Legal Backgrounder

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BUSINESSES' PRIVACY AND PROPERTY RIGHTS THREATENED IN CALIFORNIA

by

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Since last summer, media headlines have been filled with anecdotal, unsubstantiated stories that "secret settlements" entered into by Ford Motor Company and Firestone "hid" problems with tires and kept other safety concerns from government regulators and the public. These stories — regardless of their accuracy — resonated with the public's negative perceptions of large corporations, and led to calls for legal system reforms, many of which threaten the legitimate privacy and informational and intellectual property rights of businesses.

In California, the Ford and Firestone publicity has led to a proposal which takes aim at civil litigation, and virtually would ban the use of all protective orders (which keep discovery exchanged in civil litigation confidential) and confidential settlement agreements (which seek to keep information disclosed during the case confidential after it is resolved). The plaintiffs' bar is the prime proponent of the new California measure, and if it is successful, every company doing business in the state will be at risk of losing the confidentiality of its intellectual and informational property and competitive information if sued for an alleged "product defect," "environmental hazard," financial fraud, or insurance "bad faith." This legislation, if enacted, would create a ***presumption*** that all civil discovery "concerning" one of these claims would be ***public***, thereby making it fair game for anyone to obtain.

The History of Efforts to Limit Protective Orders and Confidential Settlement Agreements. In the early 1990s, plaintiffs' attorneys took up the issue of protective orders and confidential settlement agreements in earnest for the first time. Protective orders and confidential litigation settlements agreements, said the plaintiffs' bar, allow "bad" corporations to keep the public in the dark about defective products, toxic environmental hazards, and other purported misdeeds.

Businesses, however, countered that protective orders are not used to keep misconduct secret.

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Instead, they argued such orders encouraged litigants to freely provide discovery while simultaneously ensuring that valuable intellectual property and confidential business information would not be disseminated to competitors. In addition, responded the corporate community, confidential settlement agreements are not used to bury problems. After all, when a plaintiff files a complaint to start the litigation process, the allegations about the defendant's purported misdeeds are a matter of public record, and many plaintiffs' attorneys announce the filing of a lawsuit by holding a press conference designed to publicize the allegations made. Moreover, many defendants settle lawsuits — and wish to keep the terms confidential — for reasons unrelated to culpability. In short, the business community replied that the whole premise that protective orders and confidential settlement agreements serve only to hide the "truth" was misguided.

In light of the plaintiffs' bar's charges, a number of states and the federal government entertained proposals to ban these traditional tools of civil litigation. The debate over a proposed amendment to Rule 26(c) of the Federal Rules of Civil Procedure to limit the use of protective orders was particularly heated, and eventually the Federal Judicial Conference was directed to study whether protective orders truly are misused as plaintiffs' lawyers charged. In 1998, the Judicial Conference's Committee of Rules of Practice and Procedure reported the findings of its objective study. Significantly, the evidence demonstrated that there was no misuse of protective orders to conceal public hazards. In addition, the study confirmed the importance of protective orders to efficient civil litigation, because a significant amount of information exchanged in discovery is of a private nature and deserving of protection from public disclosure, and discovery would be more burdensome and costly to the litigants and the courts if the use of protective orders was restricted. Following the report's 1998 release, the federal debate over civil litigation reform subsided, and the plaintiffs' bar turned their efforts to individual states.

Previous Attempts in California to Severely Limit Protective Orders. Despite the Federal Judicial Conference's report endorsing protective orders only a year earlier, in 1999 then-California state senator Adam Schiff introduced a state measure — SB 1254 — that would have practically banned all protective orders and confidential settlement agreements in lawsuits involving alleged product defects, environmental hazards, or financial fraud. By the time the business community took note of the measure, it already had passed through one legislative committee on a party-line vote.

Over 100 entities registered their opposition to the measure, and the opponents were not only those in the specifically-targeted industries — such as automotive and pharmaceutical manufacturers — but included businesses from every sector of California's economy, from the entertainment industry, to high tech companies, to the wine industry. Each opposing company recognized that the measure, if passed, would place all California businesses at risk of losing their confidential information to competitors with the filing of each new lawsuit, regardless of merit.

The opposition stalled the measure, and it was withdrawn without ever reaching a floor vote. Though the business community initially breathed a sigh of relief, it would be short-lived. The publicity surrounding Firestone and Ford provided the plaintiffs' bar new energy on this issue and rather than letting the measure lie, they resurrected a new version of the bill.

New Efforts. Upon withdrawing SB 1254, the plaintiffs' bar set to work at revising the measure's most egregious provisions to make it more palatable, while leaving the bill's effective ban on protective orders and confidential settlement agreements fully intact. The new measure was simultaneously introduced as AB 36 and SB 11 in the Assembly and Senate. Like the prior measure, AB 36/SB 11 is aimed at any lawsuit claiming a "financial fraud," a "defective product," or an "environmental hazard," and it adds "bad faith" conduct by an insurance company. The mere filing of a complaint with one of these allegations will trigger the provision.

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Though it is derived from the deeply flawed 1999 proposal, AB 36/SB 11 rightly should be viewed as even more dangerous to businesses operating in California, because it begins by declaring a broad ***right*** of public access to ***all*** discovery materials. With this broad new public right of access, presumably any member of the public, the media, or a competitor who knows civil litigation is underway could demand a copy of all discovery responses and produced documents — and intervene in the litigation to enforce production if the request is denied. In contrast to the extreme position struck by this new measure, when the United States Supreme Court considered the issue of whether the public has any right to access to discovery materials exchanged between private litigants, it concluded that no such right existed at common law, or derived from the constitution. Seattle Times Co. v. Rhinehart, 467 U.S. 20, 32-33 (1984); accord NBC Subsidiary (KNBC-TV), Inc. v. Superior Court, 20 Cal. 4th 1178, 1208-09 n.25 (1999) (acknowledging same principle).

