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BNA INSIGHTS

Court Orders Spoliator Imprisoned, Surveys Differing Preservation And Sanctions Standards: An In-Depth Look at *Victor Stanley II*

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Chief Magistrate Judge Paul W. Grimm of the U.S. District Court for the District of Maryland, a well-known author of opinions and articles about electronic discovery, recently issued a significant decision about preservation and sanctions that should be of particular interest to organizations facing complex issues regarding preservation of electronically stored information ("ESI"). The opinion, *Victor Stanley, Inc. v. Creative Pipe, Inc., et al.*, __ F.R.D. __, 2010 WL 3703696 (D. Md. Sept. 9, 2010) ("*Victor Stanley II*"), follows Judge Grimm's previously-issued decision in the *Victor Stanley* case regarding what constitutes reasonable care to prevent disclosure of privileged information (and thus be entitled to a claw back due to inadvertent production) and the inherent limitations of keyword searches, "*Victor Stanley I*."[1]

Much as the well-known line of *Zubulake* decisions by Judge Shira Scheindlin of the Southern District of New York morphed from fairly innocuous issues regarding cost-shifting for the restoration of back-up tapes in *Zubulake I* to harsh sanctions for willful destruction of e-mails in *Zubulake V*, *Victor Stanley* will likely be remembered for Judge Grimm's order in *Victor Stanley II* that the principal of Creative Pipe, Inc. ("CPI") defendant Mark Pappas, be imprisoned for up to two years for his repeated, intentional destruction of thousands of electronic documents.[2] Mr. Pappas can avoid imprisonment if he pays the attorney's fees and costs to be awarded to Victor Stanley, Inc. ("VSI") for

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[1] *See Victor Stanley, Inc. v. Creative Pipe, Inc.*, 250 F.R.D. 251 (D. Md. 2008).

[2] *Victor Stanley II*, 2010 WL 3703696, at *1.

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its prolonged efforts to investigate and demonstrate Pappas' spoliation, which is likely to be a substantial sum.[3]

Recent Precedent

Preservation—and the sanctions imposed when a party fails to preserve relevant documents—has been the subject of previous high profile opinions in 2010. Judge Scheindlin in her somewhat controversial opinion in *Pension Committee* (self-referentially subtitled ''*Zubulake* Revisited: Six Years Later'') in January and, soon thereafter, Judge Lee Rosenthal of the Southern District of Texas in *Rimkus* offered in-depth analyses of the standards for imposing an array sanctions for preservation failures.[4]

Judge Grimm has joined the dialogue in *Victor Stanley II* with a thorough and scholarly survey of preservation and sanctions standards in the federal courts. Particularly helpful to those who must navigate the morass of opinions in the different circuits regarding the scope of the duty to preserve and the requirements for sanctions, Judge Grimm provided an appendix to his opinion laying out by circuit the scope of the duty to preserve and the culpability and prejudice requirements for the various sanctions available.

Facts of the Case

The facts of *Victor Stanley II* are extreme by any reckoning. The case involved claims that someone at CPI under the pseudonym ''Fred Bass'' extensively downloaded from VSI's website design drawings and specifications of its products, which CPI used in manufacturing competing products.[5]

Calling defendants the ''gang that couldn't spoliate straight,'' Judge Grimm found by clear and convincing evidence that CPI and Pappas not only failed to implement a litigation hold, but also engaged in an often bungled effort to intentionally destroy incriminating evidence in violation of their common law duty to preserve and preservation orders.[6]

The Bad Acts. A few of the many examples contained in the many pages of the opinion discussing the evidence of spoliation include: the deletion of an internet form using the name ''Fred Bass'' on Pappas' home computer; the deletion of nearly 10,000 files from Pappas' work computer the afternoon before a discovery hearing; the deletion of another 4,000 files (followed by the running of a disk defragmenter program immediately afterward, rendering the files unrecoverable) the week before Pappas' work computer was scheduled to be imaged; the failure to preserve and produce an external hard drive containing over 62,000 files (the names of which corresponded with many of the parties' agreed-upon search terms) that were transferred from Pappas' work computer shortly before the suit was filed; and Pappas having instructed a business contact in Argentina who had been hired to prepare CPI design drawings based on the downloaded VSI drawings to destroy all e-mail references to VSI drawings.[7]

