protect good faith complaints, even if mistaken.

Endnotes:

[1] Randolph, 701 F. Supp. 2d 740 (D. Md. 2010) (order denying motion to dismiss).
[2] 29 U.S.C. § 215(c)(3).
[3] See generally Adler v. Am. Standard Corp., 291 Md. 31, 432 A.2d 464 (1981).
[4] 29 U.S.C. § 215(a)(3) provides that an employer may not "discharge or in any other manner discriminate against any employee because such employee has filed any complaint or instituted or caused to be instituted any proceeding under or related to this chapter, or has testified or is about to testify in any such proceeding…"
[5] Kennedy, No. 7:08cv579, 2009 WL 1321691, at *3 (W.D. Va. May 12, 2009) (order granting in part and denying in part a motion to dismiss).
[6] See 29 U.SC. §§ 206(d), 215(a)(3).
[7] Sapperstein, 188 F.3d 852 (7th Cir. 1999)
[8] 29 U.S.C. § 203(s)(1)(A)(i)-(ii).
[9] Sapperstein, 188 F.3d at 857.
[10] Mitchell, 361 U.S. 288 (1960).

Grim Consequences for Spoliation of Evidence

By David Scher, Esq.
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On September 9, 2010, Judge Paul W. Grimm of the U.S. District Court for the District of Maryland decided a crucial motion in the four year long case of Victor Stanley, Inc. v. Creative Pipe, Inc.[1] Judge Grimm was appointed Chief Magistrate Judge of the U.S. District Court for the District of Maryland in May of 2006, and was appointed by the Chief Justice of the United States as a member of the Advisory Committee for the Federal Rules of Civil Procedure in September of 2009.[2] In the case before him, Judge Grimm responded to Plaintiff's Motion For Terminating And Other Sanctions Arising Out Of Defendants' Intentional Destruction Of Evidence And Other Litigation Misconduct by holding that:

(1) pursuant to Fed. R. Civ. P. 37(b)(2)(A)(vi), a default judgment will be imposed as to Count I (copyright infringement);
(2) pursuant to Fed. R. Civ. P. 37(b)(2)(C), the Plaintiff Victor Stanley, Inc. ("VSI") will be awarded attorney's fees and costs associated with Defendants' spoliation of Electronically Stored Information ("ESI");
(3) pursuant to Fed. R. Civ. P. 37(b)(2)(A)(vii), the pervasive and willful violation of multiple court orders to preserve and produce ESI by the President of Creative Pipe, Inc. ("CPI"), Mark T. Pappas, be treated as civil contempt of court; and
(4) Pappas be imprisoned for a period not to exceed two years, unless and until he pays Plaintiff the aforementioned attorney's fees and costs.[3]

Background

The parties in the case – VSI and CPI – are competing businesses that manufacture a broad line of high quality furnishings for public and commercial sites, such as receptacles, benches, tables, and chairs.[4] VSI alleges in its Complaint that someone at CPI downloaded VSI design drawings and specifications from VSI's website using the pseudonym "Fred Bass."[5] To be allowed to download the drawings, website users must agree to VSI's limited licensing agreement, which prohibits the use of those drawings in competition with VSI.[6] VSI further alleges that Pappas sent drawings downloaded from VSI's website out of the country to be copied as CPI drawings so that Pappas could then submit them as part of its bid documents for the type of work which CPI competed against VSI.[7] Under Count I of the complaint, VSI alleges copyright infringement, and under other counts, VSI primarily alleges patent infringement and unfair competition.[8]

Pappas's Spoliation of ESI

Judge Grimm listed eight specific failures by Pappas to either preserve or produce evidence:

(1) a failure to implement a litigation hold;
(2) deletions of ESI after VSI filed its lawsuit;
(3) a failure to preserve an external hard drive after VSI demanded preservation of ESI;
(4) a failure to preserve files and emails;
(5) deletion of ESI after the Court issued its first preservation order;
(6) the use of computer programs to permanently delete files after the Court admonished both parties of their duty to preserve evidence and issued its second preservation order;
(7) a failure to preserve ESI on CPI's computer server; and
(8) the continued use of computer programs to permanently delete ESI after the Court issued numerous production orders.[9]

