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A legal update from Dechert's White Collar and Securities Litigation Group

Electronic Discovery Rule Changes Upcoming

Executive Summary

- The *Zubulake* case ($29 million plaintiff's verdict) and the *Coleman* case ($1.4 billion plaintiff's verdict) establish the enormous downside risk in electronic discovery process failure.
- The Federal Rules are scheduled to be amended effective 12/1/06 in large part to deal with these electronic discovery issues.
- The proposed rule amendments are designed to close the gap between the existing rules and the reality of massive data volume associated with electronic discovery.
- The proposed rule amendments encourage so-called "non-waiver," "quick-peek," or "clawback" agreements which allow production of documents without conducting a full privilege review subject to later assertion of privilege or attorney work-product protection. However, such procedures will continue to involve significant risk to the producing party.
- The proposed rules address the expense of producing material on back-up or disaster-recovery tapes by allowing a party to respond to a discovery request by identifying such relatively inaccessible material as not produced because of undue burden or cost. New procedures, including data sampling, will allow an organization at the outset of a litigation to obtain a ruling whether it must preserve such tapes, and who must bear the cost of restoring or converting the data to accessible form.
- Proposed Rule 37(f) provides a limited "safe-harbor" as follows "[a]bsent exceptional circumstances, a court may not impose sanctions under these rules on a party for failing to provide electronically stored information lost as a result of the routine, good-faith operation of an electronic information system."
- However, the good faith required by the proposed rule may require that a party suspend routine computer operations to prevent the loss of information subject to preservation or litigation hold obligations.
- Putting an appropriate litigation hold directive in place and then complying with that directive continue to be crucial to avoid the fate of the defendants in *Zubulake* and *Coleman*, *i.e.*, an adverse inference instruction that any missing information would have been helpful to your adversary.
- Parties are well-advised to consider preservation obligations at the first threat of a litigable claim.

The Federal Rules of Civil Procedure are scheduled to be amended effective December 1, 2006, to reflect that litigation discovery has been revolutionized by electronic storage of vast amounts of information. These rule changes were preceded and informed by judicial application of the existing rules to electronic discovery issues. This article will first describe two prominent cases that have turned on electronic discovery issues and then will discuss the rule changes. The extent to which the *Zubulake* case, in particular, drove the rule changes is significant and noted below.

Electronic Discovery Surfaces as a Critical Issue in 2005

Two civil trials that received a tremendous amount of media attention in 2005 turned on issues of electronic discovery and yielded startling jury verdicts against two bank defendants. In the *Zubulake* case in New York federal court, the court read an "adverse inference" charge to the jury, essentially telling the jury that they could conclude that e-mails may have been deleted and not produced in discovery because they were not helpful to the defense.[1] In April 2005, the jury in that gender discrimination case returned a verdict for plaintiff of over $29 million.

[1] *Zubulake v. UBS Warburg, LLC*, 217 F.R.D. 309 (S.D.N.Y. 2003); *Zubulake v. UBS Warburg, LLC*, No. 02 Civ. 1243, 2003 WL 21087136 (S.D.N.Y. May 13, 2003); *Zubulake v. UBS Warburg, LLC*, 216 F.R.D. 280 (S.D.N.Y. 2003); *Zubulake v. UBS Warburg, LLC*, 220 F.R.D. 212 (S.D.N.Y. 2003); *Zubulake v. UBS Warburg, LLC*, No. 02 Civ. 1243, 2004 WL 1620866 (S.D.N.Y. July 20, 2004); *Zubulake v. UBS Warburg, LLC*, No. 02 Civ. 1243, 2005 WL 266766 (S.D.N.Y. February 3, 2005); *Zubulake v. UBS Warburg, LLC*, No. 02 Civ. 1243, 2005 WL 627638 (S.D.N.Y. March 16, 2005).

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In the *Coleman* action in a Florida State Court, the court instructed the jury that the defendant bank was in violation of federal record keeping requirements, and had falsely certified its compliance with the court's e-mail production directives.[2] The *Coleman* court also read a redacted copy of plaintiff's complaint to the jury as findings of fact, allowed the plaintiff to argue that the defendant had engaged in concealment, shifted the burden of proof, and revoked defense counsel's *pro hac vice* admission. In May 2005, the jury returned a verdict for plaintiff of over $1.4 billion. Notably, in both cases, the juries awarded punitive damages that exceeded the amount of compensatory damages.

The *Zubulake* Decisions

The *Zubulake* case involved gender discrimination and retaliation claims brought by a securities trader against her former employer, a bank. In a series of decisions, the court ordered the bank to produce the most accessible e-mails concerning the former employee and further ordered sampling and then production of e-mails from back-up tapes, and initially shifted a portion of the cost to the plaintiff.

The discovery dispute culminated in a finding by Judge Scheindlin that the bank had failed to adequately preserve and produce requested e-mails on active servers and had failed to safeguard "key player" computer backup tapes. The court shifted the discovery costs back to the employer bank and instructed the jury at trial that it could infer that because the bank had failed to preserve and produce certain e-mails "the evidence would have been unfavorable" to the bank.[3] In April 2005, after three years of litigation, the jury found employment discrimination and awarded $29 million in damages to the plaintiff.