In sum, Judge Grimm described it as ''the single most egregious example of spoliation that I have encountered in any case that I have handled or in any case described in the legion of spoliation cases I have read.''[8]

As sanctions, Judge Grimm ordered a default judgment against defendants on VSI's copyright claims.[9] (VSI also asserted claims for unfair competition, Lanham Act and Patent Act violations, which will proceed.[10])

Judge Grimm also held Pappas in civil contempt and ordered his imprisonment for up to two years unless and until he pays the attorney's fees and costs to be awarded VSI for its lengthy efforts to investigate and demonstrate Pappas' spoliation.[11]

Survey of Federal Preservation and Sanctions Law

Despite the eye-popping sanctions (and the egregiousness of the conduct that led to them), Judge Grimm's decision in *Victor Stanley II* is most significant for its broad survey of preservation and sanctions law in the federal courts. In doing so, Judge Grimm recognized the ''collective anxiety'' about preservation issues generated by ''recent decisions'' (an obvious reference to *Pension Committee* and *Rimkus*), and states that his purpose is to provide an analytical framework that will allow lawyers and their clients to approach preservation issues ''with a greater level of comfort that their actions will not expose them to disproportionate costs or unpredictable outcomes of spoliation motions.''[12]

Nonetheless, Judge Grimm obviously laments the lack of uniform national standards and decisions imposing standards approaching ''strict liability for loss of evidence, without adequately taking into account the difficulty—if not impossibility—of preserving all ESI that may be relevant to a lawsuit[.]''[13]

The Duty to Preserve

The lack of uniform national standards regarding preservation are particularly troublesome for institutions with operations in different jurisdictions. ''Unfortunately, in terms of what a party must do to preserve potentially relevant evidence, case law is not consistent across the circuits, or even within individual districts.''[14] This places such institutions in the untenable position of only securing comfort with a preservation plan ''that complies with the most demanding requirements of the toughest court to have spoken on the issue, despite the fact that the highest standard may impose burdens and expenses that are far greater than what is

[3] *Id.*
[4] *See Pension Comm. of Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC*, 685 F. Supp. 2d 456, 470 (S.D.N.Y. 2010); *Rimkus Consulting Group, Inc. v. Cammarata*, 688 F. Supp. 2d 598, 615-17 (S.D. Tex. Feb. 19, 2010).
[5] *Victor Stanley II*, 2010 WL 3703696, at *2.
[6] *Id.*
[7] *Id.* at *3-17.
[8] *Id.* at *16.
[9] *Id.* at *41.
[10] *Id.*
[11] *Id.* at *44.
[12] *Id.* at *17-18.
[13] *Id.* at *17.
[14] *Id.* at *25.

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required in most other jurisdictions in which they do business or conduct activities.''[15]

For example, in the Second and Fourth Circuits, documents in the possession of a non-party are considered to be under a party's ''control''—and thus subject to the party's preservation obligation—where the party has the right or practical ability to obtain the documents from the non-party.[16]

By contrast, the Third, Fifth and Ninth Circuits do not extend the preservation obligation to documents in the possession of non-parties.[17]

Courts also differ in the fault they assign when a party fails to implement a litigation hold. For example, Judge Scheindlin held in *Pension Committee* that failure to implement a written litigation hold is gross negligence *per se*, while a judge in the Northern District of Illinois stated within days of the *Pension Committee* decision that failure to implement a litigation hold is relevant but not *per se* evidence of sanctionable conduct.[18]

Similarly, some courts will impose sanctions for loss of relevant evidence regardless of whether or not the destruction was an accident or mistake, while others require actual bad faith.[19]

Trigger of the Duty. Nevertheless, there are some generally accepted principles. As to what triggers the duty to preserve, ''[t]he common law imposes the obligation to preserve evidence from the moment that litigation is reasonably anticipated.''[20] The duty does not arise, however, whenever there is some mere general or vague possibility of litigation. Rather, the preservation obligation arises from reasonably anticipated ''specific, predictable, and identifiable litigation.''[21]

At the latest, the duty exists for a defendant when it is served with the complaint.[22] A pre-litigation document preservation letter from the opposing party may give rise to a duty to preserve, but such a letter is not required for the duty to be triggered.[23]

Scope of the Duty. As to scope of the duty, it is generally recognized that when an organization has a document retention or destruction policy, it is obligated to suspend that policy and implement a litigation hold to ensure the preservation of *relevant* documents once the preservation duty has been triggered. But, ''it is well established that there is no obligation to preserve every shred of paper, every e-mail or electronic document, and every backup tape[.]''[24]