VSI's experts determined that at least two of Pappas's larger deletions of ESI from his work computer occurred on the eve of scheduled discovery. Someone deleted 9,234 files off Pappas's password protected work computer. After scheduling an imaging of Pappas's work computer, he deleted almost 4,000 files and someone ran Microsoft Window's Disk Defragmenter program immediately afterword. Disk Defragmenter transfers pieces of files around the computer's hard drive, overwriting deleted files and making most of the deleted files unrecoverable.[10] Further forensic analysis discovered that many of the deleted files had file names indicating VSI-like site furnishings. The contents of those files likely would have had probative value.[11] The expert also determined that emails were sent from Pappas's email account using Pappas's password-protected work computer (not via remote access) just prior to and just after the deletions of ESI. Furthermore, many of the deletions took place after the Court issued preservation orders and reminded both parties of their affirmative duty to preserve evidence.[12] Ultimately, experts were unable to recover any of the deleted files from Pappas's work computer.[13]

VSI's expert also concluded that an external hard drive must have been connected to Pappas's work computer after VSI filed their lawsuit. Pappas claimed he had returned the external hard drive to "Bob from Office Max" because he was "frustrated" by its automatic backup features that "would flash messages and interrupt [his] work."[14] Pappas was unable to produce a receipt or any other proof that the external hard drive was returned.

The Court then ordered CPI and Pappas to produce all relevant, non-privileged ESI to VSI's counsel. However, someone at CPI used a computer program called Easy Cleaner to delete large amounts of data from its computers and another program called CCleaner "to clear up file content in specific areas, and. . . to go through the registry. . . and clear out. . . dead registry entries" from their server months after the Court had issued its preservation orders.[15]

Defendants Response to VSI's Motion for Sanctions

In response to VSI's motion for sanctions, the Defendants admitted that fifteen CPI products were based on VSI designs. Defendants also were willing to accept as a sanction a consent judgment on liability for copyright infringement and a consent injunction on VSI's copyright claim.[16]

The Court's Authority to Sanction

The court has inherent power to "control the judicial process and litigation, a power that is necessary to redress conduct which abuses the judicial process."[17] The Court's inherent authority arises "when a party deceives a court or abuses the process at a level that is utterly inconsistent with the orderly administration of justice or undermines the integrity of the process."[18] This power is organic without need of a statute or rule for its definition.[19] Pursuant to the court's inherent authority, it may impose fines or prison sentences on parties held in contempt.[20] The court may even grant a default judgment or dismiss the case.[21] However, the court's inherent authority may only be exercised to sanction "bad-faith conduct," and "must be exercised with restraint and discretion."[22]

Under Fed. R. Civ. P. 37(b)(2), the court also has the authority to sanction a party for failure to comply with a court order "to provide or permit discovery."[23] The duty to preserve evidence is a common law duty that falls within the definition of permitting discovery.[24] Therefore, a judge's order to preserve evidence is also an order to permit discovery, and the court has authority to issue sanctions pursuant to Rule 37(b)(2) for violations of the court's preservation orders even when the order does not actually order the production of evidence.[25]

Fashioning an Effective Sanction

Judge Grimm states:

> What frustrates courts is the inability to fashion an effective sanction to address the drain on their resources caused by having to wade through voluminous filings, hold lengthy hearings, and then spend dozens, if not hundreds, of hours painstakingly setting forth the underlying facts before turning to a legal analysis that is multi-factored and involved. Adverse inference instructions do not compensate for the expenditure of court resources to resolve a spoliation dispute, nor do awards of attorney's fees and costs to the prevailing party in the dispute. Further, dispositive sanctions, the appellate courts tell us, are only appropriate where lesser sanctions will not suffice.[26]

In the Fourth Circuit, courts may impose sanctions for spoliation anytime the spoliator is found to be at fault whether it was done with bad faith, willfulness, gross negligence, or ordinary negligence.[27] The degree of fault impacts the severity of the sanctions.[28] The court must consider – holistically – the extent of prejudice, if any, along with the degree of culpability.[29]

The sanctions that a federal court may impose for spoliation include:

(1) assessing attorney's fees and costs;
(2) giving the jury an adverse inference instruction;
(3) precluding evidence;
(4) dismissing the case or granting default judgment; or
(5) treating as contempt of court the failure to obey a court order to provide or permit discovery of ESI evidence pursuant to Fed. R. Civ. P. 37(b)(2)(A)(vii).[30]

The court has broad discretion in choosing a sanction, but the appropriate sanctions should:

