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Second Circuit Rejects Bright-Line Test For Failure to Issue Hold Notice

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In a recent decision, *Chin v. The Port Authority*, 685 F.3d 135 (2d Cir. 2012), a panel of the U.S. Court of Appeals for the Second Circuit expressly rejected a bright-line test that deemed the failure to issue a litigation hold memoranda gross negligence and that arguably mandated the issuance of an adverse jury instruction in such instances for lost or destroyed evidence. Id. at 161-62. On an immediate level, the *Chin* decision resets the standard for conduct of litigants in the Second Circuit with respect to the preservation of documents and data in litigation. More broadly, however, *Chin* may reflect a rising level of appellate skepticism about the creation and issuance of hard-and-fast, prospective rules for litigants in the area of e-discovery separated from the facts of individual cases. The implications and the impact of the *Chin* decision are analyzed and discussed below.

Litigation or Legal Hold Memoranda

In-house counsel continue to face thorny questions, sometimes on a daily basis, regarding whether and when to issue so-called legal hold memoranda—instructions from an attorney to her individual or corporate client to preserve potentially relevant data and documents because of actual or potential litigation. Although the common law duty of preservation is both widely accepted and easy to state, determining whether that duty triggers a requirement to take action, particularly in companies that face constant litigation threats or have no history of litigation, remains a very real challenge.

As e-discovery jurisprudence advanced and accelerated in the past decade, some members of the bar clamored for a bright-line test that would make clear whether, when, and how attorneys should advise their clients to preserve potentially relevant information. Some attorneys viewed such guidance as essential to provide greater clarity to counsel and avoid hindsight-driven "gotcha" discovery battles, involving largely unnecessary and costly motion practice seeking sanctions.

In 2010, Judge Shira Scheindlin, a leading e-discovery jurist in the Southern District of New York, provided that clarity in *Pension Comm. of Univ. of Montreal Pension Plan v. Banc of Am. Secs.*, 685 F. Supp. 2d 456 (S.D.N.Y. 2010). Relying on early decisions (including two of her five opinions in *Zubulake v. UBS Warburg*), Scheindlin ruled that after July 2004, the failure to issue a legal hold memoranda constituted gross negligence on the part of the litigant and that such gross negligence required a court to issue an adverse jury instruction against that party for the failure if it resulted in the destruction or spoliation of potentially relevant evidence. Id. at 477, 496.[1] Since Scheindlin's ruling, several other district and state courts have adopted and endorsed the rationale of *Pension Committee*. See, e.g., *Voom HD Holdings v. EchoStar Satellite*, 939 N.Y.S.2d 321 (1st Dept. 2012); *N.V.E. v. Palmeroni*, No. 06-5455, 2011 WL 4407428 (D.N.J. Sept. 21, 2011); *Philips Elecs. N. Am. v. BC Technical*, 773 F. Supp. 2d 1149 (D. Utah 2011); *Victor Stanley v. Creative Pipe*, 269 F.R.D. 497 (D. Md. 2010); *Oto Software v. Highwall Techs.*, No. 08-cv-01897, 2010 WL 3842434 (D. Colo. Aug. 6, 2010).

Background: 'Chin v. Port Authority'

Chin involved Title VII race discrimination claims brought by 11 Asian-American police officers and the Port Authority Police Asian Jade Society (Asian Jade Society) against the Port Authority of New York and New Jersey (Port Authority), alleging that the officers were denied promotion to the rank of sergeant, the entry level supervisory position in Port Authority's management structure, because of their race. 685 F.3d at 141-42. The Port Authority's promotion process included creation of a "promotion folder" for each candidate under consideration, including performance evaluations, attendance records, commendations, awards, and disciplinary history. Id.