Because the duty is to preserve ''unique, relevant evidence that might be useful to an adversary,'' the parties may decide how to select among multiple identical copies.[25] Nevertheless, this may be of little comfort, as ''the general duty to preserve *may* also include deleted data, data in slack spaces, backup tapes, legacy systems, and metadata'' where they contain unique, relevant information that is otherwise unavailable.[26]

Breach of the Duty. According to Judge Grimm, breach of the preservation duty should be premised on reasonableness, *i.e.*, whether the party undertook reasonable and good faith efforts to retain information that may be relevant to pending or threatened litigation.[27] Judge Grimm emphasizes proportionality in determining what is reasonable and that—with the notable exception of the *Rimkus* decision issued earlier this year—courts have tended to overlook its importance.[28]

In other words, whether a party's actions were reasonable should be determined considering what was proportional to that case—for example, considering the amount in controversy and the burdens of preservation.

Sanctions

Judge Grimm also provides a survey of the differing standards for imposing an array of sanctions for breaches of the duty to preserve—*i.e.*, the ''harshest sanction'' of dismissal or default judgment (though most would also put imprisonment in this category); adverse inference and other adverse inference jury instructions; monetary sanctions; and contempt.[29] Most courts consider the culpability of the spoliating party and the prejudice to the other party in determining the appropriate sanction to impose.[30]

Judge Grimm again laments the ''multiple, inconsistent standards'' found in the federal case law.[31] Some courts require bad faith before imposing any sanctions. Some require bad faith for ''more serious sanctions'' but not for less serious sanctions. Others require something more than negligence but not necessarily bad faith. And some require a mere ''showing of fault.''[32]

Dismissal or Default Judgment. Generally, according to Judge Grimm, the sanctions of dismissal or default judgment may apply not only when both severe prejudice and bad faith are present, but also when ''culpability is minimally present, if there is a considerable showing of prejudice, or, alternatively, the prejudice is minimal but the culpability is great[.]''[33]

In some circuits, conduct that does not rise above ordinary negligence may be sanctioned by dismissal if the resulting prejudice is great. Judge Grimm observes that the ''First, Fourth and Ninth Circuits hold that bad faith is not essential to imposing severe sanctions if there is severe prejudice, although the cases often emphasize the presence of bad faith.''[34]

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[15] *Id.*
[16] *Id.*
[17] *Id.*
[18] *Id.*; *compare Pension Comm.*, 685 F. Supp. 2d at 466 (holding that failure to implement a written litigation hold is gross negligence *per se*) and *Haynes v. Dart*, No. 08 C 4834, 2010 WL 140387, at *4 (N.D. Ill. Jan. 11, 2010) (holding the opposite).
[19] *Compare, e.g.*, *Pension Comm.*, 685 F. Supp. 2d at 471 (imposing sanction absent bad faith) and *Rimkus*, 688 F. Supp. 2d at 614 (requiring bad faith).
[20] *Victor Stanley II*, 2010 WL 3703696, at *23.
[21] *Id.*
[22] *Id.*
[23] *Id.*
[24] *Id.* at *26 (quotation omitted).
[25] *Id.* (quoting *Zubulake v. UBS Warburg LLC*, 220 F.R.D. 212, 217 (S.D.N.Y. 2003) (''*Zubulake IV*'').
[26] *Id.* (quoting Paul W. Grimm, et al., *Proportionality in the Post-Hoc Analysis of Pre-Litigation Preservation Decisions*, 37 U. BALT. L. REV. 381, 410 (2008)).
[27] *Id.* at *24.
[28] *Id.*
[29] *Id.* at *38-41.
[30] *Id.* at *36.
[31] *Id.* at *35.
[32] *Id.* at *31.
[33] *Id.* at *36.
[34] *Id.*

In the Seventh, Eighth, Tenth, Eleventh and D.C. Circuits, ''the severe sanctions of granting default judgment, striking pleadings or giving adverse inference instructions may not be imposed unless there is evidence of bad faith.''[35] And, in the Fifth Circuit, ''a severe sanction such as a default judgment or an adverse inference instruction requires bad faith *and* prejudice.''[36]

