Federal Circuit Holds That Magistrate Judge Violated Duty To Disclose

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In *CEATS, Inc. v. Continental Airlines, et al.*, 2013-1529 (June 24, 2014), the Federal Circuit held that a magistrate judge who served as a mediator failed to meet his duty to disclose a prior relationship with defense counsel. The case provides a valuable discussion of a mediator's duty to disclose.

CEATS sued several Defendants for patent infringement in the U.S. District Court for the Eastern District of Texas. The parties participated in several mediation sessions before Magistrate Judge Robert Faulkner ("Faulkner" or the "mediator"). When no settlement was reached, they tried the case to a jury in the district court. The jury found that Defendants had violated CEATS' patents but that the patents were invalid. Afterwards, CEATS discovered that the mediator had relationships with Fish & Richardson, P.C. ("Fish"), counsel to several Defendants, which had not been disclosed.

CEATS' appealed from the finding of patent invalidity, but lost on the merits. CEATS also moved under Rule 60(b) for relief from the final judgment based on the lack of disclosure of the mediator's relationship with defense counsel. The district court denied that motion and held that neither Faulkner nor defense counsel had a duty to disclose the matters in question. As part of its analysis, the district court reasoned that mediators, unlike judges, did not sit in judgment of a case and therefore had less of a disclosure obligation than judges. CEATS appealed that 60(b) ruling.

The Undisclosed Relationship

The potential conflict of interest became evident due to an unrelated state court case that preceded CEATS' patent lawsuit by about three years and that partly overlapped it. In that unrelated case, the Fish firm represented a party in a partnership dispute in Texas state court. The parties agreed to arbitrate their dispute, and the state court appointed Faulkner, who at that time was with JAMS, to act as the arbitrator. Faulkner disclosed that he had participated in arbitrations and mediations with the named Fish attorneys on prior occasions but made no other disclosures. He did not amend his disclosures when Johnson, another Fish attorney, entered his appearance in the case and, in fact, acted as if he did not know Johnson. Ultimately, Faulkner entered an award in favor of Fish's client for $22 million, including $6 million in attorneys' fees. After learning that Faulkner and Johnson were previously acquainted, opposing counsel asked for permission to take discovery on the extent of their relationship. The state court denied that request and confirmed the $22 million arbitration award that Faulkner had issued.

On appeal, the Texas appellate court ruled that the lower court should have permitted discovery of the relationship between Faulkner and Johnson, and it vacated the order confirming the arbitration award. After discovery, the trial court confirmed the arbitration award again, but the Texas appellate court reversed again. This time it vacated the arbitration award altogether, holding that it was tainted by an enduring social relationship between Faulkner and Johnson that included expensive outings and gifts and an active business relationship between Faulkner and the Fish law firm. Subsequently, Faulkner was added as a co-defendant with Fish, Johnson, and others in a new state court lawsuit that sought damages for breach of the arbitration agreement and fraud in concealing the Faulkner-Johnson-Fish relationship.

The Federal Circuit's Analysis

The question for the Federal Court was whether the Faulkner-Johnson-Fish relationship—as revealed by the state court action—should have been disclosed by Faulkner before or during the time that he mediated CEATS' patent infringement case.

The Federal Circuit discussed at length the vital role that mediators play in the federal court system and rejected the district court's conclusion that a mediator's duty to disclose is any less exacting than the duty that federal judges have to recuse themselves under 28 U.S.C. § 455(a). It held that mediators are required to disclose, "as soon as practicable, all actual and potential conflicts of interest that are reasonably known to the mediator and could reasonably be seen as raising a question about the mediator's impartiality."

Applying this standard, the court had no difficulty in finding that Faulkner had failed to meet his disclosure obligations:

> At the same time Faulkner served as the court-appointed mediator [here], the Faulkner-Johnson-Fish relationship was directly at issue in a state appellate court. Importantly, this meant that Fish, as a firm, was actively defending Faulkner's personal disclosure decisions while he was mediating this case. . . . [The] fact that Faulkner testified in support of the arbitration award and was asked, not just about his relationship with Johnson, but with the Fish firm and its clients as well, further emphasizes the need for disclosure on these facts.
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> Furthermore, the Texas appeals court's decision holding that Faulkner breached his disclosure obligations in the [Texas state court action] was released . . . between the first two mediation sessions in this [federal] case and well before the third. . . [T]he state court found that the Faulkner-Johnson-Fish relationship was a disqualifying, social and business relationship . . . [That relationship] could reasonably be seen as raising a question about the mediator's impartiality [in this case as well].