On Jan. 31, 2001, the Asian Jade Society filed a charge of discrimination with the Equal Employment Opportunity Commission (EEOC) against the Port Authority. Id. at 142. Roughly four years later, the Department of Justice (in lieu of the EEOC) issued a right-to-sue letter, and the 11 plaintiffs filed suit against the Port Authority on April 15, 2005. Id. at 142-43. During discovery, it was established that following receipt of plaintiffs' EEOC charge in February 2001, the Port Authority never issued a legal hold memorandum and that performance evaluations and 32 promotion folders for Port Authority officers deemed eligible for promotion in 1999 could not be located and were presumed destroyed. Id. at 143. Seven of the 11 individual plaintiffs moved for sanctions, including

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an adverse jury instruction "that the destroyed evaluations 'would show that plaintiffs were evaluated with uniform outstanding marks on any performance evaluations that they received.'" *Port Authority Police Asian Jade Soc. of N.Y. & N.J. v. Port Auth. of N.Y. & N.J.*, 601 F. Supp. 2d 566, 569 (S.D.N.Y. 2009).

Applying the Second Circuit test for evaluating a request for an adverse jury instruction, Judge Miriam Goldman Cedarbaum denied the motion. Id. at 569-71. First, the district court determined that the Port Authority had notice and the obligation to preserve the information regarding the 1999 promotion process as of February 2001, and that the 32 folders were lost or destroyed after that date. Id. at 569.

Second, Cedarbaum considered whether the destruction of the files reflected a culpable state of mind. Id. at 570. While the court deemed the evidence regarding records maintenance and retention "contradictory and inconclusive," she concluded that the Port Authority's explanation for the loss of the records—the destruction of the Port Authority's executive offices during the September 11th attacks on the World Trade Center—reflected negligence, not gross negligence. Id.

Finally, the court evaluated whether the performance evaluations were relevant to plaintiffs' discrimination claims. Id. While noting that the evaluations "were an important part of the promotion process," there was insufficient evidence to support the requested instruction, in part because only two of the moving plaintiffs were recommended for promotion in 1999, and thus relevant to their claims. Id. Following trial, the Port Authority filed an appeal, and plaintiff Chin filed a cross-appeal seeking a new trial because of the district court's denial of the sanctions motion. *Chin*, 685 F.3d at 141.

While 'Chin' may prove useful precedent to cite in some future **cases involving spoliation and sanctions**, counsel should **proceed cautiously** given the factual record in the case.

On appeal, the Second Circuit concluded that Cedarbaum did not abuse her discretion in denying the motion for sanctions. Id. Judges Joseph M. McLaughlin, José A. Cabranes, and Debra Ann Livingston noted that the district court had the discretion to grant an adverse jury instruction if doing so would serve three purposes: deterring the destruction of evidence; placing the risk that a jury would erroneously evaluate the evidence on the party that failed to safeguard it; and restoring the party harmed by the destruction to the position had the evidence not been destroyed. Id. at 162.

While the Second Circuit devoted only three pages of its 55-page decision in *Chin* to the motion for sanctions, the court made three significant rulings in the intersecting area of preservation, litigation hold memoranda, and sanctions.

First, the Second Circuit expressly rejected Chin's argument that the Port Authority's failure to issue a litigation hold memoranda in 2001 after receipt of the EEOC charge constituted gross negligence as Scheindlin held in *Pension Committee*. Id. Rather, the appellate court embraced the analysis from Magistrate Judge James Francis IV in *Orbit Commc'ns v. Numerex*, that the failure to issue such instructions was just "one factor" to consider in evaluating discovery sanctions. Id. (quoting *Orbit Commc'ns v. Numerex*, 271 F.R.D. 429, 441 (S.D.N.Y 2010)); see also *Surowiec v. Capital Title Agency*, 790 F. Supp. 2d 997, 1007 (D. Ariz. 2011) (rejecting *Pension Committee*'s holding that failure to issue a litigation hold constitutes "gross negligence per se" because "[p]er se rules are too inflexible for this factually complex are of the law").

