IICLE CIVIL LITIGATION FLASHPOINTS - MAY 2010

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This month two recent opinions of the Illinois Supreme Court are reviewed along with a case from the Seventh Circuit.

Arbitration: Federal Arbitration Act Preemption.

Carter v. SSC Odin Operating Co., No. 106511, 2010 WL 1493626 (Ill. Apr. 15, 2010), involves an interlocutory appeal from the denial of a motion to compel arbitration pursuant to the Federal Arbitration Act (FAA), 9 U.S.C. §§1, *et seq*. The case arose out of the unfortunate death of Joyce Gott suffered when she was a resident at the defendant's nursing home in Odin, Illinois. In conjunction with her admissions to the Odin Healthcare Center on two separate occasions, a written "Health Care Arbitration Agreement" with the defendant was entered into on her behalf. The agreement required all disputes relating to her care at the facility to be submitted to binding arbitration under the FAA. Contracts containing arbitration clauses are common within the nursing home and rehabilitation facility service industry.

Following Joyce's death in January 2006, the plaintiff, the special administrator of her estate, filed a two-count complaint in the Circuit Court of Marion County asserting a survival action pursuant to the Probate Act of 1975, 755 ILCS 5/27-6, and the Nursing Home Care Act, 210 ILCS 45/1-101, et seq., along with a statutory action under the Wrongful Death Act, 740 ILCS 180/0.01, et seq. The plaintiff alleged that the decedent had suffered pain, emotional distress, mental anguish, and ultimately her own demise on account of the defendant facility's negligent acts and omissions. The defendant answered the complaint denying the allegations in relevant part and interposing a number of affirmative defenses, including the defense that the lawsuit was precluded by the parties' arbitration agreement. The plaintiff responded by opposing the motion to compel arbitration on grounds, inter alia, that the contractual arbitration clause was unenforceable because it violated the public policy contained in the Nursing Home Care Act, and that §2 of the FAA (9 U.S.C. §2) expressly shields legitimate state law-based contract defenses of general application from the Act's preemptive effect. The trial court denied the defendant's motion to compel arbitration reasoning that a plaintiff bringing a wrongful death claim on behalf of an estate cannot be bound by the decedent's arbitration agreement, and with regard to the survival action, finding the arbitration clause void in light of §§3-606 and 3-607 of the Nursing Home Care Act that provide:

Any waiver by a resident or his legal representative of the right to commence an action under Sections 3-601 through 3-607, whether oral or in writing, shall be null and void, and without legal force or effect. 210 ILCS 45/3-606.

Any party to an action brought under Section 3-601 through 3-607 shall be entitled to a trial by jury and any waiver of the right to a trial by a jury, whether oral or in writing, prior to the commencement of an action, shall be null and void, and without legal force or effect. 210 ILCS 45/3-607.

The defendant nursing home took an appeal to the appellate court from the trial court's interlocutory order denying its motion to compel arbitration under Supreme Court Rule 307(a)(1) because an order to compel arbitration is injunctive in nature. On appeal, the Fifth District Appellate Court affirmed the trial court based on its determination of a single question of law – whether the "public policy" expressed in the Nursing Home Care Act is an ordinary state law contract defense of general application, and thus beyond the preemptive reach of the FAA. Referring to the voluminous caselaw holding that a violation of Illinois public policy can be a legitimate, generally applicable defense to all contracts in this state, the appellate court held that the state law provisions of the Nursing Home Care Act were not preempted by the FAA. The appellate court reasoned that the public policy expressed in the Nursing Home Care Act concerns the validity, revocability, and enforceability of contracts generally, and does not specifically target arbitration. According to the appellate court, the principles of state law set forth by the General Assembly in the Nursing Home Care Act comported with the text of the FAA under the pronouncements of the United States Supreme Court in *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 134 L.Ed.2d 902, 116 S.Ct. 1652 (1996), quoting *Perry v. Thomas*, 482 U.S. 483, 96 L.Ed.2d 426, 107 S.Ct. 2520 (1987).

The manner in which the case eventually made its way to the Illinois Supreme Court is procedurally fascinating. Initially, the Supreme Court denied the defendant's petition for leave to appeal. The defendant then proceeded to petition the United States Supreme Court for a writ of certiorari, arguing that the appellate court's decision conflicted with *Preston v. Ferrer*, 552 U.S. 346, 169 L.Ed.2d 917, 128 S.Ct. 978 (2008), its latest decision on the subject of arbitration, as well as the decisions of multiple federal circuit courts of appeals. While the defendant's petition was pending before the United States Supreme Court, the Illinois Appellate Court, Second District, in *Fosler v. Midwest Care Center II, Inc.*, 391 Ill.App.3d 397, 911 N.E.2d 1003, 331 Ill.Dec. 773 (2d Dist. 2009), *modified upon denial of rehearing*, No. 2-08-1005, 2010 WL 1286880 (2d Dist. Mar. 1, 2010), held that the FAA preempts the anti-waiver provisions of the Nursing Home Care Act. The defendant filed a motion in the Illinois Supreme Court for reconsideration of its earlier denial of the petition for leave to appeal citing the conflict between appellate court districts that had developed in the interim. Because more than 21 days had expired from its initial denial of the defendant's petition for leave to appeal in September 2008 (the 21 days corresponds to the time period allowed by Supreme Court Rule 367 for filing a petition for rehearing in a reviewing court), the Supreme Court said that it was exercising its jurisdiction and allowing the appeal to proceed pursuant to its broad supervisory authority over the Illinois court system.

