



# E-discovery Law Alert

## New federal rules of civil procedure

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### *Pension Committee* opinion addresses legal hold standards

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In the ongoing *Pension Committee of the University of Montreal Pension Plan v. Banc of America Securities, LLC*, litigation, a group of investors seeks to recover losses of \$550M stemming from the liquidation of two British Virgin Islands hedge funds in which they held shares. The road to this recovery for at least 13 of these plaintiffs just hit a significant detour in the form of discovery sanctions for spoliation of information. In a January 15, 2010, decision, Judge Shira Scheindlin (who was the presiding judge in the landmark *Zubulake* series of legal hold decisions) found that plaintiffs had spoliated relevant evidence as a result of conduct ranging from negligence to gross negligence. *Pension Committee of the University of Montreal Pension Plan v. Banc of America Securities, LLC*, 2010 WL 184312 (S.D.N.Y. Jan. 15, 2010). The resulting sanctions imposed include additional (limited) discovery, an award of fees and, for some, an adverse inference jury instruction.

The court's analysis, which is likely to be widely-cited in other cases, focuses on three core issues:

- (1) the criteria for evaluating whether certain discovery failings constitute negligence, gross negligence, or willfulness;
- (2) the interplay between the prejudice suffered by the requesting party and the applicable burden of proof necessary to establish the sanction(s); and
- (3) identifying sanction remedies appropriate to the demonstrated culpability and the actual prejudice suffered.

The case is a must-read, and “*must-understand*,” for all in-house counsel and litigators.

### Teachings of *Pension Committee*

Judge Scheindlin's lengthy opinion makes clear that, at the end of the day, any question regarding preservation decisions and actions will be judged in hindsight by the court. Judge Scheindlin described this as “a judgment call” where the court will employ “‘a gut reaction’ based on years of experience as to whether a litigant has complied with its discovery obligations and how hard it worked to comply.” Not unexpectedly, although *Pension Committee* tries to identify contours of acceptable and unacceptable conduct, Judge Scheindlin recognized that “[e]ach case will turn on its

own facts and the varieties of efforts and failures is infinite.” Importantly, Judge Scheindlin explicitly recognized that “[c]ourts cannot and do not expect that any party can meet a standard of perfection.” *Id.* at 2.

Thus, litigants in other cases must realize that they will need to think through and be prepared to explain why the efforts in their cases were reasonable, effective, and in accordance with best practices even if they are not perfect. There is no single checklist or form to complete. Rather, independent judgment must be applied and appropriate documentation created to reflect the effective execution of that judgment.

That said, the *Pension Committee* opinion does provide meaningful guidance on a number of areas of keen interest to clients and counsel alike: legal holds, back-up tapes, collection efforts, the burden of proof regarding missing evidence, and determining the appropriate sanctions. Each of these areas is addressed below.

### ***1. Legal hold notices***

The court found that a failure to issue a written legal hold notice *per se* constitutes gross negligence because it is likely to result in the destruction of relevant information. *Id.* at 9. Taken literally, this edict imposes a sweeping requirement that written legal hold notices be issued in every case upon reasonable anticipation of litigation. Taken in the context of other opinions by Judge Scheindlin, her other written works, and best practices guidance from organizations such as The Sedona Conference, it is clear that organizations must have a water-tight legal hold process and, in the event that a written legal hold was not issued, there should be a demonstrably defensible reason why (*e.g.*, the targets were the subject of an internal investigation where notice might lead to the destruction of information, the case falls within the confines of other legal holds that are already in place, all of the data subject to preservation has already been collected).

At a minimum, organizations should review their legal hold process to assess whether they meet the following expectations:

- written legal hold notices are issued as soon as possible following “reasonable anticipation of litigation”;
- the organization continually reviews the scope of the hold notice as additional potential custodians’ and responsive information is identified and the organization issues updated holds as necessary;
- the organization has a system to track the legal hold notice distribution and acknowledgments;
- the organization documents the legal hold process so that it can respond to the question of “who received what notice when?”;
- the organization is prepared to meet and confer with opposing parties (and the court) regarding legal hold issues (including distribution and related preservation efforts); and
- if there is a special circumstance where a written legal hold notice is not feasible (or appropriate), the organization has documented the preservation measures employed that reflect a reasonable, good faith effort to preserve relevant information.

## ***2. Collection as a preservation method***

The *Pension Committee* court addressed the loss or destruction of evidence resulting from a failure to conduct a proper and timely collection of responsive documents and electronically-stored information (“ESI”). The court noted that: “the failure to collect records — either paper or electronic — from key players constitutes gross negligence or willfulness.” *Id.* at 10. For those employees that are not key players to the litigation (those that “may have had only a passing encounter with the issues in the litigation”), the failure to collect “likely constitutes negligence as opposed to a higher degree of culpability.” *Id.* at 10.

