

April 2006

## THE BUDGET

### BUSH REQUESTS RECORD \$2.77 TRILLION BUDGET

“Disastrous.”

That’s how AARP described the paltry \$200 billion increase in spending contained in the Bush administration’s fiscal year 2007 budget submission – an amount that would have funded the entire federal government 40 years ago.

“The Congress, in an election year, is not going to pass these disastrous provisions,” said AARP’s David Sloan in a national newspaper.

Of course, the obvious question is this: Had Bush completely eliminated Social Security, Medicare, and Medicaid, thereby saving \$1.17 trillion – rather than INCREASING those programs by \$87 billion – would the press release have read any differently?

Welcome to the brave new world of “baseline budgeting.”

First, the really big numbers:

- In the highly unlikely event that Congress does not increase Bush’s figures, total outlays (before \$50 billion to \$100 billion in Iraq supplemental appropriations) will be \$2,770,097,000,000 – up roughly \$200 billion from the previous year’s request and up \$61.4 billion from the current estimate of what this year’s spending will turn out to be.
- Taxes will increase from \$2.286 billion to \$2.416 billion – a tax increase of \$130 billion, partly as a result of nonindexed items like, at press time, the Alternative Minimum Tax, partly because of economic growth, and partly because of a long list of “user fees” supported by the administration.

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- The deficit is projected to drop from a record \$423.2 billion in 2006 to a “mere” \$354.2 billion – although no one expects this reduction in the deficit to survive congressional add-ons and successive supplemental funding requests.

Here, then, are the totals for next year (2007), this year (2006), and 2000 (the last full year of the Clinton administration):

	2000	2006	2007	Change
	( in billions )			2000-07 (%)
Defense	294.5	535.9	527.4*	+79.1
International				
Affairs	17.2	34.8	33.3	+93.6
Science & Tech.	18.6	24.0	25.4	+36.6
Energy	-0.8	2.6	1.0	-
Natural				
Resources	25.0	32.7	31.0	+24.0
Agriculture	36.5	26.8	25.7	-29.6
Commerce/ Housing	3.2	9.1	11.2	+250.0
Transportation	46.9	71.6	76.3	+62.7

\*Subject to \$50 billion-100 billion of additional supplemental money.

	2000 ( in billions )	2006	2007	Change 2000-07 (%)
Community Development	10.6	52.0	28.2	+166.0
Education	53.8	109.7	87.6	+62.8
Health	154.5	268.8	280.9	+81.8
Medicare	197.1	343.0	392.0	+98.9
Income Security	253.6	360.6	367.2	+44.8
Social Security	409.4	554.7	585.9	+43.1
Veterans	47.1	70.4	73.9	+56.9
Justice	28.5	41.3	44.3	+55.4
General Govt.	13.0	19.1	20.2	+55.4
Interest	222.9	220.1	247.3	+10.9
Allowances	6.4 <sup>1</sup>	3.7	5.5	-
Offsetting Receipts	6.4 <sup>2</sup>	-72.4	-94.3	-
Total	1789.1	2708.7	2770.1	+54.8
Revenues	2025.2	2285.5	2415.9	+19.3
Deficit	-	423.2	354.2	<sup>3</sup>

For what it's worth, the White House goes on to project spending (in outlays) of \$3.239 trillion by 2011 and \$3.034 trillion in revenues – with a deficit of \$204.9 billion. But, suffice it to say that anything beyond fiscal year 2007 – particularly discretionary spending – is nothing more than “monopoly money.”

## The Trends

At a time of very low inflation, total spending has risen, nominally, by roughly 54.8% in seven years – from \$1.79 trillion to \$2.77 trillion. Defense and antiterrorism efforts have grown substantially. But education funding and spending on the major entitlements have accelerated even faster – growing at a rate of 62.8% and between 43.1% and 98.9%, respectively.

