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E-Discovery Alert

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E-Discovery Sanctions: A Continuing Trend

Introduction

It is now black-letter law that electronically stored information ("ESI" for short) is discoverable if relevant or likely to lead to relevant evidence. Indeed, the revisions to the Federal Rules of Civil Procedure ("FRCP") that went into effect on December 1, 2006 addressing the discovery of ESI confirm that the 21st Century is witnessing the transformation of traditional trial practice to accommodate ESI in all phases of litigation, from initial discovery and production through trial. Given the vast amount of electronic information retained by most companies, the complex task of preserving, retrieving, and producing discoverable ESI and the prospect of extremely harsh sanctions for discovery missteps, the discovery of electronically stored information, or "e-discovery," has become a major concern and potential liability for all companies.

The genesis of e-discovery sanctions stems from the historic imposition of sanctions for "spoliation" -- the destruction or alteration of evidence, or the failure to preserve property for another's use as evidence in pending or reasonably foreseeable litigation. In federal court, a party that contravenes discovery rules or orders has always been subject to sanctions pursuant to FRCP 37. Additionally, all courts have the inherent power to police litigant misconduct and impose sanctions upon those who abuse the discovery process. The underlying basis for both Rule 37 sanctions and sanctions pursuant to a court's inherent powers is to (1) penalize the culpable parties; (2) deter others from engaging in similar conduct; (3) redress the prejudice suffered by the innocent party; and (4) compel required disclosures.

To this end, courts have broad discretion regarding the type and degree of sanctions they can impose. Depending on the egregiousness of the e-discovery missteps, companies that have engaged in intentional, negligent, or even *innocent*, spoliation of electronic evidence have been assessed monetary sanctions (including both civil penalties and costs and attorneys' fees associated with discovery), preclusion sanctions (*i.e.*, precluding the offer or other use of certain evidence), adverse inferences (*i.e.*, directing a jury to assume missing ESI is adverse to the spoliator), so-called "rummaging" (*i.e.*, giving the discovering party hands-on access to an adversary's computer system), revocation of *pro hac vice* admission of counsel, and even default judgments.

The *Zubulake* Wake-Up Call

A seminal series of e-discovery opinions were issued in the case of *Zubulake v. UBS Warburg*.[1] Filed in 2002 in the Southern District of New York, *Zubulake* involved an employment discrimination dispute in which the plaintiff, a former Wall Street executive, requested ESI during the normal course of discovery.

1 229 F.R.D. 422 (S.D.N.Y. 2004) ("Zubulake V"). *See* K&L Alert "Zubulake Jury Returns E-Discovery 'Wake-Up Call'" (April 2005).

In reaffirming the well-established principle that the duty to preserve and produce potentially relevant evidence extends to ESI, the Court found that the defendant's failure to preserve and produce electronic evidence (including not preserving allegedly relevant e-mails and backup tapes), warranted severe sanctions. These sanctions included both monetary penalties and an adverse inference instruction to the jury. The jury ultimately returned a verdict for $29.3 million -- including $20.2 million in punitive damages!

The Sanctions Trend

The *Zubulake* sanctions contributed to a focus on e-discovery and appropriate records management, but its progeny have perpetuated and expanded the field, *and the imposition of sanctions for e-discovery failures is a continuing trend*. As the following cases illustrate, Courts have issued a number of notable opinions with regard to discovery of ESI, and have imposed severe sanctions on litigants found to have fallen short in their duty to preserve and produce potentially relevant ESI:

- **Substantial Monetary Sanctions and Default Judgment for Failure to Produce Backup Tapes:**

  In 2005, a Florida jury awarded financier Ronald Perelman $1.45 billion in damages after the trial judge issued a default judgment against Morgan Stanley as a sanction for various alleged e-discovery missteps.[2] The trial judge found that Morgan Stanley initially certified that all relevant electronic records had been produced, but then repeatedly uncovered new backup tapes months after the discovery deadline had passed. The trial judge ruled that Morgan Stanley had deliberately failed to comply with discovery and instructed the jury to assume that Morgan Stanley had helped to defraud Mr. Perelman. As a result of this instruction, Mr. Perelman had to prove only that he relied on Morgan Stanley's representations to his financial detriment. While the judgment, including the award of punitive damages, was reversed on grounds unrelated to the e-discovery issues (which issues were left untouched by the appellate court), the trial court's rulings and the jury's findings are a cautionary tale regarding the potential impact of e-discovery miscues.

- **Adverse Inference and Monetary Sanctions Imposed for Failure to Halt E-Mail Recycling Program:**

  In 2005, a Minnesota judge imposed monetary sanctions and granted an adverse inference instruction against a securities company after finding that the company failed to preserve and produce potentially relevant ESI. While the court could not find that that spoliation of paper documents occurred, the judge determined that the defendants' destruction of hard drives, allegedly pursuant to a business closure, destruction of telephone recordings pursuant to defendants' standard business practices, and defendants' failure to retain e-mail messages by either placing a litigation hold on e-mail boxes or preserving backup tapes with copies of potentially relevant e-mails prejudiced plaintiffs so as to merit the sanctions imposed.

- **E-Discovery Abuse Warranted Adverse Inference Instruction:**

  In 2006, a federal district judge in Minnesota adopted a magistrate judge's recommended evidentiary sanctions against an alleged patent infringer.[3] These sanctions included an adverse inference instruction, an order barring the alleged infringer's attorney from attending the deposition of any defense witness or any third party, an order granting the plaintiff additional depositions and other discovery, and an award of reasonable fees and costs to the plaintiff associated with its sanctions motion. The court also affirmed the magistrate's warning that further sanctions, including default judgment, could result if the defendant either failed to abide by the court's rulings and the FRCP or engaged in further discovery abuse.

