New York Law Journal

A NEW YORK LAW JOURNAL SPECIAL SECTION

An incisivemedia publication

LITIGATION

Web address: http://www.nylj.com

MONDAY, DECEMBER 1, 2008

New Federal Rule of Evidence Arrives

Cost relief predictions are overstated.

BY THOMAS F. MUNNO AND BENJAMIN R. BARNETT

FEDERAL RULE of Evidence 502 (FRE 502), enacted on Sept. 19, 2008, has been heralded as a significant development which "will effectively limit the skyrocketing costs of discovery."[1] The Rule and its promotion as a cost-saving panacea have no doubt raised expectations among clients and courts alike.

As a rule of evidence, FRE 502 is significant because it (a) resolves conflicts among federal courts concerning the effect of voluntary and inadvertent productions of privileged material and (b) imposes federal evidentiary rules on state courts.[2] FRE 502 will not meaningfully reduce the costs of discovery, particularly in cases involving huge e-discovery obligations, related investigations by state government entities, and "asymmetric" discovery obligations (where one party has to produce a tremendous number of documents and the other does not) for three reasons:

1. The touting of FRE 502 as a cost-savings measure is based on the erroneous premise that mitigating the risk of waiver will substantially reduce e-discovery costs.
2. To avoid waiver, litigants must take "reasonable steps" to avoid inadvertent disclosures and "reasonable steps" to rectify productions errors, an ambiguous standard that is expensive to meet.
3. As acknowledged by its drafters, FRE 502's ability to mitigate the risk of waiver requires that state courts be bound by the Rule. Its so-called "controlling effect" provisions may not be constitutional. Until, and unless, FRE 502's constitutionality is established, it will provide little assurance to litigants that state attorneys general and private litigants will be unable to establish waiver in state court proceedings.

Other Fears Drive Discovery Costs

FRE 502 is based on the premise that litigants spend millions of dollars on privilege review, which they would not otherwise spend, out of fear that waiver of attorney-client privilege or work product protection will result from the inadvertent production of protected documents. Thus, the scope and cost of privilege review can be reduced if the risk of waiver is minimized.

While avoiding waiver is important, the practice of reviewing potentially privileged documents on a document-by-document basis is motivated primarily by the desire to prevent disclosure of the protected information contained in the reviewed documents to adversaries. Avoiding waiver is a worthwhile goal, but the risk of disclosure, itself, warrants close scrutiny of potentially privileged documents.[3]

Even if a document can be clawed back, the protected information in the document cannot be retrieved once it is viewed by an adversary. For this reason, the consensual disclosure of potentially privileged documents pursuant to "quick peek," "claw back," and non-waiver agreements is virtually inconceivable in a major litigation, where counsel has not first reviewed the documents for privilege.[4]

Clients willing to allow adversaries access to privileged documents and work product may save some money, but the costs of discovery in major cases will still be extremely high.

The high costs of e-discovery are driven by the sheer volume of documents and e-data that must be retrieved and reviewed because they are potentially "relevant" pursuant to Rule 26 of the Federal Rules of Civil Procedure. Large scale document production in the electronic age requires an integrated approach to review large numbers of documents, often on a document-by-document basis, for responsiveness, confidentiality, substantive analysis, and the need to redact trade secrets, privacy information, and other sensitive information.

Privilege review is but one component of the process, and the incremental cost of privilege review is not the most significant cost component. In short, FRE 502's attempt to achieve e-discovery cost savings by mitigating the consequences of privilege waiver is probably misplaced.

Reasonable Steps Are Expensive

Pursuant to FRE 502(b), inadvertent disclosures do not result in a waiver of privileged information or work product contained in the disclosed document only if the producing party took "reasonable steps" to prevent disclosure and "promptly" took "reasonable steps" to rectify the inadvertent production.[5]

FRE 502 does not define "reasonable steps," but case law before adoption of the Rule and common sense dictate that anything short of a document-by-document review of potentially privileged documents may not be reasonable. Thus, the reasonable step requirement imposes the very expense the Rule was designed to mitigate.

The legislative history of FRE 502 indicates that the Rule merely codifies the standard for reasonableness previously articulated by the majority of courts.[6] Although the standard was designed to be "predictable in its application,"[7] some courts apply the reasonable standard more reasonably than others.[8] Whether FRE 502 will, as it should, soften the approach taken by courts that have set rigorous standards for meeting the reasonableness test remains to be seen. As of now, counsel must design a review process that will withstand tough judicial scrutiny.

In *Creative Pipe*, the court imposed a very demanding "reasonable step" standard. There, the defendant had produced allegedly privileged documents which it had classified as not privileged as a result of the application of analytical software and word searches. The court knew that Congress was considering the passage of FRE 502, and to determine reasonableness, the court applied the factors cited by the Advisory Committee in its report to Congress.