Adverse Inference and Other Adverse Jury Instructions. An adverse inference instruction may inform a jury that it may draw adverse inferences from the loss of evidence, by ''assuming that failure to preserve was because the spoliator was aware that the evidence would have been detrimental.''[37] Such a definitive inference is not always warranted, however, so courts have crafted various levels of adverse inference jury instructions. ''The court may instruct the jury that certain facts are deemed admitted and must be accepted as true; impose a mandatory, yet rebuttable, presumption; or permit (but not require) a jury to presume that the lost evidence is both relevant and favorable to the innocent party.''[38]

Attorney's Fees, Costs and Fines. Costs, attorney's fees and fines compensate the prejudiced party, punish the offending party and deter further misconduct. According to Judge Grimm, ''[t]his Court will award costs or fees in conjunction with a spoliation motion as an alternative to a harsher sanction; if further discovery is necessary due to the spoliation; or in addition to another sanction, in which case the award may be for reasonable expenses incurred in making the motion, including attorney's fees, or also for the cost of investigating the spoliator's conduct.[39]

Judge Grimm observed that although a few courts have ordered the spoliating party to pay a fine to the clerk of court or a bar association for prolonging litigation and wasting the court's time and resources, ''it is unclear whether these unappealed trial court holdings would withstand appellate review, because in similar cases the Fourth and Tenth Circuits have vacated [such] discovery sanctions . . ., deeming them to be criminal contempt sanctions, which are unavailable without the enhanced due process procedure requirements criminal contempt proceedings require.''[40]

Contempt. Finally, a court can treat a failure to obey a court order to provide discovery of ESI as contempt pursuant to Fed. R. Civ. P. 37(b)(2)(A)(vii) or the court's inherent authority. Contempt sanctions may be civil or criminal. ''[T]o treat a party's failure to comply with a court order as criminal contempt, the court must refer the matter to the United States Attorney for prosecution. If that office declines to accept the case (a highly probable outcome in most instances), then the court must appoint a private prosecutor to bring the criminal contempt case.''[41] The burden of proof for criminal contempt is beyond a reasonable doubt and the defendant is entitled to a jury trial if the sentence will be longer than six months.[42]

To hold a party in civil contempt, the court must find (1) that there was a valid order of which the defendant had actual or constructive knowledge; (2) that the order was in the movant's 'favor'; (3) that the defendant's conduct violated the order and the defendant had actual or constructive knowledge of the violation; and (4) that the movant suffered harm as a result. The burden of proof is clear and convincing evidence.[43] Interestingly, Judge Grimm states that ''it is quite clear'' that his order of imprisonment of Pappas for up to two years ''is a civil—not a criminal—contempt sanction, because the relief is compensatory and the sanction will be imposed to coerce Pappas's compliance with this Court's order to pay attorney's fees and costs to Plaintiff[.]''[44]

Conclusion

Victor Stanley II provides a helpful overview of preservation and sanctions law in the various federal circuits. In particular, the concise appendix setting forth the scope of the duty to preserve and spoliation sanctions by circuit should be a valuable quick reference guide for practitioners.

Despite his order that Pappas be imprisoned unless he reimburses VSI's fees and costs, which likely will be substantial, Judge Grimm's opinion largely succeeds in not *adding* to the existing ''collective anxiety'' about preservation—something Judge Grimm stated at the outset of the opinion that he seeks to avoid. In particular, his emphasis on the need to consider proportionality in evaluating the reasonableness of a party's preservation efforts should provide a degree of comfort to lawyers and their clients.

Nevertheless, the differing standards and lack of clarity regarding the duty to preserve—Judge Grimm stated, for example, that the duty to preserve ''cannot be defined with precision'' and requires ''nuance''[45]—remain challenges for all those who must deal with preservation issues and emphasize the need for uniform national standards.

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[35] *Id.* (quoting *Rimkus*, 688 F. Supp. 2d at 614).
[36] *Id.* (quoting *Rimkus*, 688 F. Supp. 2d at 642).
[37] *Id.* at *38.
[38] *Id.* at *38 (quoting *Pension Comm.*, 685 F. Supp. 2d 470-71).
[39] *Id.* at *39 (quotation omitted).
[40] *Id.*
[41] *Id.* at *40.
[42] *Id.*
[43] *Id.* at *41.
[44] *Id.* at *44.
[45] *Id.* at *24 (quotation omitted).

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