In fact, with the sole exception of the luckless farmers (and an interest level determined by the economy), every category has grown by at least 3% a year. And with the further exceptions of Natural Resources (3.4% in annual growth) and Science (5.2% in annual growth), every classification of spending has grown by at least 6% annually.

Not all of the blame for that can be placed on George Bush and the Republican Congress – although they deserve a great deal of it. However, anyone interested in how the media distorts reality in

order to achieve political objectives should consider this:

On February 7, *USA Today* ranked “winners” and “losers” in the Bush budget submission. The “winners” were: foreign aid (up 14%); the judiciary (up 9.9%); antiterrorism (up 8%); the National Science Foundation (up 7.9%); defense (up 6.9%); veterans (up 5.2%); and the National Aeronautics and Space Administration (NASA) (up 3.2%).

Medicare was deemed a “loser,” on the other hand. And while *USA Today* did not specify the percentage of increase or decrease in the Medicare program between 2006 and 2007, it pointed out that the Bush budget “slows growth” by \$36 billion over five years.” (emphasis added)

In fact, Medicare will enjoy a 14.3% increase in 2007 over outlays in 2006 – a larger jump than any of the categories designated as “winners.” Yet, in the odd and politically correct parlance of Washington, NASA – with its 3.2% increase from 2006 to 2007 – is considered a “winner,” while Medicare – with its 14.3% increase during that same one-year period – is considered a “loser” because it is increasing \$7 billion a year slower than its skyrocketing “baseline.”

And before anyone sheds tears for the Medicare program, there is another reality: although Medicare has grown by an unimaginable 98.9% during the Bush administration, the growth of Medicare and other entitlements during the first six years of the twenty-first century is miniscule compared to the projected level of growth now that the “Baby Boomers” have begun to retire.

The Senate Budget Committee projects that the size of Medicare will increase by 121% over the next decade. But this seems to be a laughable underestimate, given the fact that it has grown by almost 100% in seven years during a time when the system wasn't being bombarded with retiring Baby Boomers.

The Budget Committee also estimates that the total cost of the three major entitlements (Social Security, Medicare, and Medicaid) will rise to almost 30% of the total U.S. Gross Domestic Product (GDP) by the middle of the century. And, again, this is setting aside the fact that, in general, econometric projections concerning Medicare and Medicaid have drastically failed to anticipate the rate at which health care costs would increase.

Finally, what about “tax cuts”? In fact, taxes have grown an average of close to 3% a year during

<sup>1</sup>For all “other functions.”

<sup>2</sup>For all “other functions.”

<sup>3</sup>Infinity.

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the Bush administration—and would jump by 5.7% if the White House budget were adopted unchanged. As a percentage of the GDP, revenues are expected to increase from 17.6% to 17.9% by 2011—reaching \$3 trillion in that year.

## The Details

In the area of defense, the Office of Management and Budget is proposing the following major weapons systems:

- \$10.4 billion for additional ground- and sea-based interceptors—plus two additional forward-deployed mobile radars;
- \$2.2 billion for advance procurement funds for sixty F/A-22 fighter aircraft;
- \$4 billion for development of the Joint Strike Fighter;
- \$11.2 billion for shipbuilding and conversion, including seven new warships, two DD(X) next-generation destroyers, and two Littoral Combat Ships;
- \$3.7 billion for the Army's Future Combat Systems—a system of ground vehicles intended to make the Army lighter and more agile.

New tax increases would include:

- tightening the foreign tax credit;
- penalizing charities that fail to enforce environmental easements; and
- a long list of “user fees.”

Finally, a few closing observations:

- there was a big breakthrough for anti-business “junk science,” as the National Science Foundation relishes a hefty increase of 7.9% under the Bush budget;
- NASA, which has had its “ups and downs” over the past few years, should revel in its (comparatively) generous 3.2% hike, given its recent public relations disappointments;
- The press has made a real effort to paint Republicans into a corner. The previously mentioned edition of *USA Today* incorrectly sprays the front page with the message: “Medicare, domestic programs trimmed.” Inside, it blasts health savings accounts because they would “eat up savings.” It incorrectly argues that the “[p]roposed boost for Pentagon among biggest.” It tries to forestall entitlement cuts by an article titled “Cutting Medicare Will Be Tough Sell in Election Year”—with AARP and the liberal National Committee to Preserve Social Security and Medicare as the principal sources. And it includes a pie chart purporting to demonstrate that there is “[n]ot much left to cut.” Under the circumstances, Americans can be forgiven for the misimpression that “tax cuts” and “spending austerity” are realities, rather than illusions.