Taken out of context, some observers are suggesting that all custodians must be subject to immediate collection of all potentially relevant information for preservation purposes. Of course, such an extraordinary requirement would be effectively impossible in all but the smallest organizations due to extreme costs and burdens. Instead, the *Pension Committee* language must be read reasonably and should be understood as a clear warning that simply sending out a hold notice by itself is not sufficient, and relying solely on custodians to select and collect information for the litigation is also not sufficient. Instead, parties need to have a process in place that demonstrates that they effectively executed the preservation directives, ensured that the pertinent custodians received appropriate direction and oversight in complying with directions, and, as necessary, that the organization reached out and collected information from key players and others to ensure its preservation.

As noted at the outset of the *Pension Committee* opinion, this preservation process will vary from case-to-case depending on the value of the case and the types of discoverable documents and ESI. At a minimum, organizations should consider the following in terms of assessing the preservation process:

- providing instructions to custodians that are sufficient to effectively communicate what must be done to preserve potentially relevant information;
- making good faith efforts to identify key players and others who may have potentially responsive information so that they can receive a hold notice and appropriate collection steps can be undertaken;
- utilizing a process by which relevant information can be collected from key players and others if necessary at the outset of a matter;
- utilizing a process by which forensic images of hard drives and other storage devices can be made and preserved if necessary; and
- ensuring that the organization will be able to competently discuss with opposing parties (and the court) the contours of what is, and is not, being done with respect to preservation and collection to identify and resolve any disputes early in the litigation.

## ***3. Back-up tapes/media***

The court also noted that the failure to preserve “certain backup tapes” containing data from key players “constitutes gross negligence or willfulness.” *Id.* at 10. The court, however, made clear that:

“I am not requiring that *all* backup tapes must be preserved. Rather, if such tapes are the *sole* source of relevant information (e.g., the active files of key players are no longer available), then such backup tapes should be segregated and preserved.

When accessible data satisfies the requirement to search for and produce relevant information, there is no need to save or search backup tapes.” *See* Fed. R. Civ. P. 26(b)(2)(B).

*Id.* at 43, fn. 99. In short, Judge Scheindlin’s opinion reiterates the mandate regarding back-up tapes that was set forth in the *Zubulake* opinions.

Consistent with *Pension Committee*, *Zubulake*, and best practices guidance, organizations should consider the following:

- developing and documenting a good working understanding of all backup systems so that timely and defensible decisions can be made to assess whether any such media needs to be taken out of ordinary rotation and preserved;
- establishing a process for moving quickly to identify and preserve backup tapes that the organization believes contain unique and relevant information from key custodians in any given case;
- being prepared to discuss with opposing parties (and the court) the organization’s backup systems and what, if any, steps should be taken to preserve and/or produce such data;
- being prepared to defend, with a developed factual record, decisions made not to retain backup data; and
- developing the factual support for any argument that the restoration, processing, and production of content from retained backup media imposes an “undue burden or cost” such that the data is “not reasonably accessible” and thus should not be discovered (or, alternatively, even if good cause would warrant such production then there should be an allocation of the costs of such discovery).

#### ***4. Establishing prejudice and satisfying burden of proof***

In its analysis, the court addressed a critical dilemma in discovery sanctions cases: “Who should bear the burden of establishing the relevance of evidence that can no longer be found?” and “Who should be required to prove that the absence of the missing material has caused prejudice to the innocent party?” *Id.* at 13.

Primarily relying on Second Circuit case law, the court held that once it has been determined that the spoliating party has failed to comply with a discovery preservation duty, the court must assess whether:

- the spoliating party “acted with a culpable state of mind upon destroying or losing the evidence; and
- the missing evidence is relevant to the innocent party’s claims or defenses.

*Id.* at 15.

The court specifically rejected an approach where the innocent party merely needs to show that the destroyed evidence would have been responsive to a pending document request, but, rather, indicated that that party needs to show that its ability to pursue its claims and/or defenses is

prejudiced without that evidence. Therefore, in cases involving spoliation resulting from “merely negligent” behavior, the innocent party must set forth sufficient extrinsic evidence for the trier of fact to infer that the destruction (or unavailability) of evidence would have been favorable to its case.

In cases where there has been a showing that the spoliating party acted in bad faith or in a grossly negligent manner, the analysis changes. In those situations, the court found that “relevance and prejudice may be presumed.” *Id.* at 15.

At any level of culpability by the spoliating party, a presumption of relevance and prejudice is rebuttable. The court held that following such a presumption, the burden of proof shifts and the spoliating party should have the opportunity to establish that the innocent party has, in fact, not been prejudiced by the missing information. *See id.* at 17-18.