In an opinion authored by Justice Thomas, the Supreme Court reversed the appellate court holding that the provisions of the Nursing Home Care Act voiding an Illinois resident's waiver of the right to sue or right to a jury trial were preempted by the FAA. Following an in depth analysis of the preemption doctrine derived from the Supremacy Clause of Article VI of the United States Constitution and the 85-year history of the FAA, the court observed that the FAA contains no express preemption provision or indication of congressional intent to occupy the entire field of arbitration as a matter of federal law. The case, therefore, turned on the issue of "conflict preemption" where state law is preempted when it actually conflicts with federal law and "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." 2010 WL 1493626 at *5.

According to the court, the basic purpose of the FAA is to overcome the historical reluctance of courts to enforce arbitration agreements, and to place agreements to arbitrate on the same footing as other contracts. *Allied-Bruce Terminex Cos. v. Dobson*, 513 U.S. 265, 130 L.Ed.2d 753, 115 S.Ct. 834, 837 – 838 (1995). The FAA applies equally to federal and state court proceedings. *Southland Corp. v. Keating*, 465 U.S. 1, 79 L.Ed.2d 1, 104 S.Ct. 852 (1984). The Illinois Attorney General was allowed to intervene on behalf of the plaintiff and argued that the FAA should not be allowed to preempt state law provisions prohibiting the waiver of the fundamental constitutional right to a jury trial. But, the court found the arguments advanced by the State of Illinois flawed noting that "it is axiomatic that a party may waive the right to a jury trial in a civil case by entering into a contract to arbitrate." 2010 WL 1493626 at *10. See, e.g., *Sherwood v. Marquette Transportation Co.*, 587 F.3d 841, 842 (7th Cir. 2009). Moreover, the court commented that the public policy embodied in §§3-606 and 3-607 of the Nursing Home Care Act guaranteeing nursing home residents a judicial forum, including the right to a jury trial in the event of a dispute with the nursing home, runs contrary to statutory and judicial expressions of the Illinois public policy favoring arbitration as a means of dispute resolution. The court found that the state's arguments ignored the fact that the Nursing Home Care Act's jury trial requirement did not apply to all contracts generally, but only to nursing home contracts.

The court carefully considered the "pro-judicial forum" provisions of the Nursing Home Care Act and found them to be the "functional equivalent" of the anti-arbitration legislation that is preempted by the FAA as determined by the Supreme Court in *Southland, supra*, and *Preston, supra*. Accordingly, the appellate court's order was reversed and the case remanded for consideration of certain other issues that were not before the court, including a threshold jurisdiction question whether the parties' arbitration agreement related to a transaction "involving interstate commerce" within the meaning of the FAA. 2010 WL 1493626 at *10.

Punitive Damages: Remittitur.

Slovinski v. Elliot, No. 107146, 2010 WL 1493843 (Ill. Apr. 15, 2010), is a defamation case in which a default judgment was entered against the defendant because of repeated failures to respond to discovery. The plaintiff was the former chief financial officer of a defunct company. He sued the company's CEO Elliot for defamation per se. The complaint alleged that the defendant had knowingly made false statements to a supplier to excuse the unavailability of the company's financial statements, by saying that the plaintiff had not been doing his job, came in late and left early, and spent most of his time chasing women. The plaintiff claimed that the defamatory statements damaged his professional reputation and caused a reduction in his income as well as emotional distress.

The question of damages was heard by a jury which returned an itemized verdict in awarding the plaintiff $0 for lost wages, $0 for damage to reputation, $81,600 in damages for emotional distress, and $2 million in punitive damages. The trial court allowed the compensatory damages award to stand, but remitted the punitive damages award to $1 million. The plaintiff appealed, and the appellate court further remitted the punitive damages award to equal the amount of the compensatory damages, $81,600.

The plaintiff appealed to the Supreme Court claiming that he was entitled to the full $2 million in punitive damages awarded by the jury. The Supreme Court noted that when a trial court reduces a jury's award by remittitur under §2-1207 of the Code of Civil Procedure (735 ILCS 5/2-1207), then the applicable standard of review is whether the circuit court abused its discretion, not de novo. The court, therefore, concluded that the question faced by the appellate court was whether there was a basis in the record to support the trial court's order remitting the award of punitive damages – not whether or not the trial court had made any particular findings in entering the remittitur.