What Consequence for Non-Disclosure?

Despite its holding that Faulkner had breached his duty of disclosure with respect to the mediation, the court did not reverse the judgment denying CEATS's patent claims.

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Applying the *Libutti* test to Mr. Spinosa's invocation of the Fifth Amendment at trial, the Eleventh Circuit determined that the district court did not err in allowing Coquina to call Mr. Spinosa as a witness and that an adverse inference could be drawn against TD Bank based on his invocation of the privilege.[7]

First, although no longer employed by TD Bank at the time of the trial, the Eleventh Circuit determined that Mr. Spinosa retained some loyalty to TD Bank. Specifically, TD Bank paid Mr. Spinosa's legal fees, and his attorney had previously offered to cooperate in the Bank's internal investigation of Rothstein's Ponzi scheme.

Second, because it was unlikely that Mr. Spinosa would have invoked the privilege if he had not participated and/or had knowledge of the Ponzi scheme, the Court found that Mr. Spinosa and TD Bank's interests were aligned and both advanced by invocation of the privilege.

Finally, the Court noted that Mr. Spinosa was a "key figure" in the case because of the integral role he played in recruiting Coquina's (and others') investments with Rothstein's Ponzi scheme.

The Court did not address the second factor of the *LiButti* test, the level of control TD Bank has over Mr. Spinosa, finding a sufficient relationship and enough support for allowing an adverse inference without its consideration.

Thus, the Eleventh Circuit confirmed the conclusion adopted by other circuits that, "where [a] witness invoking the privilege is a former employee of the civil defendant, and where the questions that the witness refuses to answer concern the witness's activities undertaken on behalf of the employer and during the period of employment, [then] it is proper to allow the jury to impute the witness's guilt to the defendant."[8] However, where there does not exist a relationship sufficient to render the inference trustworthy, the court may decline to impose an inference against the defendant based on a non-party witness's invocation of the Fifth Amendment. The inquiry is fact-intensive and will depend upon the circumstances surrounding the parties' relationship and interests at the time the right is asserted.[9] **SB**

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Endnotes

[1]*Coquina Investments v. TD Bank, N.A.*, 12-11161, 2014 WL 3720301 (11th Cir. July 29, 2014).

[2]*See LiButti v. U.S.*, 107 F.3d 110, 123–24 (2d Cir. 1997).

[3]Coquina Investments, 2014 WL 3720301, at *6.

[4]Cerro Gordo Charity v. Fireman's Fund Am. Life Ins. Co., 819 F.2d 1471, 1481 (8th Cir.1987).

[5]LiButti, 107 F.3d at 123.

[6]Coquina Investments, 2014 WL 3720301, at *1.

[7]*Id.*, at *6.

[8]*Davis v. Mutual Life Ins. Co. of New York*, 6 F.3d 367, 385 (6th Cir. 1993).

[9]The issue is arising with increased frequency in *qui tam* litigation. For discussion of the impact the Fifth Amendment's adverse inference has in qui tam litigation, see Thomas K. Potter, III and Mignon A. Lunsford, *What You Don't Say Can Be Used Against You: Assessing The Fifth Amendment's Role In Qui Tam Litigation*, ABA's Health & Disability & Life Ins. Law Comms. Newsletter (Winter 2014).

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Instead, it analyzed the factors for relief from a judgment under Rule 60 (b) that are discussed in *Liljeberg v. Health Servs. Acquisition Corp.*, 486 U.S. 847, 863-64 (1988) and found that reversal was not warranted.

The Court expressed concern that it was failing to provide a remedy for the mediator's non-compliance with his disclosure obligations and conceded that to some extent its failure to do so would undermine the public's confidence in the mediation process. Nonetheless, because CEATS had had a full opportunity to present its case before a neutral judge and jury, the court did not believe that refusing to grant CEATS a new trial would undermine public confidence in the judicial system as a whole. Accordingly, despite the mediator's failure to meet his disclosure obligations, the final judgment was allowed to stand. **SB**

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