## The Legislative Branch

### McCain Misfires—Twice

In preparation for his anticipated presidential run, Arizona Republican John McCain is cranking up his legislative apparatus.

At the forefront of the McCain presidential platform are two bills:

- one to “reform” the lobbying process in the wake of the Jack Abramoff scandal; and
- the other to eliminate the use of “earmarks” on appropriations bills.

### Republicans in the Wake of Jack Abramoff

At press time, disagreement over how to deal with the political damage resulting from the (separate) indictments of Jack Abramoff and Tom DeLay had created a schism in the GOP—and had temporarily slowed movement on any package of “reforms.”

The initial impetus had been toward cracking down on congressional “perks” from lobbyists:

- flying on corporate jets at less than the actual cost of the transportation;
- viewing sports events from corporate skyboxes –valued at the price of the adjoining “nosebleed seats”;
- attending lavish Scottish golf outings financed by tax-exempt organizations;
- parlaying congressional service into lucrative lobbying jobs; and
- awarding legislative favors to firms that employ the wives of congressmen and staff.

But many congressmen in “safe” seats balked at such draconian measures. As a result, some congressional leaders—led by House Majority Leader John Boehner (R-Ohio)—began to shift the focus to broader regulation of lobbyists, rather than measures directed at members.

And the McCain package—S. 2128—contained some of the most far-reaching moves in this direction:

- The bill would extend regulation of lobbying to regulation of “grassroots lobbying,” even though it was not done on behalf of any client. On the surface, communications by ideological advocacy organizations with their “members” would be excluded from the definition of “grassroots lobbying,” although the difference between what an issues advocacy group regards as a “member” and what the Federal Election Commission regards as a “member” will, no doubt, be significant.
- The bill would require quarterly filings of lobbying reports, rather than the semiannual filings, which are now required.
- The bill would require groups that participate in a coalition to separately register and report the activity of the coalition.
- The bill would increase potential penalties for lobbyists to \$100,000.

Hill veterans understand the hallmarks of a McCain initiative:

The canny Arizonan is determined in pursuit of his objectives—and isn’t afraid to ruffle feathers. During the battle over Bridgestone/Firestone legislation, McCain preempted the

prerogatives of the Majority Leader—showing up on the floor to ask for “unanimous consent” to pass his expansive new regulatory initiative—and daring any senator to object and thereby incur his wrath.

McCain, like his Democratic analog, Ted Kennedy (D-Mass.), is nevertheless willing to make whatever compromises are necessary to win. On Bridgestone/Firestone, he settled for a small industry-specific Band-Aid. And, in the fight over the McCain-Feingold campaign finance reform bill, the maverick’s legislation would have, had it not been amended, required no more than reporting of “electioneering communications.”

Finally, having crafted the best compromise possible, McCain has no reluctance to batter bureaucrats and courts in order to obtain expansive interpretations that go beyond anything either the Senate or House thought it was doing. Going back to McCain-Feingold, McCain pushed for interpretations that would extend the definition of “electioneering communications” to Internet blogs and would severely limit the ability of national party officials to raise permissible “soft money” funds for state parties.

Keeping all of this in mind, grassroots organizations are wondering how much disclosure a McCain-like “lobby reform” proposal might ultimately require. There is no doubt that groups that do grassroots lobbying would be required to disclose the aggregate amount spent for grassroots alerts. There is no doubt that, in some cases, large grassroots campaigns would have to be disclosed 20 days in advance—a revelation that could be devastating in the middle of a pitched legislative battle. There is no doubt that the definition of “grassroots activities” would be breathtakingly (and perhaps unconstitutionally) broad—extending to “any attempt to influence the general public.”

