

Navigating and Avoiding Sanctions for Failing to Preserve Electronic Information

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On January 15, 2010, District Judge Shira Scheindlin of the Southern District of New York issued an opinion that has grabbed the attention of lawyers and clients that wrestle with the task of instituting and maintaining defensible legal hold policies. This case, *Pension Committee of the University of Montreal Pension Plan v. Banc of America Securities, LLC*,¹ holds that sanctions may be imposed for spoliation of electronic data that is the result of negligent and grossly negligent conduct – not just bad faith. While this opinion sets parameters around culpability and conduct, many practitioners are still left wondering how corporate litigants can successfully navigate this challenging process. This article explores Judge

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Scheidlin's four-part analysis with regard to when spoliation warrants sanctions, including each standard of negligence and the sliding scale of corresponding sanctions that may arise when a party fails to fulfill discovery obligations. Practical guidance will also be offered to attorneys and corporate clients to help avoid the serious ramifications that may arise from a failure to preserve potentially relevant electronic information.

Case Background

This securities action was filed in February 2004 by a group of investors who sought recovery of \$550 million in losses, resulting from the liquidation of two hedge funds. Ninety-six plaintiffs were in the original action, but only the actions of 13 were the subject of this discovery opinion.

During discovery, in October 2007, the Citco Defendants (consisting of Citco NV, Citco Group Limited and former directors) alleged the plaintiffs' production was severely lacking. As a result, the plaintiffs were ordered to provide the court with declarations regarding their efforts to preserve and produce documents. Based on the information received and by cross-referencing the productions and declarations of the plaintiffs, the defendants were able to identify at least 311 responsive documents that were not included in 12 of the 13 plaintiffs' productions and discovered that nearly all the declarations were false and misleading or executed by an individual without personal, relevant knowledge of its contents. Armed with this information following the close of discovery, the defendants moved for spoliation sanctions and dismissal of the plaintiffs' complaint.

Prior to discussion of the parties' shortcomings, Judge Scheindlin opens this opinion with a framework for determining when spoliation sanctions are appropriate. Four issues are essential to this analysis: the plaintiffs' level of culpability, the interplay between the duty to preserve and evidence spoliation, which party should bear the burden of proving evidence destruction and consequences, and the appropriate remedy for the harm caused.

Culpability

Turning to the party's culpability, Judge Scheindlin discusses the standards of negligence, gross negligence and willful misconduct in the discovery context. The judge describes negligence as behavior that falls below the standard of acceptable conduct. Acceptable conduct in the discovery context is determined by "what a party must do to meet its obligation to participate meaningfully and fairly in the discovery phase of a judicial proceeding."² A party who fails to meet this acceptable conduct standard has acted negligently regardless of whether the actions resulted "from a pure heart and an empty head."³ Behaviors constituting simple negligence include the

failure to obtain records from all employees, the failure to take all appropriate measures to preserve ESI (electronically stored information), the failure to assess the accuracy and validity of selected search terms, or the failure to collect evidence.

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Gross negligence is a standard greater than simple negligence – it is a failure to exercise the same level of care a careless person would employ. Accordingly, Judge Scheindlin defines the following failures as gross negligence:

- the failure to issue a written legal hold;
- the failure to identify the key players and ensure that their electronic and paper records are preserved;
- the failure to cease the deletion of e-mail or to preserve the records of former employees that are in a party's possession, custody or control; and
- the failure to preserve backup tapes when they are the sole source of relevant information or when they relate to key players, if the relevant information maintained by those players is not obtainable from readily accessible sources.

Willful, wanton or reckless misconduct includes an intentional act, indifferent to the consequences, which "make[s] it highly probable that harm would follow."⁴ Judge Scheindlin cites the intentional destruction of relevant ESI or paper documents as examples of willful misconduct, especially if the conduct occurred after the final relevant *Zubulake* opinion was issued in July 2004. The grossly negligent actions described above may be deemed willful if the party's actions are intentional. Judge Scheindlin notes that these behaviors are not meant to establish a definitive list, but are examples of discovery failures and culpability levels.

Duty to Preserve

After discussing the various levels of culpability in the context of discovery, Judge Scheindlin turns to the duty of preservation:

By now, it should be abundantly clear that the duty to preserve means what it says and that a failure to preserve records – paper or electronic – and to search in the right places for those records, will inevitably result in the spoliation of evidence.⁵

Judge Scheindlin titled this case "*Zubulake* Revisited: Six Years Later" and used that series of seminal decisions to provide further framework for a party's obligations that stem from duty to preserve, determining "[i]t is well established that the duty to preserve evidence arises

when a party reasonably anticipates litigation.”⁶ In the instant case, the judge found the duty to preserve arose by April 2003 after the plaintiffs filed suit.

