ORIGINAL

PUBLIC

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
OFFICE OF ADMINISTRATIVE LAW JUDGES

In the Matter of	)	
LabMD, Inc., a corporation, Respondent.	)	DOCKET NO. 9357

ORDER GRANTING IN PART AND DENYING IN PART COMPLAINT COUNSEL'S MOTION FOR DISCOVERY SANCTIONS

On February 10, 2014, Complaint Counsel filed a Motion for Discovery Sanctions Against Respondent LabMD, Inc. for Failing to Comply with Discovery Obligations ("Motion"). Respondent LabMD, Inc., ("Respondent" or "LabMD") filed an opposition to the Motion on February 20, 2014 ("Opposition"). By Order issued February 20, 2014, Complaint Counsel was directed to file a reply and Respondent was permitted to file a surreply. Complaint Counsel filed its Reply on February 24, 2014 and Respondent filed its Surreply on February 25, 2014. In addition, on February 27, 2014, the Office of the Administrative Law Judges ("OALJ") requested the parties to provide OALJ, by e-mail, an updated status report on the discovery dispute. Each party provided an updated status report on March 5, 2014 ("Status Report").

As explained more fully below, the Motion is GRANTED IN PART AND DENIED IN PART.

I. Introduction

On January 10, 2014, an Order was issued granting Complaint Counsel's Motion to Compel responses to Complaint Counsel's interrogatories (Interrogatories 1, 2, and 9) and document requests (Document Requests 3, 4, 13, 21, 27, and 28) (hereafter, "January 10 Order"). The January 10 Order overruled Respondent's objections to the subject discovery requests, and ordered Respondent to provide the requested discovery by January 22, 2014. It is undisputed that Respondent did not produce all the subject discovery by January 22, 2014. It is also undisputed that Respondent made several document productions after the Motion was filed, including on February 20, 25, and 26, 2014, and on March 4, 2014.

Complaint Counsel's Motion asserted that Respondent had failed to fully comply with any of the discovery requests addressed in the January 10 Order; however, Complaint Counsel's Reply stated that Respondent's discovery responses remained deficient under the January 10

Order only as to Interrogatories 1, 2, and 9, and Document Requests 13, 21, and 28.[1]

According to Complaint Counsel's Status Report, Respondent submitted additional documents after Complaint Counsel submitted its Reply, including on February 25 and 26, 2014, and March 4, 2014, that "may be" responsive, *inter alia*, to Interrogatory 9 and Document Requests 13, 21, and 28, but that "it is difficult to assess" whether Respondent is in compliance with the January 10 Order as to these discovery requests. Complaint Counsel further stated in its Status Report that Respondent's answer to Interrogatory 2 remains deficient.

Respondent denies that its response to Interrogatory 2 is deficient and further asserts that, to the best of its knowledge, as of its most recent production on March 4, 2014, Respondent has fully complied with its obligations. Respondent also states that, to the best of its knowledge, it has produced all documents in its possession that are responsive to Interrogatory 9 (requesting, for each month from May 2008 through 2010, the cost of any changes to Respondent's security practices) and Document Request 28 (requesting documents showing Respondent's annual revenues, profits, and IT-related expenditures).

Complaint Counsel contended in its Reply that Respondent's production of documents in response to Document Request 13, which seeks "all internal and external assessments of LabMD's Security Practices," was incomplete, based upon deposition testimony of certain LabMD employees as to the existence of responsive documents that had not yet been produced. Respondent responded in its Surreply that Respondent supplied the documents referenced in these depositions on February 25, 2014, and that its obligations have, therefore, been met as to this Document Request.

Complaint Counsel's Document Request 21, as modified by the January 10 Order, required Respondent to produce documents describing the duties, job descriptions, and negative job evaluations of certain employees in LabMD's information technology ("IT") department. Respondent states that it produced responsive documents as to seven such employees. Respondent states that negative evaluations, written duties, or written job descriptions do not exist for the five employees identified by Complaint Counsel, but that, on February 25, 2014, it did produce employee agreements for two of the five identified employees, as well as the job advertisement used to hire one of the five. In its Status Report, Complaint Counsel states that Respondent's recent productions have brought Respondent into compliance with its discovery obligations as to Document Request 21.