But what they are asking themselves is whether a Federal Election Commission whose Republican members were appointed by “President McCain” could require disclosure of the content of grassroots lobbying communications—or of the list of recipients.

## Earmarks

After last year’s “reconciliation bill” was whittled from the House figure of \$50 billion in spending cuts down to \$39.6 billion in the conference report, congressional conservatives began to look around for “budget process reform”

that would overcome Washington's built-in bias toward higher and higher budget outlays.

Without any real expertise in the rules, conservatives seem to have settled on two reform proposals:

- the limitation or elimination of "earmarks" on appropriations bills; and
- a two-year budget cycle.

The aggressive McCain has attempted to seize control of the "earmark" issue through the introduction of legislation co-sponsored by mainstream Republicans like Jon Kyl (R-Ariz.) and John Sununu (R-N.H.). The McCain bill would prohibit appropriations set-asides, in addition to tightening the prohibition on "legislation" on appropriations bills – thereby allowing non-money-related language to be knocked off an appropriations conference report with no real recourse.

Conservatives have relied on earmarks in some important contexts:

- The Symms-Dixon amendment to rebuild the Polish trade union *NSZZ Solidarnosc* (Solidarity) was offered as a series of earmarks to three different pieces of legislation.
- The anti-Communist government broadcaster, Radio Martí, was created as an appropriations rider.

In addition, the McCain-Kyl-Sununu proposal would prohibit provisions that are "legislative" in nature – rather than money-related – from being added to appropriations bills or conference reports. Analysts believe that certain parliamentary defenses would continue to allow "legislation" to be attached to these money bills during their initial consideration on the Senate floor. But these "defenses" would probably not be available if the legislative provisions remained on the conference report.

Thus, a broad range of limitations imposed on regulatory agencies and government organizations like the Federal Trade Commission, the Environmental Protection Agency, and Federal Prison Industries would disappear. This, in and of itself, would be of no major concern to the sponsors and their conservative supporters.

But what may cause problems is the fact that, the McCain proposal could eliminate virtually every federal restriction on abortion, in addition to limitations on gun control, pornography, and Leftist litigation by the Legal Services Corporation:

- Thus, pro-life "conscience clauses" and limitations on Orwellian "population control" programs in the Third World would almost certainly expire.
- Elaborate restrictions on the Legal Services Corporation would almost certainly not be allowed, and the "Smith amendment" to prohibit charging a "gun tax" under the Brady Law (and a variety of related pro-gun riders) would probably not survive muster under McCain.
- The "Hatch compromise," limiting funds that obscene art receives from the National Endowment for the Arts, would probably die.
- And, finally, on top of all of that, restrictions on abortion in military hospitals, in the District of Columbia, with federal employee benefit plans, and with Medicare and Medicaid funds could cease to exist, if the parliamentarian interprets the McCain provisions broadly.

Which brings the whole issue down to Alan Fruman, the Senate parliamentarian. What does Fruman do when, after the Senate has hoisted itself on the McCain pitard, McCain tries to interpret the prohibition of "legislation" as it is interpreted in the House – prohibiting any language vesting any discretion in any bureaucrat?

All of this might fit into a different equation if the McCain language promised to bring the out-of-control appropriations process into focus. The problem is that earmarks are next-to-irrelevant in terms of the ability of appropriators to apportion federal funds.

For many years, appropriations subcommittees such as Fritz Hollings' Public Works panel simply attached "non-binding" lists of funded projects to the explanation of the conference report on the Public Works Appropriations Bill. Although none of the lists technically had the force of law, no cabinet secretary was about to incur the wrath of Hollings by deviating from his "lists."

But, like most of what goes on in Washington, appearances are more important than reality.