Burden-Shifting

Next Judge Scheindlin explores the burdens associated with the loss of documents, specifically analyzing who is responsible for demonstrating the favorability or prejudice of the lost evidence. Judge Scheindlin relates the burden of proof question to the severity of the sanctions at issue. For less severe sanctions, such as an award of costs and fees, the court’s inquiry focuses on the spoliating party’s conduct instead of the loss of evidence, and whether it was relevant or resulted in prejudice. Essentially, the innocent party must prove three elements: the spoliating party had control over the evidence and an obligation to preserve when the evidence was destroyed; the spoliating party acted with a culpable state of mind; and the missing evidence is relevant.

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When more severe sanctions are considered, such as dismissal or an adverse inference, the inquiry of the court focuses on behavior, in addition to the relevance of and prejudice caused by the unavailability of evidence. Moreover, if a spoliating party is found to have acted in a grossly negligent manner or in bad faith, relevance and prejudice may be presumed. However, this presumption is not required and is always rebuttable.

In her discussion of this issue, Judge Scheindlin sets forth a burden-shifting test as follows: if a spoliating party’s conduct is egregious enough to justify the imposition of a presumption of relevance and prejudice or if the conduct warrants permitting the jury to make that presumption, the burden shifts to the spoliating party to rebut the presumption. If the spoliating party demonstrates no prejudice occurred, then no jury instructions would be warranted, although the possibility for lesser sanctions remains open.

Arguably, the burden-shifting test seems to place a substantial burden on innocent parties since it requires an innocent party to demonstrate the relevance of evidence that it may never review due to the opposing party’s failure to preserve. As Judge Scheindlin notes, this seems unfair, but “the party seeking relief has some obligation to make a showing of relevance and prejudice, lest litigation become a ‘gotcha’ game rather than a full and fair opportunity to air the merits of a dispute.”⁷ An automatic presumption of relevance and prejudice would motivate parties to find errors and capitalize on mistakes, which the judge felt “would not be a good thing.”⁸

Remedies

Turning to the final part of her four-point analysis, Judge Scheindlin notes sanctions serve to

- (1) deter the parties from engaging in spoliation;
- (2) place the risk of an erroneous judgment on the party who wrongfully created the risk; and (3) restore “the prejudiced party to the same position [it] would have been in absent the wrongful destruction of evidence by the opposing party.”⁹

The least harsh yet most adequate sanction available should be imposed, ranging from cost-shifting and fines to preclusion and default judgment. The terminating or default judgment sanction should be imposed only in the most egregious cases, which Judge Scheindlin determined was not appropriate for the plaintiffs’ actions.

After discussing the sanctions and analyzing the varying levels of an adverse inference instruction in particular, Judge Scheindlin concludes this discussion by noting the subjectivity of a decision to award sanctions. A judge relies on experience and his or her “gut reaction”¹⁰ regarding the party’s compliance with discovery obligations, which requires a case-by-case basis approach.

A party’s best defense against sanctions is to fully comply with discovery obligations. Ignorance is no longer bliss and there seems to be decreasing protection for preservation mistakes, oversights or intentional destruction activities. By remaining vigilant in preserving information and addressing e-discovery issues, parties place themselves in the best position to avoid the court’s wrath, administered through sanctions.

Legal Hold Implementation

Following the four-part analysis to determine if and when sanctions are appropriate, Judge Scheindlin discusses the plaintiffs’ specific actions that led to the defendants’ motion. This discussion centered on whether the plaintiffs issued a litigation (or legal) hold, an imperative step in preserving pertinent information and avoiding costly sanctions. Following the final *Zubulake* opinion in July 2004, the duty to issue written legal holds was clear and the plaintiffs should have instituted a written legal hold no later than 2005, which is when the action was transferred to the Southern District of New York.

Originally, the 13 plaintiffs discussed in *Pension Committee* failed to issue written legal holds when the duty to preserve initially arose in 2003. Seven of the plaintiffs eventually issued written holds, while six plaintiffs failed to issue a written hold at any time. The seven who issued written holds were found to have acted negligently, while the six who failed to issue any were found grossly negligent and subject to a permissive adverse inference sanction.

