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2003

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Recommended Citation
2002-2003 Preview U.S. Sup. Ct. Cas. 124 (2002-2003).

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Case at a Glance

The Supreme Court has agreed to review the constitutional limits on punitive damages awards in a case in which the respondents won a verdict for $1 million in compensatory damages and $145 million in punitive damages from State Farm Mutual Automobile Insurance Company. On appeal, State Farm argues that the Utah courts were improperly punishing it for alleged misconduct that occurred outside the borders of the state of Utah and that therefore the punitive damages award went well beyond Utah's interest in punishing and deterring misconduct in Utah and protecting Utah citizens.

When Is a Court "Punishing" Out-of-State Conduct Rather Than Merely "Considering" Such Conduct?

by Rachel A. Van Cleave

PREVIEW of United States Supreme Court Cases, pages 124–130. © 2002 American Bar Association.

Rachel A. Van Cleave is a professor of law at Texas Tech University School of Law and is completing an article entitled "Death is Different"—Is Money Different? Criminal Punishments, Forfeitures, and Punitive Damages: Shifting Paradigms for Assessing Proportionality"; Rachel.VanCleave@law.ttu.edu or (806) 742-3990, ext. 271.

ISSUES

Did the Utah Supreme Court incorrectly interpret and apply *BMW of North America, Inc. v. Gore,* 517 U.S. 559 (1996), when it relied, in part, on the defendant's out-of-state conduct to bolster its decision to reinstate a punitive damages award of $145 million?

Is a punitive damages award that is 145 times greater than the award of compensatory damages "grossly excessive" in violation of the due process clause of the Fourteenth Amendment?

FACTS

This case has its roots in an automobile accident that occurred on May 22, 1981, more than 20 years ago. Curtis Campbell unsafely passed a car driven by Robert Slusher, forcing another car, driven by Todd Ospital, to veer onto the shoulder of the road and collide with Slusher's car. Ospital died at the scene and Slusher was left disabled. Campbell was insured by State Farm Mutual Automobile Insurance Company, and his policy provided $25,000 of coverage for each person injured in an accident, up to a maximum of $50,000 of coverage per accident.

Slusher sued both Campbell and Ospital's estate. Ospital then asserted a cross-claim against Campbell. Slusher entered into a settlement agreement with Ospital's estate. The attorneys for Slusher and for Ospital's estate offered to settle their claims against Campbell with State Farm for the policy limits. State Farm, however, refused to settle and continued to reject settlement offers made until the lawsuit by Slusher and Ospital began. The facts as described by the Utah Supreme Court indicate that one of State Farm's investigators had submitted a report stating that there was evidence that Campbell was at fault. State Farm rejected this

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DOCKET NO. 01-1289

ARGUMENT DATE:
DECEMBER 11, 2002
FROM: SUPREME COURT OF UTAH

report and ordered its investigator to change his description of the accident and his conclusion that the claims against Campbell were strong. *Campbell v. State Farm Automobile Insurance Co.,* 2001 UT 89, P5.

State Farm hired an attorney, Wendell Bennett, who had done work for State Farm in the past, to represent the Campbells. Bennett reassured both Campbell and his wife, Inez Campbell, on numerous occasions that they did not need to seek separate counsel, that he would represent their interests, and that their assets were safe. The case against Campbell then went to trial and the jury, finding Campbell 100 percent at fault for the accident, awarded Slusher $135,000 and Ospital's estate $50,849. These awards exceeded Campbell's policy limit of $50,000. After the verdict, State Farm refused to post a bond, pending appeal, in excess of the policy limit, and Bennett suggested to the Campbells that they put "for sale" signs on their property, making it clear that State Farm would not pay the excess judgment against the Campbells.