## **The Executive Branch**

### **SEC Goes after Reporters' Notes**

At press time, the Securities & Exchange Commission (SEC) had backed off its efforts to force Dow Jones reporters Herb Greenberg and

Carol Remond to divulge information about their discussions with stock traders and analysts.

The SEC had subpoenaed records of the reporters' discussions in connection with its investigation into Gradient Analytics and its predecessor, Camelback Research Alliance – which are accused of working with short sellers and hedge funds to manipulate stock prices.

Following a bombardment of press inquiries, however, “the S.E.C. . . . decided not to seek production of any documents from Dow Jones at this time,” according to a Dow Jones spokeswoman.

## The Judicial Branch

### Supreme Court Locks in Limited Interpretation of the Eleventh Amendment

To review the bidding: For a while, it looked as though the Ninth, Tenth, and Eleventh Amendments were at the vanguard of a “conservative revolution” in the Supreme Court.

Indeed, the Eleventh Amendment is pretty straightforward:

The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one [of] the United States by Citizens of another State. . . .

Furthermore, the Supreme Court had read this language literally to prevent suits against states in some tough cases – the toughest being its decision to prevent suits against states under the employment discrimination provisions of the Americans With Disabilities Act (ADA).

But in 2003, the retrenchment began.

That year, the Court established an odd Eleventh Amendment “balancing test” for the purpose of allowing suits against states under the Family and Medical Leave Act [*Nevada Department of Human Services v. Hibbs*, 123 S. Ct. 1972 (2003)].

Then, in 2004, the Court really cut the baby in half: In *Tennessee v. Lane*, No. 02-1667 (2004), by a 5-to-4 majority, the Court ruled that Americans With Disabilities Act (ADA) public accommodations suits against states were permissible, at least in a judicial context, even though ADA employment discrimination suits had not been. O'Connor had switched her vote, presumably because of an

egregious fact situation in which a paraplegic was expected to crawl up a flight of stairs on his belly in order to avoid being held in contempt of court.

This brought us to *United States v. Georgia/Goodman v. Georgia*, Nos. 04-1203/04-1236 (2006) – which asked the question whether the Eleventh Amendment prohibits ADA public accommodation suits by prisoners with respect to prison conditions.

The prisoner/plaintiff was a cocaine addict and convicted felon who was jailed after shooting at his girlfriend and then getting out of his wheelchair to beat her. He sought \$600,000 (per criminal) in damages.

Although some – including the trial magistrate and the Eleventh Circuit – regarded Goodman as a less-than-sympathetic plaintiff, he successfully argued before the Supreme Court –

- that he was a paraplegic (like Lane) who was placed in maximum security strictly because of his disability;
- that his cell was too small to turn his wheelchair around;
- that he had to go to the bathroom in his wheelchair; and
- that he could only get into his bed by literally hurling himself out of his chair.

Thus, in a surprisingly lopsided margin, with only one dissenting vote, the Court gave Goodman the go-ahead to proceed with his ADA suit. In a Court where “compelling interests” are less important in Eleventh Amendment cases than compelling facts, no one was betting that the Justices were going to let Goodman stew in his wheelchair, remediless. But the defection of the Court's conservative bloc was a surprise to most.

So, what does that say about the Court?

It says that the conservatives may have learned their lesson on *stare decisis* better than many of us had thought.

It says that a line of cases diminishing the importance of the Eleventh Amendment that, two months ago, stood to be reversed following Sandra Day O'Connor's departure, will now be much more difficult to reverse.

## Supreme Court Opens McCain-Feingold to Potential Constitutional Challenge

Despite the public perception, only a small amount of the Supreme Court's output hinges on 5-4 decisions—or balances precipitously on the arrival or departure of a single member. But the constitutionality of federal election law may be one of those rare cases.

Earlier this year, the Supreme Court—with the acquiescence of departing Justice Sandra Day O'Connor—took a step that may presage the reversal of *McConnell v. Federal Election Commission*, No. 02-1674 (2003), and lead the Court to overturn the McCain-Feingold campaign finance reform package.

