

In *KCI USA, Inc. v. Healthcare Essentials, Inc.*, 2020 WL 260429 (6th Cir. Jan. 16, 2020), the U.S. Court of Appeals for the Sixth Circuit reversed and remanded a sanctions award levied against a law firm and three of its attorneys because the law firm's liability was largely based on the conduct of the individual attorneys, all of whom were denied due process.

In 2014, plaintiff filed a complaint against a group of defendants, including Healthcare Essentials, Inc., alleging deceptive trade practices, conversion, unfair competition and tortious interference with prospective business relationships. *Id.* at *1. Plaintiff claimed that defendants "engaged in a pattern of theft and fraud with respect to [plaintiff's] VAC wound therapy systems." At various stages of this "hotly contested" litigation, the district court found numerous discovery abuses, including "egregious acts such as throwing [plaintiff's] property into a dumpster, lying to the court, failing to turn over thousands of responsive emails, fabricating requested spreadsheets, creating fake invoices, and deleting information on electronic devices, among other discovery violations." *Id.* (internal quotation marks omitted). The focus of the appeal, however, centered on the involvement of one law firm (the Firm) and three of its attorneys.

The Firm represented Healthcare Essentials and was involved "from the filing of the answer in 2014 until April 2016, when it withdrew as counsel." Litigation was "contentious," and the district court twice had to intervene during discovery, issuing two orders to Healthcare Essentials to produce plaintiff's requested discovery. When Healthcare Essentials failed to comply with the orders, plaintiff twice moved for sanctions against Healthcare Essentials and the Firm.

Two years into the litigation, the Firm stated that it became aware of defendants' fraud and theft. Emails showed a connection between Healthcare Essentials' owner (the owner) and a former plaintiff employee who was purportedly stealing VAC devices for the owner. The owner thereafter sent the Firm a letter firing it, "explicitly invoking the Fifth Amendment right against self-incrimination" and prohibiting the Firm from disclosing the emails. The Firm then sought to withdraw as counsel on the grounds of an "irreconcilable conflict with its client." But the Firm "did not attach the emails to the brief or disclose the ongoing crime, believing it couldn't" because of the owner's invocation of the Fifth Amendment.

In April 2016, the district court allowed the Firm to withdraw, but stated that the Firm "may be called upon to clarify, explain, or justify its prior actions as counsel in this case."

Plaintiff filed a motion to show cause after Healthcare Essentials, now represented by new counsel, failed to comply with a preliminary injunction. The district court held a status conference with counsel only, but the Firm, no longer counsel of record, did not attend. During the conference, the new counsel placed blame on the Firm for discovery misconduct. The district court thus, instructed that the Firm should appear at the next status conference.

At the second conference, with the Firm's counsel present, the court asked one of the Firm's counsel about its handling of the discovery issues and the fraudulent discovery production. After the second conference, plaintiff sought discovery from the Firm regarding the discovery violations, and the Firm then filed a second *ex parte* brief, attaching the troubling emails. At a telephone status conference that addressed Healthcare Essentials' continuing violation of the injunction and other discovery abuses, a Firm attorney testified regarding the Firm's involvement in a falsified spreadsheet Healthcare Essentials had produced.

A few months later, plaintiff finally received “the mirrored hard drive of [the owner’s] computer,” which revealed the extent of the fraud and theft. Plaintiff then filed a second motion to show cause, which primarily concerned “deletion of information stored on various electronic devices, failure to turn in electronic devices, and submission of false spreadsheets,” but did not mention the Firm, its attorneys or any of the Firm’s conduct.

A year later, after a delay caused in part by a criminal trial against the officer, the court held a hearing on plaintiff’s second-filed motion to show cause. Hours before the hearing, plaintiff filed a bench brief attacking the Firm’s attorneys and their conduct, but did not seek sanctions from the individual attorneys or name them in the brief. In response, the Firm filed a short brief and supporting affidavit stating that it was ready to defend itself. None of the Firm’s attorneys appeared at the hearing, but plaintiff repeatedly raised the Firm’s conduct during the course of the hearing.

Following the hearing, plaintiff sought monetary sanctions against the Firm — but not against the individual attorneys — attacking much of the same behavior discussed at the hearing. The Firm filed an opposition to plaintiff’s motion for sanctions, requesting an evidentiary hearing. In its reply brief, plaintiff, for the first time and in a footnote, mentioned that it was seeking sanctions against not only the Firm, but the individual attorneys as well.

The district court issued a sanctions order without holding another hearing, finding the Firm and the individual attorneys responsible for the discovery violations referenced in plaintiff’s motion. Ultimately, the district court, relying on its inherent powers, determined based on a damages hearing that plaintiff was entitled to \$365,200.67 in attorneys’ fees and costs against the Firm and two of the attorneys and \$290,488.30 against the third, all on a joint and several basis. After the district court denied their motion for reconsideration, the Firm and the individual attorneys lodged separate appeals.

On appeal, the individual attorneys’ primary argument was denial of due process. *Id.* at *3. At the outset of its analysis, the Sixth Circuit explained that while attorneys can be sanctioned under Fed. R. Civ. Pro. 26(g)(3) and 37(b)(2)(C), 28 U.S.C. § 1927, and the district court’s inherent powers, due process concerns mandate that they receive notice and an opportunity to be heard.

With respect to notice, “[w]hile formal notice detailing the penalties is not required, [plaintiff] or the court had to provide notice that sanctions were being sought against the individual attorneys and not just the firm.” *Id.* (internal quotation marks omitted). In the Sixth Circuit’s view, plaintiff’s mention of the individual attorneys in a footnote in its reply brief, where previous filings and allegations had been directed at the Firm, was “not sufficient notice.” Nor were previous admonitions from the district court or plaintiff’s prior allegations because they were directed only to Healthcare Essentials or the Firm. As the Sixth Circuit put it, “[i]t is one thing to believe your firm is going to be sanctioned and required to pay attorney’s fees and costs. It is quite another to be informed that you — individually — could be on the hook for the sanctions.”

On the question of whether the individual attorneys had had an opportunity to be heard, the Sixth Circuit explained that “[d]ue process does not mandate a full evidentiary hearing before the imposition of sanctions,” but “a party or attorney facing sanctions must still have a meaningful opportunity to respond to the allegations against them.” *Id.* at *4. Had the attorneys been afforded an opportunity to file individual briefs in response to plaintiff’s sanctions motion, that “could have

provided the procedural safeguards necessary here.” But because the individual attorneys were not implicated until plaintiff mentioned them in a footnote in its reply brief, they were afforded no such opportunity.

Ultimately, the Sixth Circuit concluded that because the individual attorneys were not afforded notice or an opportunity to be heard and because due process rights afforded to the Firm could not be imputed to the individual attorneys, “the imposition of sanctions in this manner deprived the individual attorneys of due process.” With respect to the sanctions levied against the Firm, the Sixth Circuit determined that “[b]ecause we are remanding to the district court to allow the individual attorneys to file, at the very least, responsive briefing, we necessarily have to remand the [Firm’s] appeal, since the [F]irm’s liability turns, in large part, on the individual attorneys’ conduct.”