Following a review of the law of punitive damages, but without reaching the due process principles set forth in *State Farm Mutual Automobile Insurance Co. v. Campbell*, 538 U.S. 408, 155 L.Ed.2d 585, 123 S.Ct. 1513 (2003), the Supreme Court observed that an award of punitive damages must be remitted to the extent that there is no material evidence to support it. Citing *Loitz v. Remington Arms Co.*, 138 Ill.2d 404, 563 N.E.2d 397, 150 Ill.Dec. 510 (1990). According to the court, the defendant's conduct was "on the low end of the scale for punitive damages." 2010 WL 1493843 at *7. There was no evidence presented to the jury that the defendant's defamatory statements were part of an "intentional, premeditated scheme to harm plaintiff." *Id.* In affirming the appellate court, the Supreme Court advised that even in a case of defamation per se, the requisite malicious conduct necessary to support an award of punitive damages must be proved by competent evidence and not presumed. According to the Supreme Court, the highest award of punitive damages supported by the evidence in the record was the $81,600 entered by the appellate court and equalling the amount of compensatory damages. A discussion of the issue of proportionality between punitive and compensatory damages, however, is conspicuously absent from the 6-1 majority opinion (Kilbride J., dissenting).

Discovery: Attorney-Client Privilege, Federal Rule.

In *Sandra T.E. v. South Berwyn School District 100*, 600 F.3d 612 (7th Cir. 2010), the law firm of Sidley & Austin was engaged by the School District's Board of Education to conduct an investigation into charges that a teacher had sexually molested students over an extended period of time. The investigation was headed by Scott Lassar, a former U. S. Attorney for the Northern District of Illinois, and involved interviews of past and present school teachers and administrators, as well as third-party witnesses. The attorneys took notes and drafted summaries of the interviews. Later, the Board was provided an oral report and written summary of the attorneys' findings.

In subsequent civil litigation against the School District brought by the victims of the alleged abuse, the attorneys' notes and memoranda were sought in discovery. The district court granted the plaintiffs' motion to compel production against Sidley & Austin, finding that the law firm had been hired to perform investigative services, not legal services; and, therefore, the notes and memoranda were not protected from disclosure by the attorney-client privilege.

The Seventh Circuit in a unanimous opinion reversed the trial court's order. But first, the court engaged in some interesting jurisdictional gymnastics in light of *Mohawk Industries, Inc. v. Carpenter*, ___ U.S. ___, ___ L.Ed.2d ___, 130 S. Ct. 599 (2009), in which the Supreme Court held that discovery orders adverse to a party involving the attorney-client privilege do not qualify for an immediate appeal under the collateral order doctrine. Noting that the discovery order here was not entered against a party, but rather the nonparty law firm, and that the appeal was allowed before *Mohawk Industries* was decided, the Seventh Circuit reserved the jurisdictional question for future reference in determining that it had the necessary jurisdiction to consider the appeal under the collateral order doctrine. Then, relying on the Supreme Court's decision in *Upjohn Co. v. United States*, 449 U.S. 383, 66 L.Ed.2d 584, 101 S.Ct. 677 (1981), the Seventh Circuit adopted the conclusion reached by other circuits that when "an attorney conducts a factual investigation in connection with the provision of legal services, any notes or memoranda documenting client interviews or other client communications in the course of the investigation are fully protected by the attorney-client privilege." 600 F.3d at 620.

The Seventh Circuit specifically rejected the district court's finding that the law firm was hired by the School Board only to conduct an investigation. The court of appeals observed the law firm's engagement letter, something that the trial judge failed to consider, explained that Sidley was hired "to 'investigate the response of the school administration to allegations of sexual abuse of students' and 'provide legal services in connection with the specific representation'." [Emphasis in original.] 600 F.3d at 619. In addition, the Seventh Circuit noted that the lawyers' manner of conducting the investigation confirmed that they were acting in the capacity as attorneys for the School Board. For example, no third parties were present during the interviews, the witnesses were given the so-called *Upjohn* warnings emphasizing that the law firm represented the School Board which controlled whether the interviews would remain privileged and not the individual witnesses, the report summarizing the attorney's findings was communicated to the Board in confidence, and documents were labeled as "Privileged" and "Work Product." Regarding the interviews involving nonemployees and third-party witnesses, the Seventh Circuit found them protected by the work product doctrine which applies to attorney investigations conducted in light of pending or threatened litigation.

It is important to recognize that there is a divergence between federal and state privilege law, and practitioners are advised of the likelihood of a different result in state courts. In Illinois, the control group test is used to determine whether intra-corporate communications are protected from compelled disclosure by the attorney-client privilege. *Consolidated Coal Co. v. Bucyrus-Erie Co.*, 89 Ill.2d 103, 432 N.E.2d 250, 59 Ill.Dec. 666 (1982); *Hayes v. Burlington Northern & Santa Fe Ry.*, 323 Ill.App.3d 474, 752 N.E.2d 470, 256 Ill.Dec. 590 (1st Dist. 2001).