



Based on recent court decisions, companies must follow minimum guidelines to ensure their retention schedule and legal holds policy are effective and legally defensible

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In the aftermath of the Sarbanes-Oxley Act, concerns over discovery, spoliation, and what is considered pending or potential investigations or litigation have catapulted to the priority lists of most companies. After all, severe penalties, including the possibility of jail time, are at stake for those involved in the destruction of relevant documents. Companies, therefore, must balance such severe consequences with proper management of all records, including electronic ones, during litigation.

A central and difficult issue surrounding otherwise sound retention policies is determining how and what records must

At the Core

This article

- ▶ summarizes different approaches the courts have taken toward the destruction of evidence
- ▶ identifies triggering events for legal holds, specifically when a matter becomes “potential” litigation under the law
- ▶ discusses the primary method courts use to test the reliability of a retention policy

be held from destruction. This is especially difficult when making the distinction between what is considered “potential” (or threatened) litigation as opposed to clearly “pending” litigation.

Spoliation is traditionally defined as intentional or unintentional destruction or disappearance of things or documents during litigation. The spoliation rule doctrine drives the duty to preserve documents in the context of litigation or agency investigations. However, various state and federal acts, such as Sarbanes-Oxley, broaden the reach of the spoliation doctrine from mere litigation matters to pending federal or state agency investigations.

States vary widely on whether or not to recognize spoliation as a separate cause of action or whether to give courts, at minimum, discretion for sanctions. A court's ability to sanction parties for spoliation has existed for hundreds of years, although the law has developed substantially over the past few years in light of high-profile investigations such as Enron and Arthur Andersen.

Whether or not a court sanctions a party for spoliation depends on several factors, including whether the conduct



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was intentional, the prejudice to the other side, and the availability of alternative evidence. Some states have gone so far as to recognize a separate tort or cause of action for spoliation. Thus, the range of sanctions that courts apply to spoliation includes:

- instructions to the jury that it may infer misconduct
- evidentiary sanctions (i.e., the inability to present relevant evidence because some pieces are missing)
- dismissal of the case
- recognition of a full-blown separate cause of action for either intentional or negligent spoliation

Legal Holds and the Duty-to-Preserve Continuum

Courts can exercise great discretion to impose sanctions for destroying records relevant to pending or potential litigation. Underscoring this discretion is a variety of sources that prescribe duties to preserve potentially relevant evidence, including:

1. statutory or regulatory obligations
2. statutes of limitations
3. potential or threatened litigation or investigation
4. preservation letters from opposing counsel or agency
5. service of a complaint and resulting civil discovery statutes, discovery requests, or court orders

The first two should be considered in creating actual records retention schedules. They are not factors in determining legal holds because these laws simply set forth proactive obligations to preserve records until the expiration of a specified retention or limitations period. On the other hand, the last two items set forth easily identifiable reactive events that should trigger a legal hold. Finally, the third item is critical to the legal hold decision, yet it is difficult to standardize as all sources point to reasonable foreseeability and, at times, outright prediction. This makes the ultimate decision regarding legal holds fact-specific and thus impossible to standardize.

Notice of pending, potential, or threatened litigation or agency investigations can be in the form of:

- a preservation letter or other written notice from opposing counsel
- pre-litigation discussions, demands, and agreements
- facts or circumstances that would otherwise put a reasonable person on notice

Preservation Letters or Other Written Notice from Opposing Counsel

Prudent counsel seeking to obtain discoverable records can formally trigger the duty to preserve simply by sending notice to the opposing party spelling out a request to preserve certain data that might otherwise be deleted in the ordinary course of business. The letter may simply state:

“Our firm has been retained by Mr. Plaintiff regarding his recent termination from employment at your company. We are currently evaluating whether or not Mr. Plaintiff has a claim against your company for wrongful termination, among other potential claims. We therefore request that you preserve all records in whatever medium that pertain to Mr. Plaintiff.”


A seemingly innocuous e-mail from an opponent's counsel to someone at the company advising them of such potential litigation may suffice to trigger a duty to preserve and legal hold. The key, then, is to have a procedure and policy that routes the communication to individuals designated to initiate legal holds on the applicable records.

Pre-litigation Discussions, Demands, and Agreements

Pre-litigation discussions, demands, and agreements with the potential plaintiff, agency, or their counsel also trigger a duty to place a legal hold on relevant records. Published opinions usually deal with this issue in the context of spoliation or evidentiary sanctions. In *Nation-Wide Check Corporation v. Forest Hills Distributors*, for instance, the First Circuit Court examined the facts surrounding Forest Hills' destruction of checks that would have proven Nation-Wide's priority rights to certain assets. The rights had been assigned through advice of Nation-Wide's counsel, who had worked on this matter with the Forest Hills counsel prior to the ensuing action.

The circuit court noted that the destroyer of the records that Nation-Wide needed for its case – namely, the

counsel for Forest Hill Distributors – had been given previous notice. At least four months before he destroyed the documents, Forest Hills’ counsel had communicated with Nation-Wide’s attorneys about the date Nation-Wide’s rights first assigned. Although the court found that Forest Hills’ counsel might not have been “completely aware” of the significance of the records, he proceeded to destroy them without further inquiry even though they theoretically could have disproved as well as proved Nation-Wide’s claim of rights to the assets.