McCain-Feingold was amended in the Senate to prohibit “electioneering communications” within 30 days of a primary or 60 days of a general election. And, although supposedly the leader of the opposition to McCain-Feingold, Kentucky Republican Mitch McConnell quietly encouraged Republican senators to support the draconian provision in order to strengthen the constitutional challenge that McConnell intended to bring.

Wiser heads cautioned of the dangers of relying on the Supreme Court to save Congress from constitutional calamity. And, sure enough, in 2003,

the Court, by a 4-to-4 vote, upheld virtually all of McCain-Feingold, including the prohibitions on “electioneering communications.”

Now comes Wisconsin Right to Life, Inc., arguing that, if McCain-Feingold is not facially unconstitutional, it is unconstitutional as applied to them. But while *Wisconsin Right to Life, Inc. v. Federal Election Commission*, No. 04-1581 (2006), may, on the surface, deal with unconstitutional application, it goes much deeper:

This is because Justice O'Connor cast the deciding vote upholding the statute's facial constitutionality, while her replacement, Samuel Alito, could well vote the other way. So, given that the lower court had dismissed Right to Life's constitutional challenge, it is significant that the Supreme Court, rather than affirming, sent the case back to the D.C. court for further deliberations.

So, when the case comes back before the Supreme Court, the “swing vote” will have been replaced by a Justice who is widely expected to feel differently about the issue.

This is not to say the outcome is preordained. Justice Alito has just received months of lectures on the importance of *stare decisis*. But the issue is now “in play.”

\* \* \* \* \*

### **ENSURING THE COMPETITIVENESS OF AMERICAN BUSINESS: RESTORING THE PROPER REGULATORY AND ENFORCEMENT BALANCE**

The edited proceedings of a major conference, sponsored by the Center in 2005, is now available. *Ensuring the Competitiveness of American Business: Restoring the Proper Regulatory and Enforcement Balance* provides insights and potential solutions to the unintended consequences of post-Enron “reforms.” The following topics were discussed in detail by a faculty of experts and make up the chapters of the book. The program was moderated by R. William (Bill) Ide, partner in the law firm of McKenna Long & Aldridge LLP, former President of the ABA, and former General Counsel of Monsanto.

POST-ENRON TRENDS IN CORPORATE REGULATION AND LITIGATION	Jeffrey B. Kindler, Moderator
THE REDEFINED ROLE OF DIRECTORS	Charles A. Bowsher, Moderator
WHAT IS CRIMINAL BEHAVIOR? THE ROLE OF CRIMINAL LAW AND CORPORATE INTENT IN REGULATING CORPORATE BEHAVIOR	Stanley A. Twardy, Jr., Moderator
THE IMPACT OF CIVIL LITIGATION: IT'S TIME TO DRAW THE LINE	Michael D. Fricklas, Moderator
SELF-REGULATION AS THE MOST EFFECTIVE DETERRENT TO CORPORATE ABUSE	Stuart M. Gerson, Moderator

The keynote presentations by the Attorney General of the United States, Alberto R. Gonzales, and the Secretary of the Treasury, John W. Snow, are also included in this publication.

To order this publication, please contact the Center at (202) 466-9360 or e-mail [ijacoby@nlcpi.org](mailto:ijacoby@nlcpi.org).

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Author: Geoffrey A. Vance, McDermott Will & Emery LLP

This *Briefly* discusses the pitfalls associated with electronic data, including costs associated with identifying, preserving and ultimately producing electronic information. The author analyses the seminal decision in this area – *Zubulake v. UBS Warburg LLC*, and the significance of post-*Zubulake* case law and rule changes. For example, many of the mistakes committed by the defendant in *Zubulake* were also committed by Morgan Stanley, which suffered a \$1.45 billion judgment based in large part on failure to properly preserve and produce electronic information. The *Zubulake* case foreshadows a day where discovery of electronic information will be as routine and uneventful as the discovery of paper files.

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