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[1] Complaint Counsel's Reply also refers to an allegedly deficient response to Document Request 23. However, Document Request 23 was not part of the January 10 Order, and was not addressed in Complaint Counsel's Motion. Accordingly, it will not be addressed as part of the Motion for Sanctions. In addition, Complaint Counsel's Status Report refers to allegedly deficient responses to Document Requests 3, 4, and 27. Specifically, Complaint Counsel states that certain documents produced on February 26, after Complaint Counsel filed its Reply, are insufficient as to Document Requests 3, 4 and 27, because the time period was limited to May 2008 through 2010, rather than January 1, 2006 through December 31, 2013. This issue also will not be addressed in the context of this Motion for Sanctions. Complaint Counsel's assertion in its Status Report of deficiencies in Respondent's responses to Document Requests 3, 4 and 27, is contrary to Complaint Counsel's Reply, which clearly excluded these Document Requests from the universe of alleged deficient responses. An e-mailed status report to the Administrative Law Judge is not an appropriate or effective way to materially alter a position previously taken in a filed pleading.

Complaint Counsel proposes an order barring Respondent from introducing into evidence at trial, or otherwise relying upon, any "improperly withheld or undisclosed materials, witnesses, or other discovery"; and barring Respondent from objecting to the introduction and use of "secondary evidence to show what the withheld documents or other evidence would have shown." Proposed Order at 2. In addition, Complaint Counsel's proposed order requests certain "adverse inferences," as follows:

1. Respondent's failure to produce and/or identify internal and external assessments of Respondent's security practices establishes that Respondent's information security practices failed to provide reasonable and appropriate security for personal information on its computer networks. This failure also establishes that Respondent did not use readily available measures to identify commonly known or reasonably foreseeable security risks and vulnerabilities on its networks.

2. Respondent's failure to provide information about the cost of changes to its security practices (for the period May 2008 to 2010) establishes that Respondent did not correct its security failures at relatively low cost using readily available security measures.

3. Respondent's failure to fully specify the types of personal information that employees had access to establishes that Respondent did not use adequate measures to prevent employees from accessing personal information not needed to perform their jobs.

4. Respondent's failure to fully provide information about the purchasing, maintaining, servicing, updating or replacing of its hardware and software establishes that Respondent failed to maintain and update operating systems of computers and other devices on its networks.

Complaint Counsel's Proposed Order at 1-2, attached to Motion for Sanctions.[2]

[2] Complaint Counsel's Motion was based upon Respondent's failure, as of February 10, to produce any discovery required under the January 10 Order, and sought adverse inferences as sanctions. In its Status Report, however, Complaint Counsel attempts to modify its proposed order, requesting only a portion of adverse inference number 4, above, and proposing entirely different sanctions for alleged prejudice caused by the delay in Respondent's completing its discovery obligations under the January 10 Order. *See, e.g.*, Complaint Counsel's Status Report at 6 (requesting as a consequence for delayed production of documents showing the duties, salaries, and negative evaluations of certain employees named on Complaint Counsel's Preliminary Witness List, that Respondent be estopped from arguing that such individuals failed to perform their duties in accordance with LabMD's expectations); Complaint Counsel's Status Report at 7 (requesting, as a consequence of late production of documents regarding the cost of any changes made to Respondent's security practices, that Respondent be estopped from using late produced documents to argue that Respondent made expenditures to change its data security practices, and that Respondent be estopped from arguing that it made any such expenditure not identified in the produced documents); *see generally* Status Report (requesting that Respondent be estopped from using any documents that were not produced by March 5, 2014). These alternative proposed sanctions will not be considered. As explained in footnote 1, an e-mailed status report is not an appropriate, or effective, method to materially alter the sanctions that Complaint Counsel requested in its Motion.