The Campbells then retained other counsel and entered into an agreement with Slusher and Ospital that provided, in part, that Slusher and Ospital would not seek satisfaction on their judgment against the Campbells. In exchange, the Campbells would pursue a bad faith action against State Farm and pay a portion of any money recovered from State Farm to Slusher and to Ospital's estate. After the Utah Supreme Court affirmed the judgment against Campbell in *Slusher v. Ospital,* 777 P.2d 437 (Utah 1989), State Farm paid the entire award to Slusher and Ospital.

Shortly after State Farm paid the judgments against Campbell, the Campbells filed this action against State Farm alleging bad faith, fraud, intentional infliction of emotional distress, and a claim for punitive damages.

At the request of State Farm, the trial court "bifurcated" the trial into two phases. In phase one, the jury determined that State Farm had acted unreasonably and in bad faith when it failed to settle the claims against Campbell because there was a substantial likelihood that a verdict against him would exceed his policy limits. At the conclusion of phase two, the jury awarded the Campbells $2.6 million in compensatory damages and $145 million in punitive damages. The trial court ordered a remittitur of the awards to $1 million in compensatory damages and $25 million in punitive damages. The trial court stated that it remitted the punitive damages award because it believed that state precedent placed a legal limit on the ratio of punitive damages to compensatory damages. On appeal, the Utah Supreme Court reinstated the $145 million punitive damages award against State Farm after reviewing the issue of excessiveness under a *de novo* standard pursuant to *Cooper Industries, Inc. v. Leatherman Tool Group,* 532 U.S. 424 (2001). A *de novo* standard of review does not require the reviewing court to accord any deference to the conclusion of the lower court.

State Farm petitioned the Supreme Court for review, and the Court granted certiorari on June 3, 2002.

CASE ANALYSIS

Jurisprudence from the United States Supreme Court concerning the constitutional review of punitive damages awards is relatively young. After rejecting invitations to review punitive damages awards for excessiveness under the excessive fines clause of the Eighth Amendment in *Browning-Ferris Industries of Vermont, Inc. v. Kelco Disposal, Inc.,* 492 U.S. 257 (1989), the Court hinted that perhaps the due process clause of the Fourteenth Amendment places outer limits on the size of punitive damages awards. However, the Court did not evaluate the $6 million punitive damages award in *Browning-Ferris* because the petitioner failed to raise the due process argument in the lower courts.

Two years later, in *Pacific Mutual Life Insurance Co. v. Haslip,* 499 U.S. 1 (1991), the Court evaluated the procedural safeguards used by the state court to guard against unfettered jury discretion that could lead to a punitive damages award violative of due process. Once the Court determined that the procedural protections were constitutionally sound, it briefly considered the size of the punitive damages award. Haslip's fraud action was based on the fact that an agent of Pacific Mutual had embezzled insurance premiums rather than remitting them to Pacific Mutual. As a result, Pacific Mutual cancelled Haslip's insurance and her credit was adversely affected. The trial court found that the punitive damages award was appropriate because the conduct involved "evidenced intentional malicious, gross, or oppressive fraud" and that it was necessary to deter similar conduct by insurers. *Id.* at 23. The Supreme Court pointed to these findings and noted that the $840,000 punitive damages award was four times the compensatory damages and thus "close to the line" but held that such an award did not "cross the line into the area of constitutional impropriety." *Id.* at 23-24. Thus, the court acknowledged that there *is* a constitutional line over which punitive damages awards may not cross.

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In 1993 the Court addressed another fraud claim in *TXO Production Corp. v. Alliance Resources Corp.*, 509 U.S. 443, 458 (1993), and expressly stated what it had implied in *Haslip:* the due process clause of the Fourteenth Amendment prohibits a state from imposing "grossly excessive" punishment on a tortfeasor. TXO had brought a frivolous declaratory judgment action regarding the title of certain property in an attempt to defraud Alliance Resources. However, the Court upheld the punitive damages award of $10 million, which was more than 526 times the actual damages awarded. In addition to considering the ratio of the punitive damages award to the actual damages, the Court determined that "the amount of money potentially at stake, the bad faith of [TXO], the fact that the scheme employed in this case was part of a larger pattern of fraud, trickery and deceit, and [TXO]'s wealth" supported a conclusion that the punitive damages award was not "grossly excessive." *Id.* at 462.