2 *Coleman (Parent) Holdings, Inc. v. Morgan Stanley & Co., Inc.*, No. CA03-5045 (15th Jud. Cir., Palm Beach Cty., Fla.), *rev'd on other grounds*, No. 4D05-2606 (Fla. Dist. Ct. App. Mar. 21, 2007).

3 *3M Innovative Props. Co. v. Tomar Elecs.*, 2006 WL 2670038 (D. Minn. Sept. 18, 2006).

- **Adverse Inference Instruction, Preclusion of Evidence Order, and Award of Attorneys' Fees Imposed for a Small Number of E-Mails Lost Pursuant to "Long-Standing" Document Policy:**

  In 2006, the Southern District of California imposed sanctions against a defendant, an investor in Napster, Inc., in a copyright infringement action regarding musical compositions.[4] After learning that the defendant's employees routinely deleted e-mails pursuant to its "long-standing" document policy, without regard to whether the deleted e-mails were relevant to the litigation, the court issued a preclusion of evidence order, an adverse inference instruction, and an award of attorneys' fees. The court determined these sanctions to be the appropriate remedy despite the fact that the defendant's conduct did not constitute a pattern of deliberately deceptive litigation practices, and notwithstanding evidence that the number of e-mails actually lost was small.

- **Variety of Severe Sanctions Issued for Failing to Search E-Mails and Permanently Losing Others Pursuant to Standard Practices:**

  In 2006, the New Jersey Federal Court imposed significant sanctions upon an ERISA class action defendant for repeated e-discovery abuses, including failing to search e-mails and permanently losing others due to standard e-mail retention practices.[5] While reserving decision as to the propriety of a default judgment until certain class action issues had been resolved, the court, notwithstanding its proclaimed reluctance to sanction parties, issued a variety of sanctions, including: (1) deeming certain facts admitted by defendant for all purposes; (2) precluding evidence that was not produced by the defendant in discovery; (3) striking various privilege assertions by the defendant; (4) directing the payment of substantial costs and attorneys' fees related to defendant's misconduct; (5) imposing fines in an amount to be determined after the court considered defendant's financial condition; and (6) appointing a discovery monitor at the defendant's expense to review defendant's compliance with the court's discovery orders.

- **Inadequate Record Hold Notices Resulted in Adverse Inference Instruction and Award of Attorneys' Fees:**

  Ushering in 2007, the Southern District of New York granted plaintiff's motion for sanctions in the form of an adverse inference instruction and awarded plaintiff its costs and attorneys' fees incurred in connection with its sanctions motion, as well as additional discovery costs where the defendant was only able to produce e-mails for 13 out of the 57 current and former employees who were identified as "key players" in the suit.[6] While the defendant sent out document hold notices early in the case, it failed to issue a reminder notice after going through a corporate reorganization that resulted in the creation of two separate entities, and, moreover, the initial hold memos that it distributed were ignored. The court explained that, in the Second Circuit, the "'culpable state of mind' requirement [for the granting of an adverse inference instruction] is satisfied . . . *by a showing of ordinary negligence*."[7]

- **Court Orders Default Judgment for Failure to Produce "Smoking Gun" E-Mails:**

  In a 2007 suit for specific performance of a contract for the purchase of a radio station, the Southern District of Florida awarded a default judgment and attorneys' fees and costs to plaintiff based upon defendants' discovery misconduct.[8] The court found that the defendant, among other abuses, failed to produce key "smoking gun" e-mails during discovery. The e-mails, later obtained from a third party,

4 *In re Napster, Inc. Copyright Litig.,* 2006 WL 3050864 (N.D. Cal. Oct. 25, 2006).
5 *Wachtel v. Health Net, Inc.,* 2006 WL 2538935 (D.N.J. Dec. 6, 2006).
6 *In re NTL, Inc. Sec. Litig.*, 2007 WL 241344 (S.D.N.Y. Jan. 30, 2007).
7 *NTL*, 2007 WL 241344 at *19 (emphasis added).
8 *Qantum Communications Corp. v. Star Broad., Inc.*, 2007 WL 445307 (S.D. Fla. Feb. 9, 2007).

directly contradicted testimony by defendant that it was in compliance with the purchase agreement's exclusive dealing provision. Despite defendant's assertion that the e-mails were purged "as a part of ongoing business practice . . . due to the limited amount of storage space," the court found the entry of a default judgment to be warranted.

Conclusion

While the costs of complying with e-discovery can be expensive, the consequences of noncompliance can be far worse. As the above cases illustrate, courts across the country are increasingly willing to take a hard line with corporate litigants who mishandle e-discovery. Litigants can now expect some courts to review their e-discovery procedures in great detail before deciding whether their actions were reasonable.

Clients and counsel that do not focus sufficient attention on ensuring the preservation and production of relevant ESI face the risk that the destruction of potentially relevant electronic evidence, regardless of whether the destruction was unintentional, can lead to severe sanctions and even tip the balance in determining litigation outcomes. For a more detailed evaluation and analysis of how your company can act now to implement best practices with regard to records management, and how you can reduce e-discovery risks and costs in future or currently pending litigation, please be in touch with one of your K&L Gates contacts or any of the other lawyers listed above.