Next, the Second Circuit ruled (again, in apparent direct contravention of *Pension Committee*) that a finding of gross negligence in the failure to preserve documents does not require a district court to issue an adverse jury instruction in favor of the injured party. *Chin*, 685 F.3d at 162. Rather, the Second Circuit echoed Cedarbaum's ruling below that "a finding of gross negligence merely permits, rather than requires, a district court to give an adverse inference instruction." Id. See also *Point Blank Solutions v. Toyoba Am.*, No. 09-61166-CV, 2011 WL 1456029, at *10 (S.D. Fla. April 5, 2011) (holding that grossly negligent conduct is insufficient to permit an adverse inference instruction; evidence of "bad faith" is required).

Finally, the appellate panel steered clear of establishing any bright line test for issuance of litigation holds or sanctions rulings and insisted that the evaluation of culpability and relevance be done on a case-by-case basis in which the district court will have significant discretion that will not be disturbed absent an abuse of discretion. *Chin*, 685 F.3d at 162. See also *Surowiec*, 790 F. Supp. 2d 997 at 1007 ("An allegedly spoliating party's culpability must be determined case-by-case").

Practical Lessons Following 'Chin'

There are several practical lessons that counsel and companies that litigate in the Second Circuit district courts can glean from the *Chin* decision.

First, it is important not to read too much into the decision. The Second Circuit panel did not suggest that litigation or legal hold memoranda had no role with respect to fulfilling the common law duty of document or data preservation. Rather, the court concluded that the failure to issue such guidance did not automatically constitute gross negligence on the part of a litigant or their counsel. See id. The prudent and advisable course remains to issue a litigation hold notification, particularly when warranted by the facts and circumstances surrounding potential litigation or an investigation.

Second, the facts underlying the *Chin* litigation are very unique. Most instances of document or data destruction do not involve terrorist attacks on the United States resulting in horrific human losses and wholesale destruction of office buildings. While *Chin* may prove useful precedent to cite in some future cases involving spoliation and sanctions, counsel should proceed cautiously given the factual record in the case.

Third, at the risk of stating the obvious, it is very important to "win" these disputes at the district court level. For the most part, discovery rulings by a district court will be reviewed under an abuse of discretion standard. Absent an error in law or a clearly erroneous assessment of the relevant facts, it is unlikely that the Second Circuit will reverse the district court's discovery rulings. This places significant importance on convincing the district court that your client's conduct in discovery complied with both the letter and spirit of the federal rules or prior judicial rulings. Given that the Second Circuit has now clearly ruled that these issues need to be addressed on a case-by-case basis, your job as counsel remains to gather, marshal, and present the facts so your client prevails at the district court level.

Fourth, while not entirely clear from Cedarbaum's decision in the district court, it appears that one factor in denying the motion for sanctions was the language of the proposed adverse jury instructions. Given that some evidence did exist with respect to some plaintiffs eligible for promotion, Cedarbaum may have concluded that plaintiffs over-reached with their proposed instruction. See *Port Auth. Police*, 601 F. Supp. 2d at 570. As such, should you find yourself in a position to affirmatively seek an adverse jury instruction because of document destruction, be mindful of aligning your proposed instruction with the evidence that does exist in a specific case.

1. In Zubulake IV, Scheindlin held that UBS acted with gross negligence in failing to retain certain backup tapes containing the emails and other electronic data for a human resources employee. 220 F.R.D. 212, 221 (S.D.N.Y. 2003). The tapes covered the time period after the employment discrimination complaint had been filed and therefore UBS was "unquestionably on notice of its duty to preserve." Id. (emphasis in original). Schiendlin recognized that rules requiring large corporations to save every backup tape would "cripple" a company like UBS, and further noted that "a party need not preserve all backup tapes even when it reasonably anticipates litigation," only those containing the data of "key players" to the litigation. Id. at 217 (emphasis). When dealing with a broker-dealer, however, it is important to note that the SEC's rules enforce significant additional and more rigorous retention requirements for records relating to all securities transactions. See 17 CFR §§240.14a-3, 240.17a-4.