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This case imposes a duty to inquire further about the significance of records affected by pre-litigation discussions prior to destroying them.

Facts, Circumstances, Comments, or Other Signs: Reasonable Foreseeability and Institutional Notice

Most jurisdictions find that a party has notice if litigation is “reasonably foreseeable.” For example, in *Blinzler v. Marriott International Inc.*, the First Circuit Court held that a spoliation inference is proper only when the destroying party knows “of circumstances that are likely to give rise to future litigation.” In *Blinzler*, the court

allowed the jury to infer Marriott had destroyed certain PBX operator records pertaining to the time Blinzler called from her hotel room to inform the operator that her husband was having a heart attack. Her husband eventually passed away from a mild heart attack, in part because the PBX operator took too long to call the ambulance after Blinzler placed the urgent call. Marriott had destroyed the operator records even though it was aware of Blinzler’s potential lawsuit.

The court concluded that when evidence indicates a party is aware of circumstances likely to result in future litigation but destroys potentially relevant records without particularized inquiry, a fact-finder may infer that the party probably did so because the records would harm its case.

The Texas Supreme Court has not directly addressed this issue, but Justice Baker, in his concurring opinion in *Trevino v. Ortega*, argued that a party has notice when “the party either actually anticipated litigation or a reasonable person in the party’s position would have anticipated litigation.”

Most courts hold that a duty to preserve evidence arises once a party has notice of possible litigation. For example, in *Akiona v. United States*, the Ninth Circuit Court held that the government did not spoliage evidence because it did not foresee litigation when it destroyed documents. In that case, the plaintiff, Aaron Akiona, was injured when someone threw a grenade into a Honolulu restaurant’s parking lot. The grenade was manufactured for and shipped to the United States, but the U.S. government had no record of what happened to the grenade after shipment. In accordance with its document retention policy, the United States had destroyed the grenade’s record two years after it was “disposed of.” The parties did stipulate, however, that the grenade was acquired “unlawfully and without the knowledge or consent of the government.”

The lower court had penalized the government by instructing the jury that it could draw an adverse inference from the government’s destruction. The Ninth Circuit reversed the lower court, stating that an adverse inference against the government was improper because the government did not destroy the grenade records “in response to th[e] litigation.” Akiona failed to show that “the government was on notice that the records had potential relevance to litigation.”

In light of the holding in *Akiona*, companies must consider not only whether there is potential litigation, but also whether particular records are relevant to the potential litigation.

Institutional notice arises when the person who destroys does not have reasonable notice of a controversy, but the institution as a whole does. Although the reasonable foreseeability requirement is usually satisfied by the spoliator’s personal knowledge, it is sometimes satisfied by related litigation and/or institutional notice. For example, in *Lewy v. Remington Arms Co.*, the defendant had records of previous complaints about the safety latch of the gun that accidentally went off in the Lewy household, injuring Mrs. Lewy. The Eighth Circuit instructed the trial court to consider whether “lawsuits concerning the complaint or related complaints have been filed, the frequency of such complaints, and the magnitude of the complaints.”

Another illustration of related investigation notice is the Arthur Andersen case. As the demise of Enron unfolded, Arthur Andersen was apprised of significant financial irregularities at Enron at least by August 2001. By early October, the auditor was aware that it would be the target of a Securities and Exchange Commission (SEC) investigation concerning the Enron filings. Nonetheless, a massive worldwide document destruction effort was launched during the second week of October 2001. An e-mail from in-house counsel called for compliance with an existing document reten-

tion program. This policy directed that upon completion of an audit, extraneous materials not central to the final audit report should be destroyed. As a result, Arthur Andersen destroyed dozens of boxes of paper documents and deleted or overwrote thousands of electronic documents, spreadsheets, databases, and e-mails.

In early November 2001, Arthur Andersen received its first subpoena for records from the SEC and produced in response the expurgated files. Within two months, in the course of preparing senior executives for congressional testimony, the purge came to light, and Arthur Andersen was compelled to inform the SEC and the public. Despite its hope that coming forward might ward off a prosecution for obstruction of justice, Arthur Andersen was indicted and convicted at trial.

Perhaps the most extreme example of institutional notice is set forth in the *Testa v. Wal-Mart* case. Testa slipped in the parking lot when he arrived at Wal-Mart for a delivery. Wal-Mart photographed the ramp that day and proceeded to conduct a full investigation of the incident. Before the month was out, a Wal-Mart employee prepared an internal report noting, among other things, that Testa had uttered his intent to sue. When Testa sued, Wal-Mart asserted in its defense that it had notified the plaintiff that the store would be closed and that he should not show up. However, Wal-Mart had only its own testimony to assert this defense, as Wal-Mart had destroyed the records of its instructions to Testa according to its retention policy.

The First Circuit Court held that entities could satisfy the notice-of-potential-litigation requirement via “institutional notice – the aggregate knowledge possessed by a party and its agents, servants, and employees.” In this case, Wal-Mart’s employee witnessed Testa’s threat to sue and then prepared an internal report.