(1) deter parties from engaging in spoliation;
(2) place the risk of an erroneous judgment on the party who wrongfully created the risk; and
(3) restore the prejudiced party to the same position he would have been in the absence of wrongful destruction of evidence by the opposing party.[31]

The duty to preserve evidence is a duty owed to the court. Therefore, it is also appropriate for a court to consider whether the sanctions it imposes will "prevent abuses of the judicial system" and "promote the efficient administration of justice."[32] The court must impose the least harsh sanctions that provide an adequate remedy while also striking the appropriate balance between those that are normative and those that are compensatory."[33]

In the Fourth Circuit, courts may dismiss a case or order a default judgment when the court is "able to conclude either (1) that the spoliator's conduct was so egregious as to amount to a forfeiture of his claim, or (2) that the effect of the spoliator's conduct was so prejudicial that it substantially denied the defendant the ability to defend the claim."[34] To impose an adverse jury instruction the court "must only find that the spoliator acted willfully in the destruction of evidence;" a showing of negligence or even gross negligence is insufficient yet the conduct need not rise to the level of bad faith.[35] Less severe sanctions include the costs, attorney's fees, and fines that compensate the prejudiced party but also punish the offending party. When assessing fees or fines, the court's inquiry focuses more on the conduct of the offending party than on the actual relevance of the ESI.[36]

Treating Spoliation as Contempt of Court

The contempt sanctions under Fed. R. Civ. P. 37(b)(2)(A)(vii) may be civil or criminal. A drawback of issuing criminal contempt sanctions is that they require additional proceedings with enhanced due process procedures.

> When the nature of the relief and the purpose for which the contempt sanction is imposed is remedial and intended to coerce the contemnor into compliance with court orders or to compensate the complainant for losses sustained, the contempt is civil; if, on the other hand, the relief seeks to vindicate the authority of the court by punishing the contemnor and deterring future litigants' misconduct, the contempt is criminal. . . .[37]

For example, if the court imposes a prison sentence for a definite period of time, the sanction is punitive and therefore criminal contempt; however, if the sanction merely requires the defendant to remain in jail until he performs an affirmative act, the sanction is remedial and therefore civil contempt.[38] To hold a party in civil contempt, the court must find that four elements have been established by clear and convincing evidence:

(1) the existence of a valid decree of which the alleged contemnor had actual or constructive knowledge;
(2) that the decree was in the movant's "favor;"
(3) that the alleged contemnor by its conduct violated the terms of the decree, and had knowledge (at least constructive knowledge) of such violation; and
(4) that [the] movant suffered harm as a result.[39]

Judge Grimm's Sanctions

Judge Grimm stated:

> Taken individually, each [act of spoliation] demonstrates intentional misconduct done with the purpose of concealing or destroying evidence. Collectively, they constitute the single most egregious example of spoliation that I have encountered in any case that I have handled or in any case described in the legion of spoliation cases I have read in nearly fourteen years on the bench.[40]

Pappas cannot avoid sanctions by blaming his prior counsel or Information Technology employees. Counsel and IT employees are Pappas's agents, and spoliation done by them is attributed to Pappas under agency law.[41] Judge Grimm found that Pappas and his agents acted willfully and in bad faith.[42] Defendants' bad faith conduct allowed the Court to presume both relevance and prejudice from the spoliation of ESI.[43]

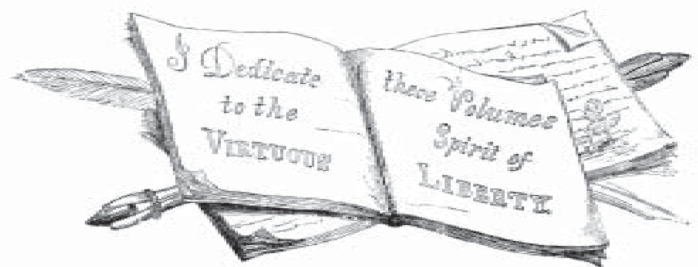
Judge Grim held that default judgment of Count I (copyright infringement) in favor of VSI is clearly appropriate since Defendants admit spoliation, relevance, and prejudice, and consented to default judgment.[44] Defendants also agreed to a permanent injunction prohibiting them from further infringing on VSI's copyright.[45] Judge Grim held pursuant to Fed. R. Civ. P. 37(b)(2)(C)

that Plaintiff is entitled to a reasonable attorney's fees and costs because Defendants failed to comply with a court order to provide or permit discovery. The fees and costs awarded include all the costs related to uncovering Defendants' discovery abuses; preparing, filing, and arguing Plaintiff's ESI motions; and retaining ESI experts.[46] Lastly, Judge Grimm stated:

