

## **COURTS WIELD HARSH PENALTIES FOR ABUSING THE DISCOVERY PROCESS**

by  
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A federal district court last summer issued the ultimate sanction of dismissal due to plaintiffs' abuse of the discovery process and persistent refusal to abide by the court's discovery orders. *Internet Law Library, Inc. v. Southridge Capital Management*, 2003 WL 21537782 (S.D.N.Y. July 8, 2003). ITIS, Inc., formerly known as Internet Law Library, Inc., and its CEO, along with several of its shareholders, brought an action against defendant investors alleging their involvement in a scheme to defraud plaintiffs and to manipulate downward the price of ITIS stock in violation of federal and state laws. *Internet Law Library, Inc. v. Southridge Capital Management*, 223 F. Supp. 2d 474, 477-78 (S.D.N.Y. 2002).

Judge Robert L. Carter of the United States District Court for the Southern District of New York dismissed the suit with prejudice as to all defendants due to plaintiffs' repeated attempts to expand and misconstrue the court's orders on the ground that Federal Rule of Civil Procedure 37(b)(2)(C) authorizes dismissal of a plaintiff's complaint along with other sanctions if a party "fails to obey an order to provide or permit discovery." *Internet Law Library*, 2003 WL 21537782 at \*3. While dismissal is indeed the harshest sanction available to a court, it is appropriate where a party who has disobeyed an order has done so willfully, in bad faith, or is in some way at fault. *Id.* The court held that plaintiffs' failure to respect the court and its orders justifies dismissal of the complaint as both a remedy and a deterrent to future misconduct. *Id.* at \*4.

ITIS is a publicly traded company owning subsidiaries that operate Internet sites specializing in legal and other types of research and litigation support services. *Internet Law Library, Inc. v. Southridge Capital Management*, 223 F. Supp. 2d 474, 478 (S.D.N.Y. 2002). The CEO of ITIS, in seeking out capital, was referred to defendant Southridge and negotiations between these entities ensued thereafter. *Id.* Plaintiffs alleged that defendants made a number of misrepresentations during these negotiations, including, *inter alia*, that defendants would refrain from selling ITIS stock for a year after the closing because they had a long-term investment interest in ITIS, and that they would not manipulate ITIS stock with the intention of depressing its price. *Id.*

In reliance on these misrepresentations, ITIS entered into a Convertible Preferred Stock Purchase Agreement with Cootes Drive, inserted in lieu of Southridge as a signatory at the last minute. *Id.* Defendants then allegedly sold ITIS stock short and otherwise manipulated the stock, despite representations that it would not do so. *Id.* Plaintiffs alleged that this short-selling activity was part of a larger strategy that defendants have repeatedly employed to manipulate the stock price of companies in which they have invested. *Id.*

Defendants moved to dismiss this action due to plaintiffs' discovery abuses claiming that plaintiffs attempted

to override and misconstrue the court's authority several times. *Internet Law Library*, 2003 WL 21537782 at \*1. First, plaintiffs misinterpreted the court's ruling which denied defendants' protective order request for all document productions and stated that any information gained in discovery was not to be used to identify new clients or initiate new litigation, but that it could be used to "locate additional witnesses or join new parties on a showing of good cause." *Id.* Further, the court also indicated that plaintiffs' use of any information gained in discovery before another judge in a different litigation would be subject to the presiding judge's ruling. *Id.* Plaintiffs interpreted this ruling, however, to entitle them to request every manner of discovery from defendants and nonparties with regard to all companies that bore a resemblance to the way in which ITIS was financed and thereby served subpoenas on the National Association of Securities Dealers (NASD) and the National Securities Clearinghouse Corporation requesting the records of trading in ATSI Communications (ATSI) securities by several nonparty companies who are parties in a different action brought by ATSI before Judge Kaplan. The only common thread between these two actions was plaintiffs' counsel. *Id.* at \*2

Second, plaintiffs' counsel misrepresented to the ATSI court that the subpoenas were issued with the permission of the court and further defended them as a permissible search for pattern and practice evidence of defendants' manipulative investment schemes. *Id.* Third, plaintiffs' counsel also attempted to violate the discovery stay in the ATSI action mandated by the Private Securities Litigation Reform Act (PSLRA) by attempting to use the subpoenaed information from the ITIS case in the ATSI action. Judge Kaplan barred plaintiffs from using this information in the ATSI action. *Id.*

The court thereafter made it "very clear" that its previous ruling directed plaintiffs to seek witnesses and not trading records with regard to nonparties. Further, the court quashed the subpoenas and warned plaintiffs that any further violation of the court's orders would result in dismissal of the case. *Id.*

The plaintiffs' final violation of the court's orders took place when they served a subpoena on the NASD seeking every short sale made since March 30, 1999, irrespective of the identity of the stock or the trader. *Id.* at \*3. The court quashed the subpoenas and requested that plaintiffs justify their actions promptly in order to rule on defendants' motion. Plaintiffs' position was that the court's order was unclear and therefore they could not have violated it. *Id.*

Judge Carter dismissed plaintiffs' complaint with prejudice pursuant to Rule 37 (b)(2) due to plaintiffs' repeated and flagrant disregard for the court's orders. *Id.* The court found it never gave permission to plaintiffs to issue the ATSI subpoenas in the manner represented to Judge Kaplan, and that plaintiffs intended to abuse the court's subpoena power to circumvent the PSLRA's constraints in the ATSI case. Further, the court found it was impossible for plaintiffs' to claim that they misunderstood the court's order. *Id.*

Rule 37(b)(2) gives the court broad discretion to make whatever disposition is just in light of the facts of the particular case. See *Charles Alan Wright, Arthur R. Miller & Richard L. Marcus*, Federal Practice and Procedure: Civil 2d §2289. Since the Supreme Court's decision in *National Hockey League v. Metropolitan Hockey Club*, 427 U.S. 639 (1976), the leading case in Rule 37 sanctions, courts have shown an increasing readiness to impose extreme sanctions not only as punishment, but deterrence as well. See e.g. *Metropolitan Life Ins. Co. v. Estate of Cammon*, 929 F.2d 1220 (7<sup>th</sup> Cir. 1991). The dismissal sanction has been imposed, upheld or affirmed by courts where the record indicates a history of discovery abuse and where the party was warned of dismissal potential. See e.g., *Friends of Animals, Inc. v. U.S. Surgical Corp.*, 131 F.3d 332, 334 (2d Cir. 1997) (dismissal sanction upheld where record demonstrated a history of discovery abuse and party was warned of dismissal potential); *Selby v. Arms*, 1995 WL 753894 at \*1 (S.D.N.Y. March 25, 1995) (repeated failure to comply with court orders constituted willful conduct and reflected "disregard for the integrity of the discovery process and indeed, the integrity of the court"); *Young v. Office of the United States Senate Sergeant at Arms*, 217 F.R.D. 61, 71 (D.C.2003) (plaintiff's willful obstruction of discovery process in violation of court order and where any sanction short of dismissal would be inadequate to deal with plaintiff's misconduct warranted dismissal).

The *Internet Law Library* decision is noteworthy as an important reminder that courts will not be reluctant to dismiss a case involving the obvious disregard of court orders and discovery abuse. While the court did consider other sanctions before imposing dismissal, they were ultimately determined to be insufficient punishment and would not effectively deter future misconduct were the litigation to continue. This decision demonstrates that parties should not, and will not, be able to reap benefits from their misconduct. Litigants must therefore be more cautious than ever in conducting themselves responsibly and respectfully throughout the discovery process.