II. Applicable law

The authority to impose discovery sanctions is delineated by Commission Rule 3.38(b), which states in pertinent part:

> If a party or an officer or agent of a party fails to comply with any discovery obligation imposed by these rules, upon motion by the aggrieved party, the Administrative Law Judge or the Commission, or both, may take such action in regard thereto as is just, including but not limited to the following:
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> (1) Order that any answer be amended to comply with the request, subpoena, or order;
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> (2) Order that the matter be admitted or that the admission, testimony, documents, or other evidence would have been adverse to the party;
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> (3) Rule that for the purposes of the proceeding the matter or matters concerning which the order or subpoena was issued be taken as established adversely to the party;
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> (4) Rule that the party may not introduce into evidence or otherwise rely, in support of any claim or defense, upon testimony by such party, officer, agent, expert, or fact witness, or the documents or other evidence, or upon any other improperly withheld or undisclosed materials, information, witnesses, or other discovery;
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> (5) Rule that the party may not be heard to object to introduction and use of secondary evidence to show what the withheld admission, testimony, documents, or other evidence would have shown;
>
> (6) Rule that a pleading, or part of a pleading, or a motion or other submission by the party, concerning which the order or subpoena was issued, be stricken, or that a decision of the proceeding be rendered against the party, or both.

16 C.F.R. § 3.38(b).

The adverse inference rule "provides that when a party has relevant evidence within his control which he fails to produce, that failure gives rise to an inference that the evidence is unfavorable to him." *Matter of International Telephone & Telegraph Corp.*, 104 F.T.C. 280, 1984 WL 565367 at **125 (July 25, 1984).

> As Professor Wigmore has said: ". . . The failure to bring before the tribunal some circumstance, document, or witness, when either the party himself or his opponent claims that the facts would thereby be elucidated, serves to indicate, as the most natural inference, that the party fears to do so, and this fear is some evidence that the circumstance or document or witness, if brought, would have exposed facts unfavorable to the party. These inferences, to be sure, cannot fairly be made except upon certain conditions; and they are also always open to explanation by

> circumstances which make some other hypothesis a more natural one than the party's fear of exposure. But the propriety of such inference in general is not doubted."

Int'l Union, United Auto. v. NLRB, 459 F.2d 1329, 1335-36 (D.C. Cir. 1972).

"Rule 3.38 is designed both to prohibit a party from resting on its own concealment and to maintain the integrity of the administrative process." *In re Grand Union Co.*, 102 F.T.C. 812, 1983 FTC LEXIS 61 at *594 (July 18, 1983). Thus, the explanation for a party's failure to comply with a discovery order "is crucial in determining whether to invoke the sanctions." *Id.* Sanctions may be imposed for failing to comply with a discovery order where the failure to comply was "unjustified and the sanction imposed 'is reasonable in light of the material withheld and the purposes of Rule 3.38(b).'" *ITT*, 1984 WL 565367 at **127 (quoting *Grand Union*, 1983 FTC LEXIS 61 at *595). With respect to the requirement that an imposed sanction be reasonable, it has been held that an "adverse ruling is a severe sanction," which should be imposed only in "extraordinary circumstances." *ITT*, 1984 WL 565367 at **127; *Grand Union*, 1983 FTC LEXIS 61 at *595.

III. Analysis

Interrogatory 2 requested Respondent to identify the types of personal information to which each of its employees were permitted access via LabMD's computer network. Complaint Counsel asserts that the responses provided by Respondent are insufficiently specific because Respondent noted only that its various employees had "various levels of access" to various types of personal information, and did not specify the types of personal information to which each such employee had access, as requested by the Interrogatory. Respondent replies that it cannot provide the specificity demanded by Complaint Counsel. In support of this contention, Respondent points to deposition testimony of LabMD employees tending to show that, while employees knew they had limited access to personal information, they could not specify the exact types of personal information that were within, or beyond, the employees' ability to access. Respondent concludes that its responses correspond to the information it has, and that answering further would require it to "fabricate and speculate" as to each employee's specific access to particular personal information. Complaint Counsel responds that, to the extent LabMD lacks the information necessary to respond further to Interrogatory 2, it should submit a response expressly stating that it is unable to answer Interrogatory 2 fully, to specify the reasons therefor, and to describe its efforts made to locate the requested information, as set forth in Complaint Counsel's Interrogatories Instruction No. 6.