In addition to their failure to ever issue a written legal hold, these six plaintiffs conducted discovery in a grossly negligent manner. Their searches were “severely

deficient,” and they failed to engage in any preservation or collection efforts prior to 2007 – four years after the duty to preserve technically arose. Not only did these plaintiffs fail to collect or preserve documents, they also actively continued to destroy electronic documents and backup data that may have contained responsive data. As such, it was fair to presume that the missing documents were relevant and the defendants were prejudiced. Regarding the backup tapes, Judge Scheindlin amended the original opinion to clarify that preserving all backup tapes is not required. Rather, the preservation obligation arises when the backup tape is the sole source of relevant information.¹¹

For the seven plaintiffs who eventually did issue written legal holds, Judge Scheindlin notes that the duty to issue a hold was not well established in early 2004. Based on this fact, the rule of lenity applied and the belated issuance of the legal hold alone was insufficient to find that these plaintiffs engaged in grossly negligent conduct. Like the other six plaintiffs, these seven had additional discovery shortcomings that contributed to their conduct being deemed sanction-worthy. These shortcomings included deficient, unsupervised searches and relevant documents that were not produced.

Judge Scheindlin also found all 13 plaintiffs worthy of monetary sanctions because they “conducted discovery in an ignorant and indifferent fashion,”¹² and awarded the defendants reasonable attorney fees and costs associated with the motion. Finally, Judge Scheindlin ordered two of the plaintiffs to search backup tapes for relevant documents or demonstrate why this task could not be performed, but she declined to order further discovery with regard to the other 11 plaintiffs because the burden would far outweigh the benefit.

As demonstrated in *Pension Committee*, the failure to issue a legal hold will result in sanctions. Yet, as reported in a recent study by Kroll Ontrack, only 57% of U.S. corporations have an identified means to preserve potentially relevant data when litigation or a regulatory investigation is anticipated.¹³ This statistic is alarming. Corporations are unable to comply with their duty to preserve potentially relevant information if they lack an appropriate means to suspend the expulsion of potentially responsive data. By failing to implement measures necessary to issue a legal hold, a company’s ESI readiness policy cannot be effective and the company is at risk for costly motions and sanctions.

Furthering the precariousness of the legal hold process is the divide between corporate legal and IT departments, which share an increasing amount of responsibility for creating ESI strategy and enforcement. This relationship is moving in a more collaborative and cooperative direction, but it is far from perfect. Role confusion, vernacular barriers and budgetary ownership are all common subjects of contention. Thus, implementation and enforce-

ment of the company’s ESI strategy – which includes legal holds – should not be overlooked, and efforts should continue to strengthen the legal-IT relationship.

***Pension Committee* Distinguished**

In February 2010, Judge Lee Rosenthal¹⁴ from the Southern District of Texas authored an opinion that distinguishes and limits the *Pension Committee* ruling. The opinion, *Rimkus Consulting Group, Inc. v. Cammarata*,¹⁵ addresses sanctions for the intentional destruction of electronic evidence. In this case, the defendants (who were the plaintiffs in the original action) contended that the deletion of evidence, including e-mails and attachments, was part of their routine business practice. Disagreeing with those arguments, Judge Rosenthal determined the defendants intentionally lost, altered and deleted e-mails the plaintiff requested in the discovery process. As a result, it was appropriate to send the case back to a jury with a permissive adverse inference instruction, and to award attorney fees and costs incurred during the plaintiff’s investigation into the spoliation.

In exploring the preservation and spoliation issue, Judge Rosenthal discussed *Pension Committee*, paying particular attention to the U.S. Circuit Court differences with regard to culpability of parties and the burden of proof associated with relevance and prejudice of spoliated evidence. In regard to culpability levels, caselaw in the Second Circuit (as applied in *Pension Committee*) allows the imposition of sanctions for negligent evidence destruction, whereas in the Fifth Circuit, negligent destruction – as opposed to intentional, bad faith destruction – is insufficient for the imposition of an adverse inference instruction.¹⁶ Judge Rosenthal concluded that these different culpability holdings “limit the applicability of the *Pension Committee* approach.”¹⁷

In regard to burden of proof requirements, Judge Rosenthal made another distinction between the Second and Fifth Circuits, noting the Fifth Circuit has not addressed the presumptions of relevance and prejudice even in the context of bad faith. However, caselaw within the Fifth Circuit suggests that an adverse inference instruction is not considered appropriate unless there is a showing of relevance.

These differences highlight the continued confusion about the duty to preserve ESI. Organizations must make diligent efforts to understand the applicable legal standards and become better educated about the technology that can simplify and economize the discovery of ESI. Regardless of what legal standards apply, parties cannot ignore preservation obligations established by courts across the country. As Judge Rosenthal noted in *Rimkus Consulting Group*, the “spoliation of evidence – particularly of electronically stored information – has assumed a level of importance in litigation that raises grave concerns” and “distract[s] from the merits of a case, add[s]

costs to discovery, and delay[s] resolution.”¹⁸ Courts are recognizing the increasing impact presented by e-discovery related issues and are growing more intolerant of party missteps in this arena.