Most recently, and for the first time, the Supreme Court struck a punitive damages award as "grossly excessive." *BMW of North America, Inc. v. Gore,* 517 U.S. 559 (1996). In that case, BMW failed to disclose to Dr. Gore that it had repainted the car he purchased. The parties presumed that the car had been damaged while being transported between the manufacturing plant and the preparation center. Gore sued BMW for fraud based on BMW's suppression of a material fact. The jury awarded him $4,000 in compensatory damages, apparently based on evidence that the repainted car was worth 10 percent less than the value of a new car that had not been damaged or repainted. Gore argued that BMW had failed to disclose such information in about 1,000 other instances and that the jury should multiply this number by the $4,000 reduction in value to arrive at a punitive damages award of $4 million. The jury awarded Gore $4 million in punitive damages.

The Alabama Supreme Court ruled that the jury improperly included similar sales in *other states* in its calculation of punitive damages and ordered a remittitur to $2 million. The United States Supreme Court determined that even this reduced punitive damages award was grossly excessive. In reaching this conclusion, the Court stated that due process requires that a person receive fair notice of the severity of any penalty a state might impose. To evaluate the constitutionality of a particular punitive damages award, the Court considered three guideposts: "the reprehensibility of the nondisclosure; the disparity between the harm or potential harm suffered by Dr. Gore and his punitive damages award; and the difference between this remedy and the civil penalties authorized or imposed in comparable cases." 517 U.S. at 575. The Court determined that, compared to the behavior of the defendants in *TXO* and *Haslip,* BMW's failure to disclose was less reprehensible than the "deliberate false statements and acts of affirmative misconduct" present in *TXO* and *Haslip,* especially where BMW believed, in good faith, that there was no duty to disclose such information. *Id.* at 579-80. In addition, the Court pointed out that the harm Gore suffered was "purely economic," having no effect on the safety of the car. *Id.* at 576.

As to the ratio, or proportionality, of the punitive damages award to the actual harm suffered by Gore, the Court held that 500 to 1 was "dramatically greater than [the ratios] considered in *TXO* and *Haslip,*" especially in the absence of any threat of additional harm. *Id.* at 582.

The third guidepost engages the Court in a comparative analysis, examining possible statutory sanctions for the same conduct in the jurisdiction in question as well as in other jurisdictions. In *BMW,* the Court pointed out that in Alabama, the maximum fine authorized under Alabama law for a violation of the Deceptive Trade Practices Act is $2,000. Civil penalties in other jurisdictions range from $50 for a first offense to $250 for subsequent violations. The most severe penalties range from $5,000 to $10,000. Thus, the $2 million punitive damages award was "substantially greater than the statutory fines available in Alabama and elsewhere." *Id.* at 584. The Court acknowledged the state's interest in "punishing unlawful conduct and deterring its repetition" but concluded that BMW's conduct was not sufficiently egregious to justify such a large punitive damages award. *Id.* at 568 and 585. In the present case, *State Farm v. Campbell,* the Court is asked to strike another punitive damages award as grossly excessive.

Overall, State Farm argues that the Utah courts punished State Farm for alleged misconduct that occurred outside the borders of the state of Utah and thus that the punitive damages award went well beyond Utah's interest in punishing and deterring misconduct in Utah and protecting Utah citizens. Thus, claims State Farm, the breadth of evidence considered by the Utah courts tainted their consideration of each of the guideposts set out in *BMW.*

In evaluating the first guidepost regarding the reprehensibility of State Farm's conduct, the Utah Supreme Court relied on detailed findings made by the trial court showing that State Farm had engaged in a pattern of "trickery and deceit," "false statements," and

other "acts of affirmative misconduct" targeted at "financially vulnerable" persons. 2001 UT 89, P32. The trial court's findings were based, in part, on State Farm's "Performance, Planning and Review," or PP&R policy, which had been in effect for more than 20 years and applied to State Farm employees nationwide.