Despite the fact that the notice came by way of a verbal threat followed by an internal Wal-Mart report regarding

same, the court found that when Wal-Mart destroyed the documents, it had notice both of a potential lawsuit and of the documents’ relevance to the claim that underlay such a suit.

This case poses serious concern for companies, as essentially all employees will have to treat all threats of litigation with due diligence and consideration. A company must be prepared to have its counsel make a determination of foreseeability on a case-by-case basis for all threats of litigation and, by extension, federal or state investigations.

Application and Enforcement of Legal Holds

Once a duty to preserve records is identified, companies confront putting retention policies in place that accommodate notice of pending or potential litigation. Courts will scrutinize the retention policy and its application with a specific three-part test that was set out by the court in *United States of America v. Taber*. The District Court noted: “This is not a three-part test where each factor must be met, but rather three factors to be considered in determining whether sanctions should be imposed. First, was the document retention policy ‘reasonable considering the facts and circumstances surrounding the relevant documents?’ Second, did the litigant know, or should it have known, that the documents would become material and, thus, should be preserved? Finally, was the policy instituted in bad faith?”

In *Taber*, the defendants sought discovery sanctions because the U.S. government destroyed its files pertaining to a 1988 Navy contract, RB24, for a landing mat in which Taber served as a vendor or subcontractor. The Federal Acquisition Regulations and a Defense Logistics Agency manual established the government’s record retention policy. The policy provided that contract records were to be maintained for six

years and three months.

The Arkansas District Court found no evidence to suggest this document retention policy was unreasonable or instituted in bad faith and, thus, the government met two parts of the three-part test. However, it deferred to the Eighth Circuit Court, noting that a mere policy does not relieve a defendant from the burden of preserving documents that are relevant to litigation, or potential litigation, or are reasonably calculated to lead to the discovery of admissible evidence:

Haphazard implementation will not provide a defense in a negligent spoliation claim.

“Even if the court finds the policy to be reasonable given the nature of the documents subject to the policy, the court may find that under the particular circumstances certain documents should have been retained notwithstanding the policy. For example, if the corporation knew or should have known that the documents would become material at some point in the future, then such documents should have been preserved.”

Finding in favor of the government after applying the “knew-or-should-have-known” analysis, the Arkansas District Court determined that it was not convinced the government knew or

had reason to know of the relevancy of the RB24 documents. Taber never requested the information about RB24 from the government until after the documents had already been destroyed. This suggests that neither party knew the contract was relevant until it was too late.

A more recent decision reveals how far the courts have come in acknowledging the importance of preservation of electronic records and the need for counsel to communicate with IT to prevent destructions. In *Zubulake v. UBS Warburg*, the court granted Zubulake an inference of misconduct jury instruction due to UBS's willful destruction of e-mail. The court set forth three criteria to meet in seeking an adverse inference instruction:

- The party had a duty to preserve the evidence when it was destroyed.
- The evidence was destroyed with a "culpable state of mind."
- The destroyed evidence supported the requesting party's claim or defense.

Using the above criteria, the court determined that the few e-mails found on the backup tapes UBS was required to restore in 2003 proved that other e-mails related to Zubulake had been deleted after UBS had been instructed to retain them. Because some of the recovered e-mails supported Zubulake's claim and implied that the deleted e-mails would have as well, the three criteria required for an inference of misconduct were met. The court acknowledged that UBS's attorneys generally fulfilled their duty to communicate with their client on its duty to preserve and produce data. However, it noted certain key shortcomings, most notably the attorneys' failure to communicate with the client's IT personnel. In a postscript to the opinion, Judge Scheindlin noted that, given the significant strides in spoliation case law over the past few years, "all parties and their counsel are fully on notice of their responsibility to preserve and produce electronically stored information."

General Guidelines for Effective and Legally Defensible Policies

Based on these court opinions, companies must heed the following minimum guidelines to ensure their retention schedule and legal holds policy are effective:

1. Companies must have a clear, written document retention policy and schedules that meet its business needs and are fully endorsed by senior management. The policy should define when, where, and by whom records required by law, contract, or value to the company are routed to appropriate archives and stipulate records no longer required are properly destroyed. Companies also must specify the means of destruction.
2. Companies must take reasonable steps to ensure that this policy is effectively communicated to employees and is actually followed (e.g., through periodic audits, compliance days, certifications). Haphazard implementation will not provide a defense in a negli-

gent spoliation claim. Deferred compliance, as in the Arthur Andersen case and especially if it occurs only when a problem looms, is likely to be even more damaging.

3. Companies must enact administrative procedures that will immediately stop the routine destruction of records when and if they become the subject of corporate governance, regulatory, or legal concerns.
4. Companies must guide and train all employees on how to prepare effective, accurate records. ■

Editor's Note: This article is based on a study recently conducted with funding from the ARMA International Educational Foundation (www.armaedfoundation.org). The full results of the study are available in the report "Legal Holds and Spoliation: Identifying a Checklist of Considerations that Trigger the Duty to Preserve," which is available through the ARMA International Bookstore (www.arma.org/bookstore).

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Read More About It

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