The *Zubulake* decisions were handed down in the midst of the drafting of the proposed electronic discovery rule amendments and the public comment period and undoubtedly had a major influence on the form of the proposed rules.

Upcoming Electronic Discovery Rule Changes

The Judicial Conference of the United States, the rule-making body of the federal court system, has recently approved extensive proposed amendments to the federal rules of civil procedure, including a number of changes addressing electronic discovery. The United States Supreme Court has the authority to prescribe the federal rules, and must transmit the proposed amendments to Congress by May 1, 2006. The proposed rule changes are scheduled to go into effect on December 1, 2006, assuming approval by the Supreme Court and absent adverse action by Congress.

Significant changes concerning electronic discovery are proposed for Federal Rules 16, 26, 33, 34, 37, and 45 (the proposed rule changes are voluminous and cannot be reprinted in full here; they are available at www.uscourts.gov/rules). The proposed amendments seek to address many of the electronic discovery issues that Federal District Judge Shira A. Scheindlin identified in the seven *Zubulake* decisions that were entered from 2003 to 2005. (Judge Sheindlin is a member of the Rules Advisory Committee for the Civil Rules). These issues include whether a producing party needs to search back-up computer storage tapes, and whether a party needs to cease automatic data overwrite functions upon learning of a potential claim.

Rules 16(b) and 26(f): These proposed amendments require the parties to discuss, prior to the first pretrial conference, the topic of discovery of electronically stored information and to include this topic in the parties' report to the court. The Rule 16 amendments also give the court discretion to include electronic discovery as a topic in its scheduling orders. The provisions focus on the form that electronic disclosure will take, preservation of information, and the assertion of privilege.[4] The Rule 26(f) amendments encourage the parties to enter into voluntary agreements under which the inadvertent production of privileged or attorney work-product materials would not result in a waiver. In other words, the amendment suggests, without requiring, that a producing party may produce now and later assert privilege or attorney work-product protection.

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2 *Coleman (Parent) Holdings, Inc. v. Morgan Stanley & Co., Inc.* Fla. Cir. Ct., 15th Cir., Palm Beach Co. Case No. 502003CA005045XXOCAI (March 1, 2005); *Coleman (Parent) Holdings, Inc. v. Morgan Stanley & Co., Inc.* Fla. Cir. Ct., 15th Cir., Palm Beach Co. Case No. 502003CA005045XXOCAI (March 23, 2005).

3 *Zubulake v. UBS Warburg, LLC*, No. 02 Civ. 1243, 2004 WL 1620866 (S.D.N.Y. July 20, 2004).

4 The related proposed committee note recognizes that "[c]omplete or broad cessation of a party's routine computer operations could paralyze that party's activities," and this expressly recognizes that the need to preserve evidence must be balanced against the need to continue ongoing party operation.

The amendment reflects a concern that the burden of conducting a full privilege review in the context of electronic discovery may be onerous, where millions of documents may be subject to production. However, it is not yet clear that such non-waiver agreements provide the intended protection. Indeed, a number of cases have rejected so-called "non-waiver," "quick peek," or "clawback" agreements, and Magistrate Judge Paul W. Grimm has recently issued a decision in the District of Maryland reviewing the proposed rule amendment and warning parties against relying on an agreed right to assert privileges post-production.[5] Nonetheless, the prevalence of such agreements will no doubt increase particularly in light of the burden and expense of reviewing voluminous electronic files for embedded information or "metadata" that may be privileged.[6]

Rule 26(b)(2)(B): The amendments would allow a party to respond to a discovery request by identifying as not produced electronically stored information that is not reasonably accessible because of undue burden or cost. The requesting party may then move to compel preservation or production. The amendment also recognizes that the responding party may wish to resolve the issue by moving for a protective order.

The amendment reflects the reality that such preservation and protective orders have become a critical issue in cases like *Zubulake* where a large organization needs to determine at the outset whether it must preserve archival, backup, or other relatively inaccessible information. Presumably, the key player backup tapes referenced in *Zubulake* would fall into the category of information storage that could be identified pursuant to the proposed provision. The responding party has the burden to demonstrate that the information is not reasonably accessible. The court will then apply the familiar balancing test in the existing rule, including consideration of whether the "the burden or expense of the proposed discovery outweighs its likely benefit." The application of the balancing test in the third published *Zubulake* decision remains good law, *i.e.*, to the extent a party seeks "inaccessible" data, that party may, in the court's discretion, be required to bear at least part of the cost of restoring or converting the data to accessible form but not the cost of producing the data once it has been rendered accessible.

The proposed rule amendment and related Committee Note also contemplate that a "staged" or "two-tier" proceeding may be useful to the court in deciding information recovery cost-shifting issues. Here, again, we see a reflection of the *Zubulake* decisions. In the first published *Zubulake* decision, the court ordered the bank to restore and produce certain e-mails from a sampling of back-up tapes. In the third published *Zubulake* decision, the court, with the sampling results in-hand, applied a cost-shifting analysis and required the employee to bear 25% of the cost of restoring the back-up tapes to accessible form.

