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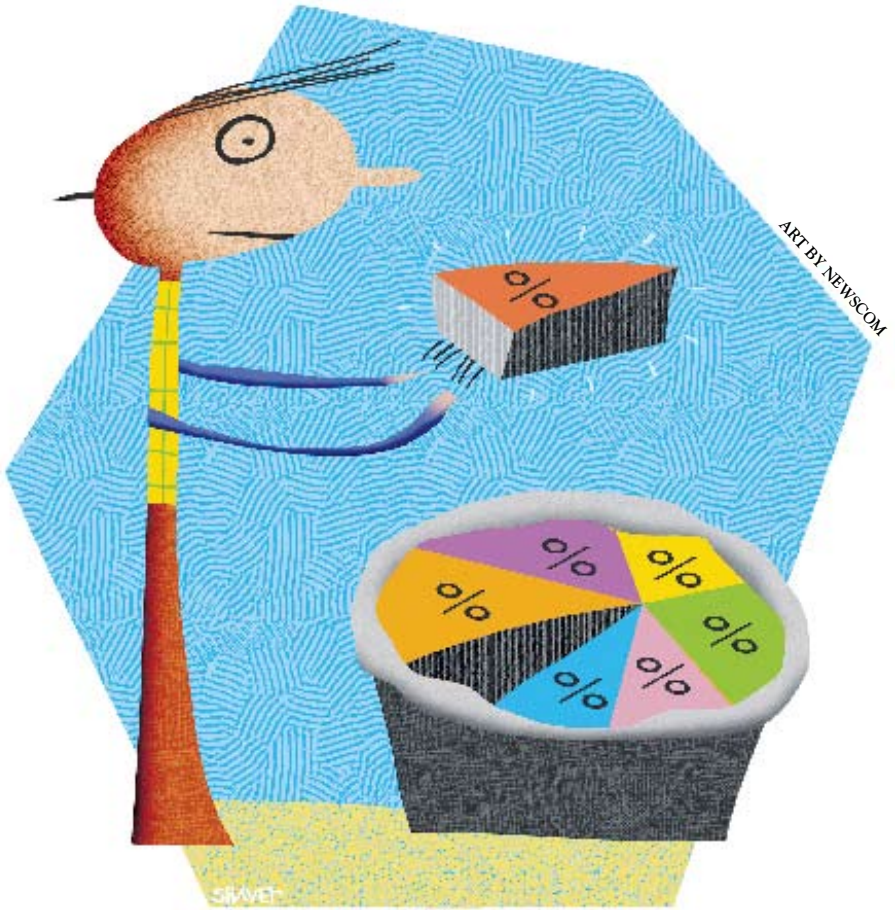
Whose Fault Is It Anyway?

Relative causation, the 51% rule, and other state law principles.



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BY ROBIN A. HENRY

HIGH STAKES litigation is increasingly being brought under state law, rather than under the federal securities laws. For instance, state law governs claims of improper margin calls on leveraged trades. Similarly, claims contesting the enforceability of credit default swaps and other forms of credit protection are being framed under state law (e.g., the failure of the underlying instrument was a result of misrepresentations with respect to the collateral or the deal structure).

Such litigation often raises difficult damages and causation questions. What caused the loss at issue? Was it, as the plaintiff claims, defendant's conduct? Or was it, as defendants typically argue, the plaintiff's own conduct (its failure to appropriately manage against the risk) or a broader change in market conditions (a change in interest rates or downturn in the housing market)?

This article highlights the significance of three core state law principles (comparative fault, relative causation and imputation) to these questions.

Comparative Fault

Most, although not all, states have abandoned strict contributory fault in favor of comparative fault schemes.

As a general matter, comparative fault permits a plaintiff to recover such of its damage that does not result from its own conduct, whereas contributory fault bars any recovery where the plaintiff is at all responsible for its losses. Under the tort reform laws of many states, however,

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a plaintiff recovers nothing if, including any imputed conduct, it is more than 50 percent at fault for its damage (the "51 percent Rule").[1] Many comparative fault states do not have such a rule (e.g., New York), but many do (e.g., Connecticut and New Jersey) and there are important differences even within those states that have adopted a 51 percent Rule.