Best Practices

Commentators widely believe the *Pension Committee* and *Rinkus Consulting Group* decisions raise the bar of acceptable conduct for corporate litigants. Merely understanding the details discussed in these cases is not enough to meet this heightened bar. Instead, best practices, like the ones outlined below, must be instituted to successfully navigate all stages of data management and litigation response.

The exact moment the duty to preserve arises remains a tricky issue and is often considered the most challenging step of the e-discovery process.

Implement an Archiving System

As legal requirements become more stringent, it is increasingly important that organizations arm themselves with the proper tools to defend against the risks presented by the mountains of data created and maintained in the course of business. One solution is implementing an effective archiving system. Archiving enables efficient records management that not only facilitates business and storage efficiency, but can also ensure compliance with legal and regulatory requirements. E-mail and filing archiving will allow legal, IT and compliance teams to appropriately preserve, manage, locate and produce relevant ESI, in addition to allowing for quick enforcement of the company’s document retention policy.

An archiving solution streamlines the ability to administer legal holds. It facilitates efficient identification of potentially relevant ESI through enterprise-wide searching and enables legal holds to be immediately put into place, preventing liability for preservation issues. Data that is not relevant to the investigation, regulatory matter or litigation can be released easily, decreasing data stores that may eventually progress to the next phases of the e-discovery process.

Create an Application Inventory and Data Map

Another way to proactively approach data management is to create an application inventory and data map. An application and inventory map provides organization to IT environments and allows for a quick identification of pertinent data and custodians that are key to the fulfillment of preservation obligations. It also prevents the

need to search for information throughout the organization’s electronic information. Possessing this tool will help strengthen defensibility arguments if the opposing party moves for spoliation sanctions in the event some data does not get preserved.

Once the application inventory and data map is in place, it must be routinely updated as an organization’s technology environment is constantly changing. The periodic updates should intertwine with technology asset management processes, storage planning, information security assessments and other peripheral processes. When applications or systems are retired, information should be included as to where the final set of data is kept and what process will be required to restore if necessary. Maintaining this information and checking with the pertinent parties prior to requiring a restoration, will save time, cost and effort down the road.

Know When the Duty to Preserve Arises

The exact moment the duty to preserve arises remains a tricky issue and is often considered to be the most challenging step of the e-discovery process. The Federal Rules of Civil Procedure provide little guidance as to a party’s preservation obligation and when the duty to preserve arises. Thus, litigants must rely on caselaw to determine the proper course of action.

In a separate case from the Southern District of New York, United States Magistrate Judge James C. Francis IV found the duty to preserve arose no later than the lawsuit’s filing.¹⁹ In the District of Maryland, the court found the duty to preserve arose when a plaintiff sent a letter informing the defendant that he had consulted attorneys regarding the matter.²⁰ The Western District of Kentucky has held the notice of litigation was established after a phone call from the plaintiff and the filing of a complaint.²¹

As demonstrated by the sampling of cases above (which by no means present an exhaustive list of possibilities), it is no wonder parties are confused as to when the duty to preserve arises. It is better for parties to be safe than sorry by implementing a written legal hold sooner rather than later if litigation appears to be on the horizon. To increase defensibility, parties should maintain detailed notes of the preservation protocol followed, which include when the hold was issued, what details were included in the hold, to whom the hold was issued and the efforts taken to continually monitor compliance.

Issue Written Legal Holds

As highlighted by *Pension Committee*, issuing legal holds is an essential step of the process. Upon reasonable anticipation of litigation, counsel must issue written legal holds and communicate them appropriately to employees of the organization. This ensures all department heads, IT personnel and pertinent employees are made aware of the hold. The written hold should include the purpose for

the hold, a description of the lawsuit or investigation, and the guidelines for determining what data should be preserved and by whom. Counsel should then work jointly with IT to notify legal opponents and any relevant third parties of their duty to preserve potentially responsive information. Internal automatic destruction must also be suspended, which includes halting defragmentation software and other forms of automatic or routine drive “cleanup” activities.

The failure to properly issue a legal hold and prevent the disposal of information spells disaster for parties and their counsel. In addition to *Pension Committee*, federal caselaw from across the country is peppered with incidents involving spoliation and sanctions requests. Indeed, according to Kroll Ontrack’s 2009 *Year in Review* report, 66.7% of federal cases in 2009 that addressed sanctions involved preservation and spoliation issues. To provide an example, consider an Eastern District of New York case from March 2009 that addressed legal holds. In *Acorn v. County of Nassau*,²² the defendants claimed they issued a “verbal” legal hold and instructed key individuals to search for responsive documents, despite lacking the technical resources to locate and access electronic documents. Finding the defendants possessed a duty to preserve and were grossly negligent in failing to issue a proper legal hold, the court awarded the motion costs and attorney fees to the plaintiffs.