On review, the Utah Supreme Court did not set out all of the findings regarding the reprehensibility of State Farm's conduct but pointed to a few representing State Farm's "most egregious and malicious behavior." *Id.* at P28. These included that State Farm, for over two decades, encouraged adjusters to pay less than the market value for claims and rewarded those adjusters who were successful. Agents changed contents of files, lied to customers, and committed other dishonest and fraudulent acts. In the underlying lawsuit against Campbell, a State Farm official instructed the adjuster to change the report of the accident to include a statement that Ospital was "speeding to visit his pregnant girlfriend." The Utah Supreme Court stated that there was no evidence to support either fact asserted in this statement.

State Farm's witnesses admitted that documents were routinely destroyed to avoid potential disclosure through discovery. In addition, there was evidence that State Farm instructs its attorneys and claims superintendents to employ "mad dog defense tactics" designed to wear out opposing attorneys by using the company's resources to prolong litigation, make meritless objections, claim false privileges, and destroy documents. The Utah Supreme Court concluded that the pattern of State Farm's fraudulent practices supported a high punitive damages award.

Before the United States Supreme Court, State Farm argues that both the trial court and the Utah Supreme Court improperly relied on nationwide conduct by State Farm—conduct that did not occur in Utah and thus did not affect Utah citizens. State Farm also argues that some of the misconduct relied on by the Utah courts was not at all similar to the alleged misconduct in the *Campbell* case. Certainly, the admissibility of evidence of "other acts" of a defendant is purely a matter of state law. However, the question raised in this case is whether such evidence can support a finding of especially reprehensible conduct to justify such a large punitive damages award, consistent with the due process requirements of the Constitution.

In *BMW,* the Court concluded that the state court correctly decided that it was error for the jury to use a multiplier that included similar car sales in other states when calculating punitive damages. The Court went on to state that evidence of out-of-state transactions may, nonetheless, "be relevant to the determination of the degree of reprehensibility of the defendant's conduct." It is not clear exactly what the difference is between these two uses of a defendant's out-of-state conduct. *BMW*, 517 U.S. at 574, n.20. In *TXO,* the Court stated that reliance on evidence of "wrongdoing in other parts of the country" may be considered in assessing punitive damages. *TXO,* 509 U.S. at 462, n.28. The Supreme Court approved such a factor in *Haslip* as well.

State Farm argues that the Utah Supreme Court did more than rely on out-of-state conduct to assess the issue of reprehensibility; the state court's decision indicates that it actually sought to *punish* State Farm for nationwide conduct over a 20-year period that included conduct dissimilar to that which affected the Campbells, and some of which was lawful in other states. Specifically, State Farm points out that the decision to take the Campbells' case to trial, rather than settle, involved a third-party claim. Yet, the Utah courts considered evidence of State Farm's conduct with respect to first-party claims, which are quite different. Additionally, State Farm points to reliance on evidence of destruction of documents and discrimination by State Farm when neither of these were relevant to the Campbells' case. State Farm also argues that the Utah courts cast too wide a net when considering the effect of State Farm's conduct on others. The Utah Supreme Court considered the effect of the fraudulent practices on other customers, State Farm employees, and the insurance industry generally.

By contrast, the Campbells argue that much of the out-of-state conduct evidence was presented to rebut State Farm's argument in phase two of the trial that its failure to settle the case against Campbell was an "honest mistake" or an "isolated lapse in judgment." Thus, evidence of fraudulent conduct in other states was admitted to show that this was not the case. Furthermore, such out-of-state conduct evidence showed repeated instances of fraud and other misconduct to support a determination that State Farm's conduct was so reprehensible as to require "strong medicine" in the form of a large punitive damages award. *BMW,* 517 U.S. at 577. The Campbells also argue that many of the types of out-of-state fraud and misconduct were present in the Campbells' case as well and thus not wholly irrelevant to the issue of reprehensibility.