### ***5. Appropriate sanction remedies***

The final key issue addressed by the *Pension Committee* court is the appropriate remedies that should be imposed depending on the willfulness of the spoliating party’s conduct and the prejudice suffered by the innocent party.

The court reviewed the available sanction options in its evaluation of the conduct of the thirteen individual spoliating plaintiffs. In assessing the sanction options from least severe to most severe, the court identified considerations that may result in the imposition of a particular sanction:

- *Dismissals and default judgments* should only be imposed in cases of intentional bad faith conduct (such as in cases involving deliberate document destruction, tampering with computer hard drives, and/or deliberately misleading the opposing party regarding the preservation and production of evidence).
- *Issue preclusion* stops short of a full dismissal or default judgment, but is still to be reserved for egregious intentional conduct.
- *Special jury instructions* may be imposed across a continuum — “allowing the jury to consider both the misconduct of the spoliating party as well as the proof of prejudice to the innocent party.” *Id.* at 23. In matters involving spoliation that was willful or performed in bad faith, the court may choose to direct the jury that certain facts are deemed to be admitted by the spoliating party. In other matters where there is a lesser showing of willful/reckless behavior, the court may choose to direct the jury to presume that the missing evidence would have been favorable to the innocent party, however such a presumption would be rebuttable by the spoliating party. Finally, the least harsh instruction would permit (but not require) the jury to presume that the lost evidence was both relevant and favorable to the innocent party. In this final scenario, it is up to the jury to decide whether to draw an adverse inference against the spoliating party. *See id.* at 22.
- *Monetary sanctions and cost shifting* are appropriate to punish the spoliating party’s conduct and deter future similar conduct while also compensating the innocent party for the costs and burdens associated with the imposition of unnecessary discovery expenses and disputes.

The court found that monetary sanctions are most appropriate where there is not a sufficient showing of prejudice to the innocent party to support a finding of more culpability than negligence. The court held that a finding of gross negligence supports, at a minimum, the use of a spoliation jury instruction. *Id.* at 41.

In the context of the *Pension Committee* facts, the court found that each of the thirteen individual plaintiffs had acted with either negligence or gross negligence. *Id.* at 41-82. The court imposed monetary sanctions on each plaintiff and, for those found to be grossly negligent, a special jury instruction that permitted the jury to presume that the lost evidence was relevant or would have been favorable to the defendants. *Id.* at 83. The court also required one plaintiff to continue to search backup tapes for additional discovery productions. *Id.* at 85.

## Conclusion

Even with the 88-pages of analysis in the *Pension Committee* opinion, there is no uniform set of discovery behavior that will guarantee a court's blessing (or sanctions). But Judge Scheindlin did set forth a useful listing of certain discovery actions that, in her view, are a "failure to adhere to contemporary standards and can be considered gross negligence":

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

Again, it must be noted that Judge Scheindlin recognized that the findings and conclusions in any given case will be highly fact-specific. It also must be noted that the key will be establishing what the acceptable community standards expect — not simply a comparison of conduct against the language in *Pension Committee* or any one select case.

For litigants in the federal courts (and increasingly in state courts), the admonishments in the *Pension Committee* case should be read carefully. Failure to conduct discovery in accord with "contemporary standards" exposes litigants to findings of gross negligence (or worse). Beyond the imposition of costs and fines, the attendant sanctions to such a finding may well serve to compromise a party's substantive position in the underlying litigation and related cases.

To avoid these sidetracks, a party must continually conduct discovery with good faith, diligence, and a clear understanding of the legal requirements for preservation and production. For the thirteen *Pension Committee* plaintiffs, the inability to meet this standard has substantially impacted their ability to pursue a \$500+ million suit, which is certainly no small repercussion.

As Judge Scheindlin quotes George Santayana in her introduction: "*those who cannot remember the past are condemned to repeat it.*"

## **Recommended Reading Regarding Best Practices For Legal Holds**

*The Sedona Principles (Second Edition): Best Practices, Recommendations and Principles for Addressing Electronic Document Production* (July 2007)

*The Sedona Guidelines: Best Practices Guidelines and Commentary for Managing Information and Records in the Electronic Age* (November 2007)

*The Sedona Conference® Commentary on Legal Holds* (August 2007 Public Comment Version)

*The Sedona Conference® Commentary on Inactive Information Sources: Guidance Principles for Identifying, Classifying, Retaining and Destroying Orphaned, Legacy and Dormant ESI* (July 2009 Public Comment Version)

*Seventh Circuit Electronic Discovery Pilot Program - Statement of Purpose and Preparation of Principles*

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