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Autumn 2006

Boot Up Your Servers—New Electronic Discovery Rules Set to Take Effect

By STANLEY A. BOWKER

These days, nothing in litigation strikes fear into the hearts of attorneys and IT professionals alike more than the need to provide electronic discovery. The long-awaited amendments to the Federal Rules of Civil Procedure, dealing with issues relating to the discovery of electronic documents, are scheduled to become effective as of December 1, 2006. These new rules are of interest both to attorneys and their clients whose documents are subject to discovery. What follows is a brief overview of some of the more important changes that are on tap.

First, Rule 26(f) mandates a discussion of electronic discovery issues at the very beginning of a case at the discovery planning conference. Among the issues that must be addressed is the preservation of discoverable information. Prior to any such conference with opposing counsel, it is essential that the attorney establish the lay of the land with respect to her client's documents, both electronic and good, old-fashioned paper. In this regard, discussions with the client and personnel from the client's IT department are essential. Such discussions will focus on the location of potentially relevant documents and, crucially, the preservation of those documents. Recent court decisions, for example the widely reported *Zubulake* case, emphasize the critical responsibilities of counsel for insuring that relevant evidence is not destroyed. In this regard, counsel should consider sending a letter to the client at the beginning of the case, emphasizing the importance of document preservation, which may include a suspen-

sion of the client's normal document retention policies.

Costly Electronic Discovery Failures

Failure to preserve relevant evidence can have dramatic effects. In the *Zubulake* case, the court issued an adverse inference instruction to the jury as a result of the failure of the defendant, UBS Warburg, to preserve certain relevant e-mails. Subsequently, the plaintiff won a jury verdict of over \$29 million. Likewise, in a Florida state case, the financier Ron Perelman sued Morgan Stanley. As a result of certain discovery abuses relating to electronic documents, the judge issued an adverse inference instruction and a

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financial services/securities corner

Court Permits Early Appeal of Enron Bankruptcy Claims Trading Ruling. The United States District Court for the Southern District of New York has granted leave to appeal certain interlocutory bankruptcy court orders in favor of Enron Corporation and its affiliates. These rulings by U.S. Bankruptcy Court Judge Arthur Gonzalez held that a transferee of a bankruptcy claim is subject to later attack and possibly subordination or disallowance of that claim regardless of whether that transferee had any knowledge of the transferring creditor's alleged inequitable conduct. In allowing the appeal, U.S. District Judge Shira A. Scheindlin found that this "is one of the rare cases in which an immediate review of an interlocutory order is warranted." Enron had argued that there was no need for an immediate appeal because either settlements or decisions finding that the transferring creditors were not liable for misconduct could end the litigation against the claims buyers. The court found that it was "precisely the risk" that these rulings will go unreviewed that makes this an exceptional case that, although typically disfavored in the Second Circuit, warranted leave to appeal the interlocutory bankruptcy court orders. *In re: Enron Corp.*

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partial default judgment against Morgan Stanley. The jury subsequently returned a verdict of \$1.45 billion in favor of Mr. Perelman's company.

Many companies have document retention policies that specify how long certain categories of documents, both paper and electronic, should be preserved. For example, a company might have a policy that all e-mails older than 60 days are automatically deleted and that backup tapes are periodically written over. Such policies are highly advisable and have in fact been approved by the Supreme Court in the *Arthur Andersen* case. The Court noted that such policies "are created in part to keep certain information from getting into the hands of others, including the Government. . . It is, of course, not wrongful for a manager to instruct his employees to comply with a valid document retention policy under ordinary circumstances."

Document Retention Policies Can Provide a "Safe Harbor"

The issue of document retention policies is addressed in the new rules. Rule 37(f) provides that a court may not impose sanctions 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." This is the so-called "safe harbor" provision of the new rules. But,

as Judge Shira Scheindlin has observed, it is a very shallow safe harbor. The Committee Note to Rule 37(f) emphasizes that "good faith" is essential and that "[g]ood faith in the routine operation of an information system may involve a party's intervention to modify or suspend certain features of that routine operation to prevent the loss of information."

In short, once a party becomes aware of the possibility of litigation, a duty is triggered to preserve relevant documents despite the existence of a document retention policy. Courts sometimes refer to the preservation of documents as the imposition of a "litigation hold." Putting in place the litigation hold is one of the key actions that must be taken very early in the litigation process. As discussed earlier, failure to preserve documents can have very dramatic adverse consequences.

The "Two-Tier" Approach

Other issues addressed by the new rules include the so-called two-tier approach to the discovery of electronically stored information. In general, electronically stored information that is "reasonably accessible" must be produced. Rule 26(b)(2)(B) provides that information that is not reasonably accessible need not be produced. The rules do not provide a definition of reasonably accessible but it seems clear that reasonably accessible information consists of material that is accessed on a regular basis in the ordinary course of business. Not reasonably accessible information would include backup tapes (used for disaster recovery and other purposes) and "deleted" material.