As to the second guidepost regarding ratio, State Farm argues that the

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145 to 1 ratio of punitive to compensatory damages is an example of punitive damages "run wild." The Utah Supreme Court acknowledged that the punitive damages award against State Farm is "without precedent in Utah" but pointed out that there is no "mathematical formula" for evaluating the appropriate ratio. 2001 UT at P19, P54. In *BMW,* the Supreme Court held that due process requires a "reasonable relationship" between punitive and compensatory damages, but that there is no ratio above which all others are constitutionally disproportionate. *BMW,* 517 U.S. at 580. In *Haslip,* the Court upheld a ratio of 4 to 1, and in *TXO* a ratio of 526 to 1, or not more than 10 to 1 when potential harm was factored in with actual damages. In *BMW,* however, the Court struck an award with a "breathtaking 500 to 1 [ratio]." The Court found such a ratio disproportionate given the fact that neither Gore nor other purchasers of BMWs were threatened with additional potential harm, as well as the fact that the Court found that BMW's conduct was not sufficiently reprehensible to support such a large punitive damages award. Thus, it seems that if the defendant's conduct was not very reprehensible, the ratio should be smaller, but if the conduct was very reprehensible, this could support a higher ratio.

State Farm argues that the Utah courts incorrectly considered State Farm's relative wealth. The Utah courts determined that the award of $145 million in punitive damages represented only 0.26 of 1 percent of State Farm's wealth, and that a large punitive damages award was necessary to deter future misconduct by the company. The Supreme Court has approved consideration of a defendant's wealth when evaluating punitive damages awards. *TXO,* 509 U.S. at 462, n.28; *Haslip,* 499 U.S. at 22. In addition, State Farm contends in an argument similar to its argument regarding reprehensibility, it was improper for the state courts to consider of out-of-state and dissimilar conduct. Instead, the state courts should have considered only the nature of the specific claim against State Farm by the Campbells —an unreasonable and bad faith failure to settle the claims against Mr. Campbell.

The Campbells claim that the conduct by State Farm was sufficiently reprehensible to support a high ratio of punitive to compensatory damages. In addition, they argue that the conduct involved here is more like that at issue in *TXO,* which involved a "larger pattern of fraud, trickery and deceit," *TXO,* 509 U.S. at 462, and not a single, isolated instance of misconduct. The Campbells also point to the state court's finding that it is likely that State Farm would be punished only once in 50,000 cases. State Farm did not dispute this figure before the state courts. Thus, the likelihood that State Farm is able to evade such liability so often is said to justify a large punitive damages award.

Finally, State Farm argues that the state courts incorrectly applied the third *BMW* guidepost, which compares the punitive damages award to possible civil or criminal penalties for similar misconduct. State Farm claims that the state courts should have compared the $145 million punitive damages award to the penalties for the specific misconduct found by the jury in phase one of the trial against State Farm—that State Farm had acted unreasonably and in bad faith in failing to settle the claims against Mr. Campbell. Instead, the Utah courts compared the large punitive damages award to penalties under the state RICO statute and to criminal penalties. State Farm argues that this comparison was inappropriate since its conduct did not come within any substantive criminal offense. In addition, State Farm argues that Supreme Court precedent requires a comparison to "civil penalties authorized or *imposed* in comparable cases." *BMW,* 517 U.S. at 575. State Farm claims that it would be subject to a fine of at most $10,000 under the Utah Unfair Claims Practices Act for a single instance of conduct comparable to that involving the Campbells.

By contrast, the Campbells claim that the evidence of fraud could support much more severe civil and criminal penalties, and further, that the Utah courts properly considered the maximum penalties that *could* be imposed, not simply those that have been imposed. Once again, the arguments about this issue involve the extent to which a court may allow consideration of conduct other than that for which a jury found liability.