Monitor Legal Hold Compliance

Once a legal hold notice is issued, counsel should actively monitor internal suspension measures and ensure compliance. This includes sending update notices to keep key players and new employees informed, reminding them of their preservation obligations. Detailed and accurate records should also be kept of what data have been preserved and how, should the opposing party bring preservation methods into question. Counsel should ensure the legal hold is in effect until final judgment, a settlement has been reached and a formal release has been signed by all parties, or the case is dismissed and no related claims remain outstanding. To lift the legal hold, counsel should circulate an explicit notice that serves to officially resume scheduled disposal. Care must be taken to ensure the hold is not lifted prematurely on particular data that may be concurrently under hold for another matter.

A recent case from the Middle District of Florida highlights this ongoing obligation of counsel. In *Swofford v. Eslinger*,²³ the court cited *Zubulake IV* and found that it is insufficient for in-house counsel to simply notify employees of preservation notices. Rather, counsel “must take affirmative steps to monitor compliance”²⁴ to ensure preservation. *Swofford* is a novel case as it marks one of the first instances where in-house counsel was sanctioned for discovery failures. The court issued an adverse inference sanction for the evidence destruction and awarded

attorney fees and costs to the plaintiffs, holding the defendants and in-house counsel jointly and severally liable.

Conclusion

Judge Scheindlin reiterates in *Pension Committee* that perfection is not required, but parties must take the necessary steps to properly preserve relevant records for collection, review and production. Although the specific definitions of unacceptable conduct and relational levels of culpability provided in *Pension Committee* are not meant to establish a definitive list of behavior in the discovery process that will result in sanctions, the message is abundantly clear. Courts will impose sanctions for a failure to properly fulfill discovery obligations. Counsel can help avoid spoliation by properly planning for electronic discovery prior to litigation. Investing resources in proper preservation and legal hold management from the outset will return dividends by ensuring that discovery practices withstand judicial scrutiny in the unfortunate event opposing counsel files a motion seeking spoliation sanctions. ■

1. 2010 WL 184312 (S.D.N.Y. Jan. 15, 2010).
2. *Id.* at *3.
3. *Id.* at *3.
4. *Id.* at *3.
5. *Id.* at *1.
6. *Id.* at *4 (citing *Fujitsu Ltd. v. Fed. Express Corp.*, 247 F.3d 433, 436 (2d Cir. 2001)).
7. *Pension Committee* 2010 WL 184312 at *5.
8. *Id.* at *5.
9. *Id.* at *6 (citing *West v. Goodyear Tire & Rubber Co.*, 167 F.3d 776, 779 (2d Cir. 1999)) (quoting *Kronisch v. U.S.*, 150 F.3d 112, 126 (2d Cir. 1998)).
10. *Id.* at *7.
11. *Id.* at *12 n.99.
12. *Id.* at *23.
13. Kroll Ontrack, *Third Annual ESI Trends Report* (2009).
14. Judge Rosenthal currently serves as chair of the Federal Judicial Conference Advisory Committee for the Federal Rules of Civil Procedure, and led the committee when the Federal Rules of Civil Procedure were amended in 2006 to address electronically stored information.
15. 2010 WL 645253 (S.D. Tex. Feb. 19, 2010).
16. Judge Rosenthal also notes that bad faith is required for an adverse inference instruction in the Eleventh Circuit, and that the Seventh, Eighth, Tenth and D.C. Circuits appear to require bad faith. *Id.* at n.11.
17. *Id.* at *7.
18. *Id.* at *1.
19. *Green v. McClendon*, 262 F.R.D. 284, 2009 WL 2496275 (S.D.N.Y. Aug. 13, 2009).
20. *Goodman v. Praxair Servs., Inc.*, 632 F. Supp. 2d 494 (D. Md. 2009).
21. *KCH Servs., Inc. v. Vanaire, Inc.*, 2009 WL 2216601 (W.D. Ky. July 22, 2009).
22. 2009 WL 605859 (E.D.N.Y. Mar. 9, 2009).
23. 671 F. Supp. 2d 1274 (M.D. Fla. 2009).
24. *Id.* at 1281 (citing *Zubulake v. UBS Warburg LLC*, 229 F.R.D. 422, 432 (S.D.N.Y. July 20, 2004)).

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