Differences between the states' 51 percent Rules include the theories of relief to which they apply: Connecticut's comparative fault statute applies by its terms only to "causes of action based on negligence"[2] and explicitly precludes its application to causes of action sounding in breach of fiduciary duty or fraud,[3] whereas the New Jersey Comparative Negligence Act applies to negligence actions "whether couched in terms of contract or tort and like theories."[4]

Another key question is to whom fault can be apportioned. Connecticut law permits the apportionment of fault by and between "each party whose negligent actions were a proximate cause of the injury, death or damage to property including settled or released persons"[5] as well as parties added solely for apportionment purposes.[6] New Jersey law similarly allows the apportionment of fault among all "persons against whom recovery is sought" or "all parties to a suit." N.J. Stat. Ann. §2A:15-5.1; §2A:15-5.2(a)(2).

In contrast, New York appears to allow apportionment to non-parties.[7]

Another important difference concerns the treatment of judgment-proof defendants. For example, Connecticut's comparative fault statute directs that if any liable defendant is judgment-proof, that defendant's share of the judgment will be reapportioned to the other liable defendants based on their respective share of the fault.[8] In contrast, the comparative fault schemes of New York and New Jersey do not distinguish between judgment-proof and non-judgment proof defendants.[9]

Because 51 percent Rules provide an avenue for limiting, and potentially eliminating, liability, parties to state law litigation should analyze how best to position the case to obtain (or avoid) such a result. Parties to state law suits should thus consider choice-of-law issues that may give rise to the application of a 51 percent Rule, including whether the case can or should be positioned for an early ruling on choice of law. As noted above, there are substantial differences between the 51 percent Rules of those states that have them, which should be considered in any such choice-of-law analysis.

Relative Causation

Equally important to a strategy of obtaining or avoiding a "zero damages" result are principles of "relative causation," which allow the finder of fact to divide a plaintiff's damage among various causes.[10] Relative causation and comparative fault are related but distinct methods of allocating responsibility for a single harm to multiple sources.

Relative causation is a common law, causation-based defense that allows a defendant to demonstrate that discrete portions of plaintiff's injury are attributable to ***causes*** other than the defendant's conduct in order to limit the portion of plaintiff's total damage for which the defendant can be held responsible. Comparative fault, on the other hand, seeks to determine the relative ***fault*** of the parties for the plaintiff's harm.

Importantly, many of the limitations that apply in the context of comparative fault, such as limitations on those to whom fault can be allocated and on what claims, do not apply to determinations of relative causation.

While relative causation and comparative fault principles may be applied separately, they are not mutually exclusive.[11] In the circumstance where damages are indivisible or have been divided by cause into such component pieces as far as reasonable, the fact finder then applies principles of comparative fault, including any applicable 51 percent Rule, to the indivisible whole or to each component part of damage.

The interaction of these two doctrines, comparative fault and relative causation, and their potential implication for damages raises important strategic considerations for parties to any litigation in which they apply.

An initial question is how best to characterize the claims at issue. Consider, for instance, a hypothetical common law claim arising out of the current credit crisis: Plaintiff is an investor in, or guarantor of, some form of asset-backed security that has declined substantially in value; defendant "sold" the investment at issue.

The plaintiff argues that defendant misrepresented the underlying collateral at the time of the sale, but perhaps concedes that some amount of the value decline is due to a change in market conditions. The defendant argues that a change in market conditions is substantially to blame for plaintiff's losses and, to the extent any issues exist with respect to the collateral, plaintiff's failure to conduct due diligence makes it at fault for its own losses.

Is it more advantageous for either party to quantify that portion of the plaintiff's losses caused by neutral, non-actionable causes (e.g., a change in market conditions), leaving a residual piece on which fault would then be allocated? Such an approach reduces the defendant's overall exposure, but potentially isolates a piece of damage with respect to which the defendant has a lesser ability to meet the 51 percent threshold that would result in a zero damages verdict. The more damage that is "backed out" that could otherwise arguably have been characterized as allocable to the plaintiff's fault, the less conduct there is to count toward the 51 percent and the less likely a zero damages verdict.

Strategy Determinations

A variety of factors implicate whether it is more advantageous—for either party—to separate out and isolate the effect of the allegedly wrongful conduct versus treating the plaintiff's claimed damages as incapable of separation by cause.

While the answer will vary from case to case, the following should be considered:

(1) the size of the total damage claim;

(2) the size of the damage claim that can safely be isolated as allocable to the alleged wrongdoing; and

(3) the clarity of the line between the allegedly wrongful conduct on the one hand and innocent causal factors on the other.

Where the size of the total damage claim is

unmanageably large, the defendant may want to consider an approach to damage that seeks to take portions of it "off the table" through arguments of relative causation. Although this may isolate a portion of damage as to which the defendant has less opportunity to obtain a zero damages result, such an approach may be preferable to a high stakes gamble on the entire claim.