SIGNIFICANCE

Broadly speaking, this case continues the debate about punitive damages. A number of the *amicus* briefs dispute whether there is a problem. Some *amici* for State Farm argue that punitive damages are out of control and that juries are inconsistent and unpredictable when it comes to such awards. On the other hand, *amici* for the Campbells argue that punitive damages awards are relatively infrequent and that juries behave rationally when they do impose such damages.

A number of Supreme Court justices have been concerned about punitive damages awards, stating that such awards are "skyrocketing." Justice O'Connor dissented in both *Haslip* and *TXO* when the majority found that the punitive damages awards did not violate due process. Other justices, such as

Justices Rehnquist, Scalia, Thomas, and Ginsburg, who all dissented in the *BMW* case, believe that the Supreme Court should not intrude into an area traditionally within the province of the states, especially when a number of states have instituted reforms to limit punitive damages awards.

More specifically, however, this case presents the Court with an opportunity to clarify the difference between considering out-of-state wrongdoing when evaluating the reprehensibility of a defendant's conduct, which is proper, and punishing a defendant for out-of-state misconduct, which is not proper. Despite approving consideration of a defendant's out-of-state conduct, the Court has never detailed the precise parameters of such evidence.

In *BMW,* the Court expressed disapproval of the practice of multiplying compensatory damages by the number of similar sales out of state. The primary concern seemed to be that by allowing use of such a multiplier, one state might impose its standards on other states. Relevant to the facts in *BMW,* different states have different standards for requiring disclosure of presale repairs, reflecting different policy judgments. To allow Alabama to punish BMW for sales that might be legal in other states would go beyond Alabama's legitimate interests in punishing BMW and deterring future violations of Alabama law. The defendants in both *TXO* and *Haslip* engaged in fraudulent conduct that probably did not involve the same degree of disparity of treatment among states.

In the present case, the Court will have to decide whether there is a disparity of legislative judgment as to the conduct engaged in by State Farm that is akin to the disparity that existed regarding BMW's conduct in the *BMW* case. The Court will also have to decide just how broadly a court may look, in terms of time, geography, and type of conduct, when evaluating the reprehensibility of the defendant's conduct.

In addition, this case may require the Court to set out a more specific method for calculating the ratio of punitive to compensatory damages. Specifically, to what figure will the Court compare the punitive damages? Some ratios are based on the compensatory damages actually awarded, such as the $1 million awarded to the Campbells. Sometimes, ratios are based on the plaintiff's out-of-pocket expenses, which is how the Utah Supreme Court characterized the ratio in *Haslip.* A ratio has also been calculated based on the *potential* harm that could have resulted from the defendant's misconduct, which is how the Court came up with the ratio of 10 to 1 in *TXO.* The Campbells argue that the ratio in their case is really 70 to 1, once the $1 million in compensatory damages is added to the excess verdict against Mr. Campbell, the attorneys' fees and expenses, and the special damages. Given the ease with which the ratio can be manipulated, the Court should determine which figures will be used to calculate this number.

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Amicus Briefs

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American Council of Life Insurers (William F. Sheehan (202) 828-2000)

American Tort Reform Association (Roy T. Englert Jr. (202) 775-4500)

Business Roundtable (Malcolm E. Wheeler (303) 292-2525)

Chamber of Commerce of the United States (Andrew L. Frey (212) 506-2500)

Common Good (Philip K. Howard (202) 662-6000)

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DeKalb Genetics Corporation (Seth P. Waxman (202) 663-6000)

Ford Motor Company (Theodore J. Boutrous Jr. (202) 955-8500)

Health Insurance Association of America et al. (Nancy L. Perkins (202) 942-5000)

International Mass Retail Association and American Chemistry Council (Daniel H. Bromberg (202) 879-3939)

National Association of Manufacturers (Gene C. Schaerr (202) 736-8000)

National Conference Insurance Legislators (Patrick Lynch (213) 430-6000)

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Certain Leading Social Scientists, Theodore Eisenberg et al. (William M. Shernoff (909) 621-4935)

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Minnesota et al. (Mike Hatch (651) 296-3353)

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