> [Pursuant to Fed. R. Civ. P. 37(b)(2)(A)(vii),] I order that Pappas's acts of spoliation be treated as [civil – not criminal –] contempt of this court, and that as a sanction, he be imprisoned for a period not to exceed two years, unless and until he pays to Plaintiff the attorney's fees and costs that will be awarded after the Plaintiff has submitted an itemized accounting of the attorney's fees and costs associated not only with filing this motion, but also with respect to all efforts expended throughout this case to demonstrate the nature and effect of Pappas's spoliation. These costs and fees likely will amount to a significant figure, and that will properly vindicate this Court's ability to enforce its discovery orders. . . .[47] This result is absolutely essential as a civil contempt sanction because without it, I am convinced that Pappas will do all that he can to avoid paying any money judgment or award of attorney's fees that is in the form of a civil judgment alone. Without the threat of jail time, Pappas's future conduct would be predicted by his past, and the Plaintiff will receive a paper judgment that does not enable it to recover its considerable out-of-pocket losses caused by Pappas's spoliation.[48]

Endnotes:

[1] Victor Stanley, Inc. v. Creative Pipe, Inc., 269 F.R.D. 497 (D. Md. 2010).
[2] Chief Magistrate Judge Paul W. Grimm, www.mdd.uscourts.gov/publications/JudgesBio/grimm.htm
[3] Victor Stanley, Inc., 269 F.R.D at 500.
[4] Id. at 502.
[5] Id.
[6] Id. at 507.
[7] Id.
[8] Id. at 502.
[9] Id. at 501.
[10] Id. at 504.
[11] Id. at 509.
[12] Id. at 510.
[13] Id. at 512.
[14] Id. at 507.
[15] Id. at 513-14.
[16] Id. at 514.
[17] Id. at 517 (quoting United Med. Supply Co. v. United States, 77 Fed. Cl. 257, 263-64 (2007) (internal quotation omitted)).
[18] Id. at 517 (quoting United States v. Shaffer Equip. Co., 11 F.3d 450, 462 (4th Cir. 1993)).
[19] Id. at 517 (citing Shaffer Equip. Co., 11 F.3d at 462).
[20] Id. at 518 (citing United States v. Hudson, 11 U.S. (7 Cranch) 32, 34 (1812)).
[21] Id. at 518 (citing Roadway Exp., Inc. v. Piper, 447 U.S. 752, 765 (1980)).
[22] Id. at 518 (quoting Chambers v. NASCO, 501 U.S. 32, 50 (1991) and Schaffer Equip. Co., 11 F.3d at 461-62).
[23] Id. at 519.
[24] Id.
[25] Id. at 519-20.
[26] Id. at 527 (citing Silvestri v. Gen. Motors Corp., 271 F.3d 583, 590 (4th Cir. 2001)).
[27] Id. at 529.
[28] Id. at 529 (citing Silvestri, 271 F.3d at 590).
[29] Id. at 533.
[30] Id.
[31] Id. at 534 (citing Silvestri, 271 F.3d at 590).
[32] Id. at 534.
[33] Id.
[34] Id.
[35] Id. at 536.
[36] Id. at 536-47.
[37] Id. at 537 (quoting Hicks v. Feiock, 485 U.S. 624, 631-32 (1988)).
[38] Id. at 537.
[39] Id. at 538 (quoting Ashcroft v. Conoco, Inc., 218 F.3d 288, 301 (4th Cir. 2000)).
[40] Id. at 515.
[41] Id. at 516 (citing, inter alia, Rouse v. Lee, 339 F.3d 238, 249 (4th Cir. 2003) ("Former counsel's errors are attributable to [plaintiff] not because he participated in, ratified, or condoned their decisions, but because they were his agents, and their actions were attributable to him under standard principles of agency.")).
[42] Id. at 531.
[43] Id. at 533.
[44] Id. at 538.
[45] Id. at 539.
[46] Id.
[47] Id. at 540-41.
[48] Id. at 541.



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