And not only will the measure give the public the right to obtain discovery materials, it will prevent the litigants, absent extraordinary circumstances, from entering into any discovery protective order or settlement agreement designed to keep those materials confidential. As a result, a business charged with a product defect or financial fraud could be compelled to produce financial records, business plans, client lists, and a host of other sensitive commercial materials, without any assurance that the plaintiff's attorney would keep those materials confidential. In fact, the proposal would leave it entirely to the discretion of the plaintiff's attorney whether to post those materials on the Internet, or provide them to a competitor of the defendant. In fact, particularly unscrupulous competitors could fabricate allegations of a financial fraud for no other reason than to use the discovery process to obtain proprietary information to which they are not entitled.

Impact on Litigants. Plaintiffs' attorneys dismiss concerns from the business community about the competitive threat posed by AB 36/SB 11, and point to a provision in the measure that would allow litigants to keep trade secrets confidential. This superficial argument, however, overlooks the fact that actual "trade secrets" are few and far between, and businesses have legitimate privacy interests in a broad range of information that falls outside the narrow legal definition of a true "trade secret." The definition of a trade secret was written with only a limited type of business information in mind — the formula to Coca-Cola, for example. Businesses are concerned with preserving the confidentiality of other types of information, not because confidentiality allows them to hide safety concerns, but because commercially competitive information often is obtained at considerable expense and valuable only to the extent it is unknown to competitors.

The business community also notes that the proposal's exception for trade secrets is of limited utility, because courts are permitted to enter a protective order or enforce a confidential settlement agreement pertaining to a trade secret only after first concluding that a legitimate trade secret is at issue. Accordingly, to obtain protection even of a bona fide trade secret under AB 36/SB 11, a business defendant will have to identify each and every document it wishes to keep confidential, submit them to the court, and obtain a ruling that the documents meet California's definition of a trade secret. Absent such a finding, a business defendant would have the formidable, if not impossible task, of proving that a substantial overriding interest and narrowly-tailored confidentiality provision should overcome the declared public right of access to discovery to obtain a protective order or enforce a confidential settlement agreement.

The restrictions in AB 36/SB 11 are also troubling because they will limit the ability of the parties and the court to protect confidential information simply because a lawsuit is filed — regardless of whether the lawsuit's allegations of product defect, financial fraud, environmental hazard, or insurance bad faith are ultimately disproved. In fact, despite widespread concern in the business community that too many tort actions are entirely frivolous, the proposal would prohibit courts from issuing any type of protective order or enforcing any confidentiality agreement, ***even if*** the defendant wins on summary

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judgment or after trial, and ***even if*** the court ultimately concludes the action was so lacking in merit as to have been brought in bad faith.

Every business subject to suit in California would be affected. For example, suppose the stock price of an Internet start-up surges at the time of the initial public offering, and then sinks rapidly — or suppose the stock price of an established "old economy" company dips precipitously after it reports that it will miss earnings expectations for the quarter by a substantial amount. In both circumstances, plaintiffs' lawyers quickly file frivolous shareholder lawsuits alleging a "financial fraud" that may cause financial loss to a large number of people. In discovery, they demand the defendants' confidential business plans, marketing data, sales information, and countless other confidential commercial records. Under present law, a protective order could shield the confidential commercial information and prevent the plaintiffs from revealing it or using it outside the litigation. But under the new measure, the confidential commercial information not only would have to be produced in discovery, the public would have a right to access it. And even after the frivolous actions are dismissed in the defendants' favor, the court still would be powerless to issue a protective order for the confidential information.

As another example, assume that a plaintiff alleges that a company's product is defectively designed because there is another design already on the market. By virtue of that mere allegation, all of the defendant company's design documents would be discoverable and unprotected. In every industry, design innovations are important to maintaining a legitimate competitive edge, but the value of those innovations evaporates as soon as disclosure is compelled without a guarantee of confidentiality.

Whatever the purported concern of the plaintiffs' bar over the unsubstantiated use of protective orders and confidential settlement agreements to hide safety concerns from the public, the objective findings of the Federal Judicial Conference in 1998 establish that any measure like AB 36/SB 11 is the wrong cure for a nonexistent disease. American businesses — and California businesses in particular — already are heavily regulated. Federal agencies and state agencies (and sometimes both) are charged with oversight of everything from consumer products to securities to insurance to automobiles to drugs and medical devices. These agencies have reporting requirements, and they have investigatory powers. If underreporting of safety issues is a concern, a narrowly-tailored and appropriate solution would be to increase agency funding, and, perhaps, increase the penalties for regulatory violations.

By contrast, the California proposal will do nothing to guarantee that purported safety issues will come to the attention of the public or government officials — all it will do for certain is provide competitors and the media with a powerful tool for digging through confidential business information for their own questionable purposes.

Conclusion. With the stakes so high, and the outcome of the debate uncertain at best, it is imperative that those who care about the administration of justice and the protection of privacy and intellectual property in California closely examine this protective order proposal. Not only does it have the potential to dramatically change the litigation landscape in that state, but its proponents' successes could lead to an avalanche of similar proposals throughout the nation.

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