Complaint Counsel argues that Respondent's failure to timely comply with the January 10 Order warrants the requested sanctions because of the breadth of the failure, the relevance of the requested discovery, the lack of any adequate justification, and resulting prejudice to Complaint Counsel. Specifically, Complaint Counsel states that Respondent's delays in producing discovery have forced Complaint Counsel to proceed with "key" nonparty depositions without the benefit of full discovery, and that such depositions have now been completed.

Respondent argues that sanctions are inappropriate because it has acted in good faith, has worked diligently to comply, and has complied. Respondent argues that exigent circumstances

prevented it from timely complying with the January 10 Order, because in January 2014, LabMD began to wind down its operations, and currently employs only two persons, one of which is LabMD's CEO, Michael Daugherty, and that only Mr. Daugherty is capable of responding to Complaint Counsel's discovery requests. Opposition Exh. 1 (Declaration of Michael Daugherty ¶¶ 2-4). Complaint Counsel replies that LabMD's operating status does not excuse Respondent's failure to timely produce discovery required under the January 10 Order.

The record shows that Respondent failed to comply with its discovery obligations under the January 10 Order by failing to meet the January 22, 2014 deadline set forth therein. An appropriate sanction for this failure is to bar Respondent from introducing into evidence at trial, or otherwise relying upon, any improperly withheld or undisclosed materials, witnesses, or other discovery. To this extent, Complaint Counsel's Motion is GRANTED.[3]

However, Complaint Counsel has failed to demonstrate that its requested adverse inferences are appropriate sanctions for Respondent's conduct, and to this extent, Complaint Counsel's Motion is DENIED. It appears from the submissions of the parties that Respondent provided "rolling" productions of discovery required under the January 10 Order and completed its obligations thereunder as of March 4, 2014. Thus, Complaint Counsel has failed to demonstrate that Respondent is presently in violation of its discovery obligations to Complaint Counsel under the January 10 Order, although Respondent will be required to supplement its answer to Interrogatory 2, as directed below. The purpose of a motion for sanctions is "to induce parties to supply [requested discovery]." *ITT*, 1984 WL 565367 at **127. In this regard, Complaint Counsel's Motion has had the intended effect. Therefore, the severe sanction of adverse inferences, as requested by Complaint Counsel, is not reasonable in light of the purpose of Rule 3.38(b). *Id.* In addition, Complaint Counsel has failed to sufficiently demonstrate that Respondent's delay in completing its discovery obligations will prejudice Complaint Counsel in preparing its case.[4] Moreover, based on the submissions of the parties, it cannot be concluded that Respondent's delay was unjustified; or that its conduct was willful or taken in bad faith. In short, there are no extraordinary circumstances present that justify the severe sanction of adverse inferences. *See ITT*, 1984 WL 565367 at **127. For all these reasons, Complaint Counsel has failed to demonstrate that it is entitled to the adverse inferences requested in its Motion.

IV. Conclusion

Accordingly, for the reasons set forth above, Complaint Counsel's Motion for Sanctions is GRANTED IN PART, and it is hereby ORDERED that: (1) Respondent may not introduce into evidence or otherwise rely, in support of any claim or defense, upon any improperly withheld or undisclosed materials, witnesses, or other discovery; and (2) Respondent shall, by March 17, 2014, supplement its answer to Interrogatory 2 to confirm Respondent's assertions in the filings on this matter that Respondent is unable to answer Interrogatory 2 more fully than it

[3] Given that Respondent will be barred from relying on, among other things, any undisclosed documents, it is redundant to further bar Respondent from arguing that undisclosed documents constitute the best evidence. Thus, this proposed sanction of Complaint Counsel's is rejected as unnecessary.

[4] Complaint Counsel has not requested any extension in the discovery deadline in order to take further deposition testimony from previous deponents, in relation to documents produced after their depositions.

has and to specify the reasons therefor and the efforts undertaken to obtain the information requested.

Complaint Counsel's Motion is, in all other respects, DENIED.

ORDERED:

D. Michael Chappell
Chief Administrative Law Judge

Date: March 10, 2014