In finding that defendant had waived the privilege, the court held that to avoid waiver by reason of inadvertent production, the party asserting privilege had the burden of establishing that its reliance on the computer-based search it elected to use was reasonable and appropriate.[9] Moreover, the court ruled that the methodology used for searching for privileged documents must be selected with the "utmost" care. Failure to meet this high standard of care could result in a waiver of the privilege.[10]

Despite the stated intentions, FRE 502 did not alter the e-discovery playing field. High standards of care were and continue to be expensive. The burden is still on the producing party to prove that it took reasonable steps to prevent the inadvertent production of documents.

More importantly, FRE 502 does not necessarily eliminate the need to review a substantial number of documents on a document-by-document basis.[11] Discovery software in large scale litigation will identify tens of thousands of potentially privileged documents, including communications with attorneys, and these potentially privileged documents have to be reviewed document by document for two complementary reasons.

Thomas F. Munno *is a partner in the New York office of Dechert and* **Benjamin R. Barnett** *is a partner in the firm's Philadelphia office.* **James A. Dolan**, *an associate in New York, and* **Michael Salimbene**, *an associate in Philadelphia, assisted with the preparation of this article.*

First, a litigant cannot withhold documents as privileged merely because they were authored or received by attorneys or otherwise may be privileged. The producing party has to make a good-faith determination that a withheld document is in fact privileged, a task that requires a document-by-document analysis.[12] Second, once a document is identified as potentially privileged, a failure to review it prior to production is hard to justify as reasonable.

Is FRE 502 Constitutional?

The Advisory Committee understood that FRE 502 could not mitigate the risk of waiver if it did not bind state courts.[13] As a result, its "controlling effect" provisions provide that state courts are bound by the Rule and by federal court orders providing that privilege and work product are not waived by disclosures made in the federal case.[14] The controlling effect provisions apply even where the state proceeding is determining a state law claim and involves parties who were not parties to the federal action. Whether the "controlling effect" provisions of FRE 502 will survive a constitutional challenge is an open question.

Proponents of the Rule's constitutionality rely on the Commerce Clause,[15] which authorizes Congress to "regulate Commerce…among the several states."[16] The Supreme Court has identified three broad categories of activity that are subject to Congress' commerce powers:

(i) regulating the use of the channels of interstate commerce;

(ii) regulating and protecting the instrumentalities of interstate commerce, or the persons or things in interstate commerce; and

(iii) regulating the activities that substantially affect interstate commerce.[17]

The Court has established that Congress has the power to "regulate purely local activities that are part of an economic 'class of activities' that have a substantial effect on interstate commerce."[18] The power extends to non-commercial intrastate activity, "whatever its nature…if it exerts a substantial economic effect on interstate commerce."[19]

Because FRE 502 does not regulate the channels or instrumentalities of interstate commerce, its constitutionality likely turns on whether the Rule substantially affects interstate commerce.[20] Proponents of constitutionality argue that (a) rules regarding attorney-client privilege regulate "economic and commercial activity, including interstate activity, between attorneys and clients," and (b) those rules protect communications upon which the provision of legal services depends.[21] Thus, by protecting privileged communications, FRE 502 substantially affects interstate commerce.[22]

Guillen v. Pierce County provides support for the position that Congress can impose rules of evidence on state courts.[23] There, the Court upheld a provision in the Highway Safety Act that protected from discovery or admission into evidence the accident reports and traffic safety information compiled or collected by state and local governments. The Act applied to lawsuits filed in a state court, based only on state law causes of action involving only state residents.[24]

The Court held that the Act was a proper exercise of Congress' commerce power.[25] Although *Guillen* permitted the imposition of a federally created privilege rule on state courts, it is not directly on point because the Act was based on Congress' authority to regulate the channels of interstate commerce and the instrumentalities of interstate commerce, not the regulation of activities that substantially affect interstate commerce.[26]

The basic argument that FRE 502 is unconstitutional rests on the proposition that it regulates non-economic activity in an area of the law traditionally subject to state law.[27] A state court's determination as to when the attorney-client privilege or work product protection has been waived "is simply not economic activity or a commodity."[28] Even if the business of law constitutes legal commerce subject to regulation pursuant to the Commerce Clause, FRE 502 does not regulate that business or, for that matter, communications between lawyers and clients.[29] Rather, it regulates the evidentiary effect in state proceedings of the disclosure of privileged materials in a federal action.

> Given that the Rule's constitutionality is an open question, counsel should be cautious in placing reliance at this time on the Rule's 'controlling effect' provisions, particularly in any matter where there is or will likely be substantial litigation in state courts.

In assessing the constitutionality of FRE 502 and the likelihood that it will protect against attacks in state proceedings, counsel should bear two points in mind. First, the Rule constitutes an extraordinary expansion of federal regulation of state court rules of evidence for which there is little or no direct Supreme Court support. Second, it is as likely as not that the determination of constitutionality will be made in the first instance by state courts and not the federal court in which the documents at issue were produced.

The authors express no view as to the constitutionality of FRE 502, but believe counsel should be cautious in placing reliance at this time on the Rule's "controlling effect" provisions, particularly in any matter where there is or will likely be substantial litigation in state courts.