Rule 26(b)(5): The proposed changes to Rule 26(b)(5) provide a procedure to deal with the problem of inadvertent production of privileged or attorney work product information. As discussed above in connection with the Rule 26(f) amendment, the proposed changes seek to address the increased burden and increased risk of conducting a privilege review when the production involves many millions of electronically created and stored documents. Upon notification to the recipient of the producing party's post-production privilege claim, the recipient must return, sequester, or destroy the information until the claim is resolved, including by submission of the information under seal to the court. The proposed amendment does not attempt to address the substantive standards for waiver of privilege and work product protection, which are the subject of an extensive body of case law.[7]

Rules 33, 34, and 45: Existing Rule 33 allows a party to respond to an interrogatory by producing business records so long as the burden of answering the question from a review of the documents is substantially the same for either party. The amendment clarifies that electronic information may constitute the business records produced in lieu of an answer. Similarly, Rule 34, which covers document requests, adds "electronically stored information," as a category subject to production in addition to "documents." The Rule 45 amendment simply conforms the subpoena provision

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5 *Hopson v. Mayor & City Council of Baltimore*, 232 F.R.D. 228 (D. Md. 2005).

6 Microsoft publishes the following definition of metadata: "data about data; descriptive statistical information about the elements of a set of data." *Encarta® World English Dictionary (North American Edition) © & (P)2005 Microsoft Corporation.* For example, information about the creation, editing, access, and transmission of an electronic document may be automatically stored. Some metadata is familiar, such as the name and identification number of the document. Other types of metadata are more difficult to access, such as a record of all network users who have opened the document, when they did so, and whether they made any changes.

7 *See Hopson v. Mayor & City Council of Baltimore*, 232 F.R.D. 228 (D. Md. 2005).

of the rules to include the production of electronically stored information as well as paper documents and other things.

Rule 37(f): Proposed Rule 37(f) states in full that "[a]bsent exceptional circumstances, a court may not impose sanctions under these rules on a party for failing to provide electronically stored information lost as a result of the routine, good-faith operation of an electronic information system." Notwithstanding the brevity of this new provision, it was the focus of much of the public comment on the proposed changes. The rule addresses a critical distinction between paper records and electronic records, *i.e.*, computer systems typically operate on the basis of routine overwriting, modification, and deletion of information.

Here again, we find that the *Zubulake* series of decisions apparently informed the drafting of the proposed amendments. Specifically, in the fourth published *Zubulake* decision, the court discussed at length the scope of a party's discovery obligations concerning disaster recovery or backup tapes, which typically can be permissibly recycled, if at all, only if they are "inaccessible," and concerning more readily available information, which will likely be subject to the requisite litigation hold.

As the proposed Committee Note explains, the good faith required by the proposed rule may require that a party must intervene to suspend the routine operation of an information system to prevent the loss of information subject to preservation or litigation hold obligations. The Committee Note further clarifies that good faith may require preservation of information even on sources a party has identified has inaccessible pursuant to proposed Rule 26(b)(2).

Putting an appropriate "preservation order" or "litigation hold" in place and then complying with that directive are crucial and remain central under the new rules. These are critical elements of establishing good faith under Rule 37(f) and avoiding the fate of the defendants in *Zubulake* and *Coleman*, *i.e.*, an adverse inference instruction.

Proper preservation orders may be summary or detailed, and widely distributed or narrowly published, depending upon the circumstances of the litigation and the culture and organization of the litigant. In any event, compliance is key. In *Zubulake*, a proper litigation hold was distributed by the defendant bank but was not complied with. The proposed rules do not address the issue of when the obligation to preserve arises, generally when a party has notice that information may be relevant to future litigation.[8] Parties are well advised to consider preservation obligations at the first threat of a litigable claim.

Conclusion

The proposed federal civil rule changes concerning electronic discovery reflect that discovery production of e-mail and other electronic information is now a routine yet critical aspect of virtually every litigated case. States will undoubtedly adopt similar rules or procedures, even where state court rules do not mirror the federal rules. Some courts are already referring to the proposed rules for guidance in advance of their effective date.

The jury verdicts in the *Zubulake* and *Coleman* cases drew attention last year to the potential litigation exposure associated with electronic discovery protocol. The proposed rule amendments reflect the importance of electronic discovery, and, when the rules become effective, will mandate express consideration of the issue at the very outset of, and throughout, every federal court case.

8 *See, e.g., Kronisch v. United States*, 150 F.3d 112, 126 (2d Cir. 1998) (the obligation to preserve may arise "when a party should have known that the evidence may be relevant to future litigation").

Practice group contacts

If you have questions regarding the information in this legal update, please contact the Dechert attorney with whom you regularly work or one of the attorneys listed. Visit us at www.dechert.com/financialserviceslit or www.dechert.com/whitecollar.

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