If, however, the isolated component of damage is itself unmanageable, or, alternatively, the damage claim in full is manageable, a defendant may prefer to pursue the higher risk, but higher reward approach of foregoing any arguments of divisibility. In reverse, a plaintiff may want to consider whether to concede that some limited portion of its losses was caused by market forces or non-actionable conduct, in an effort to negate a central element of defendant's zero damage argument.

Another factor to consider in analyzing whether to argue for a causal divide, or which divides to argue for, is the clarity of the proposed division (the "firewall" between the actionable and non-actionable components of loss). Any decision to pursue causal divides should take account of the extent the firewall between the potential divides is porous.

In theory, if there truly are no defensible causal divides, the ultimate damage award should be unaffected by the decision to pursue an indivisible versus divisible approach to damage. In practice, however, firewall problems may play less of a role in a damage award under an indivisible damage approach insofar as the defendant may be able to use the 51 percent Rule to its advantage simply by including such issues as part of the overall mix of factors that go into the fault determination. A divisible approach, in contrast, permits a plaintiff to argue that defendant is at least partially at fault even for components of damage it seeks to entirely remove from the case.

Imputation

Another important consideration with respect to the 51 percent Rule is the extent to which individual conduct is imputed to the plaintiff. Only imputed conduct counts for purposes of the rule.

In this regard, it is important to note that a zero damages result obtains not when the defendant is less than 50 percent at fault for the claimed damage, but rather when the plaintiff, including all conduct imputed to it, is more than 50 percent at fault. The allocation of fault to a non-imputed party thus lessens the likelihood of a zero damages finding under the 51 percent Rule.

On the hypothetical case set out above, a defendant might consider whether the law permits it to argue that certain non-parties, perhaps the ratings agencies, were at fault for some amount of the plaintiff's losses, recognizing that any such allocation could make it more difficult to meet the 51 percent Rule threshold as regards the plaintiff's own fault.

Questions of imputation turn on state agency law,[12] which can differ widely from state to state. The applicable standards of imputation should be evaluated prior to the development of a discovery record since the determination of imputation is intensely fact-driven.

Issues of fault potentially assignable to non-imputable parties also implicate tactical questions of whether to allege claims against such individuals, be they in the form of direct claims, cross- or counterclaims or through an apportionment proceeding aimed solely at the allocation of fault. To the extent the finder of fact is forced, by virtue of claims having been asserted, to make an affirmative decision regarding whether an individual's conduct is imputable, it might reduce the likelihood of such a result.

Conclusion

These principles provide a powerful mechanism for reducing and potentially eliminating damages in cases brought under state law. The differences between state laws are substantial and should be considered both at the outset of litigation and during the development of the case to insure that the parties position the litigation to take advantage of, or avoid, such arguments.

1. The 51 percent Rule does not apply to federal securities claims. See, e.g., §11(e) of the Securities Exchange Act of 1933.
2. Conn. Gen. Stat. §52-572(h)(b).
3. Conn. Gen. Stat. §52-572(h)(k) and §52-572h(o). See also *Town of Monroe v. Underground Constr. & Survey Inc.*, 2004 WL 1193692 (Conn. Super. 2004) (rejecting defense of comparative negligence to breach of contract claim under Connecticut law because "by its own terms, the comparative negligence statute applies only to causes of action based on negligence").
4. N.J. Stat. Ann. §2A:15-5.2(c)(1).
5. Conn. Gen. Stat. §§52-572h(b), (f).
6. Conn. Gen. Stat. §52-102b. Importantly, any apportionment complaint must be served within 120 days of the return date specified in the complaint. Id. at §52-102b(a). See also *Lostritto v. Community Action Agency of New Haven*, 848 A.2d 418, 428 (Conn. 2004) (120-day requirement is mandatory and is a substantive limitation on the right to apportionment).
7. See *McKenna v. New York*, 492 N.Y.S.2d 805 (2d Dept. 1985); *Scibelli v. Herman*, 856 N.Y.S.2d 126 (2d Dept. 2008).
8. See §52-572h(g).
9. However, under the New Jersey comparative fault statute, any defendant at fault for at least 60 percent of the total damages is jointly and severally liable for the damage award. N.J. Stat. Ann. §2A:15-5.3(a).
10. See, e.g., Restatement (Third) of Torts: Apportionment of Liability §26 and Restatement (Second) of Torts §433A.
11. See Restatement (Third) of Torts: Apportionment of Liability §26.
12. See *O'Melveny & Myers v. FDIC*, 512 U.S. 79, 84-85 (1994).