Conclusion

The authors welcome the effort to curb the skyrocketing costs of e-discovery, and believe that effective cost containment can be achieved if courts substantially limit the amount of e-data that has to be retrieved and reviewed in response to document demands. FRE 502, with its focus on waiver as the cause of skyrocketing costs, does not quite hit the mark.

Parties that elect not to allow access to potentially privileged documents should take reasonable and expensive steps to prevent waiver. Parties willing to disclose privileged documents and work product to an adversary pursuant to a quick peek or non-waiver agreement will still have to review documents for responsiveness, substantive content, trade secrets, and other redactable information, and they should understand that the protection provided by the controlling effect provisions of the Rule may be unconstitutional.

1. See letter from Lee Rosenthal, Chair, Committee on Rules of Practice and Procedure, to Patrick Leahy, Chairman, Committee on the Judiciary, (Sept. 26, 2007).
2. See generally, Ainsworth, "Evidence Rule 502 Revamps Waiver-of-Privilege Analysis," NYLJ, Oct. 6, 2008.
3. Document-by-document review is also necessary to assure the good faith withholding of documents based on privilege or work product.
4. Pursuant to FRE 502(f), disclosure under these agreements does not result in a waiver of privilege or work product as to non-parties as long as the agreement is incorporated into a court order.
5. FED. R. EVID. 502(b).
6. See 154 CONG. REC. H7817-20 (Sept. 8, 2008); 154 CONG. REC. S1317-19 (Feb. 27, 2008).
7. 154 CONG. REC. S1718 (Feb. 27, 2008).
8. Compare *Victor Stanley Inc. v. Creative Pipe Inc.*, 250 F.R.D. 251 (D. Md. 2008) with *Hydraflow Inc. v. Endine Inc.*, 145 F.R.D. 626 (W.D.N.Y. 1993).
9. *Creative Pipe*, 250 F.R.D. at 253, 260.
10. Id. at 262.
11. Parties electing not to produce privileged documents to adversaries should still consider entry into a non-waiver agreement, not as a substitute for taking reasonable steps to prevent inadvertent production, but as a safety net in case those efforts fail.
12. See Fed R. Civ. P. 26(b)(5); Rice, "Attorney-Client Privilege in the United States" (West Group, 2d Edition) at §11.4.
13. See Memorandum Regarding Consideration of Rule Concerning Waiver of Attorney-Client Privilege to Advisory Committee on Evidence Rules, at 2 (March 22, 2007).
14. FED. R. EVID. 502(d), (f).
15. See Kenneth S. Broun & Daniel J. Capra, "Getting Control of Waiver of Privilege in the Federal Courts: A Proposal for a Federal Rule of Evidence 502," 58 S.C.L.REV. 211, 240 (2006) (a federal rule of evidence governing state treatment of disclosure "would have to depend upon Congress' Article I commerce clause powers"); see also Timothy P. Glynn, "Federalizing Privilege," 52 AM. U. L. REV. 59, 156-57 (2002) (federal regulation of privilege "would be a valid exercise of Commerce Clause power").
16. U.S. CONST. Art. I, §8, cl. 3.
17. *United States v. Lopez*, 514 U.S. 549, 558 (1995).
18. *Gonzales v. Raich*, 545 U.S. 1, 17 (2005) (quoting *Perez v. United States*, 402 U.S. 146, 151 (1971)). See also *United States v. Morrison*, 529 U.S. 598, 610 (2000).
19. *Raich*, 545 U.S. at 17.
20. See e.g., Henry S. Noyes, Oct. 22, 2008, Draft of "Federal Rule of Evidence 502: Stirring the State Law of Privilege and Professional Responsibility With a Federal Stick," CHAP. U. SCH. OF L., LEGAL STUD. RES. PAPER SERIES, Paper No. 08-285 at 21, 25; A. Benjamin Spencer, "Anti-Federalist Procedure," 64 WASH. & LEE L. REV. 233, 265-66 (2007); Glynn, supra note 15 at 157; Anthony J. Bellia, Jr., "Federal Regulation of State Court Procedures," 110 YALE L. J. 947, 964-65 (2001).
21. See e.g., Glynn, supra note 15 at 158-59; see also Broun & Capra, supra note 15 at 244-45.
22. Glynn supra note 15 at 158-59.
23. 537 U.S. 129 (2003).
24. Id. at 147.
25. Id.
26. Id.
27. Noyes, supra note 20 at 5, 21, 23, 27, 33, 37, 38; Spencer, supra note 20 at 266; see also Bellia, supra note 20 at 951-52, 964-69.
28. Noyes, supra note 20 at 36-37; see also Bellia, supra note 20 at 966-69.
29. See Bellia, supra note 20 at 966.

Reprinted with permission from the December 1, 2008 edition of the New York Law Journal © 2008 ALM Properties, Inc. All rights reserved. Further duplication without permission is prohibited. For information, contact 877-257-3382 or reprints-customerservice@incisivemedia.com. ALM is now Incisive Media, www.incisivemedia.com. # 070-12-08-0002