While electronic documents that are not reasonably accessible need not be produced as an initial matter, the court nonetheless may order discovery of such information if the requesting party shows "good cause." Moreover, the Committee Note to Rule 26(b)(2)(B) states that even not reasonably accessible information may be subject to preservation obligations.

The effect of these new rules will doubtless be worked out in the courts. But the

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antitrust corner

Federal Court Denies Class Certification In Major Victory For Sprint In Antitrust Treble Damage Action. Anderson Kill represented Sprint Corp. in a class action treble damage lawsuit brought against the four largest carriers of wireless telephone services alleging violations of Sections 1 & 2 of the Sherman Act. On August 17, 2006, Judge Cote of the United States District Court for the Southern District of New York denied plaintiffs' motion for certification of a nationwide class of consumers. The plaintiffs alleged that the carriers participated in a conspiracy to, among other things, lock handsets and tie the sale of handsets to the sale of cellular service, with the intent and expectation of causing artificially elevated prices for handsets and cellular service. In denying class certification, the court found that since neither the type of antitrust injury alleged by plaintiffs nor the element of coercion necessary for plaintiffs' tying claims were susceptible to generalized proof, certification of the class was not appropriate. *In re: Wireless Telephone Services Antitrust Litigation.*

Zubulake case offers a good illustration of a likely practical effect in the context of backup tapes. Laura Zubulake was an employee of UBS Warburg who was fired. She sued, alleging sexual discrimination. Her initial document demand sought e-mails from certain specified employees of UBS Warburg. The response to the document demand was obviously incomplete because it did not include certain e-mails that Zubulake already had in her possession. Thereafter, it developed that additional possibly relevant e-mails might be found on a series of backup tapes in the possession of UBS. UBS claimed that it would be too expensive to try to resurrect the information on those backup tapes, but the court nonetheless ordered that a sample of the backup tapes be searched for relevant documents.

In *Zubulake* the backup tapes were apparently properly stored and the issue was the cost of recreating the data, which was placed, in large part, on UBS. Other companies have proven to be considerably more sloppy with respect to their backup tapes. For example, in the *Morgan Stanley* case, Morgan Stanley certified that, as of a certain point in time, all relevant e-mails had been handed over to the plaintiff. But at the same time the certification was made, the “storage folks” had already located an additional 1,400 backup tapes in a closet in a back office in Brooklyn. The court concluded that Morgan Stanley had deliberately violated its orders and was guilty of bad faith, which led to the very expensive consequences set forth above.

Form of Production for Electronic Documents

One final aspect of the new rules deserves mention, namely the question of the manner in which relevant electronic documents must be handed over to the requesting party. Rule 34(b) provides that the requesting party may specify “the form or forms in which electronically stored information is to be produced.” Absent such a request,

the electronic information must be produced “in a form or forms in which it is ordinarily maintained or in a form or forms that are reasonably usable.” The Committee Note to the rule observes that while a party is free to convert the electronic information from the form in which it is ordinarily maintained to a different form, that different form cannot make it more difficult or burdensome for the requesting party to use the information efficiently. For example, if the electronic information is ordinarily maintained in a way that is electronically searchable, a party would not be permitted to produce the information in non-searchable PDF format.

A related issue that will certainly arise is the question of metadata. An electronic document stored in Word format will, of course, have data that is visible on the computer screen. In addition, the document will have embedded metadata that will include considerable background information about the document, such as the author, the date of the last edit, and even material that has been deleted from previous versions of the document. A party producing such a document may not want the metadata to be viewed by its adversary and commercially available software exists that will “scrub” such metadata from the document. Is this permissible? Neither the rules nor the comments address specifically the question of metadata, but if the production is alleged to be in “native” format, i.e., in the manner in which the documents are ordinarily maintained, then it would appear that the metadata must be

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product liability

corner

New York Court Rules Supplier's Duty to Warn Limited. Manhattan Supreme Court Justice Helen Freedman ruled that the supplier of a defective component part was entitled to summary judgment because its duty to warn “does not extend to an ultimate user where a sophisticated intermediary exists.” The court’s decision is consistent with the decisions by the New York Court of Appeals and the First and Fourth Departments of the New York Appellate Division, which have held that manufacturers may not be liable where purchasers already have knowledge of the dangers associated with the product. *Pieper v. A.W. Chesterton Co., et al.*

“The new rules will have a significant impact on the discovery process. **Computer phobia** is no longer an option.”

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produced. At least one court has recently held that metadata may not be scrubbed without notice, and that electronic documents must be produced with their metadata intact absent timely objection.



Stanley A. Bowker is an attorney in Anderson Kill's New York office and is a member of the firm's commercial litigation group. He has litigated extensively on behalf of both plaintiffs and defendants, in such areas as securities fraud, consumer fraud, breach of contract, theft of trade secrets and general corporate law. He has also been involved in bankruptcy-related litigation.

(212) 278-1346

sbowker@andersonkill.com

In sum, the new rules will have a significant impact on the discovery process. Computer phobia is no longer an option. Attorneys and their clients must carefully study these rules now and make plans for adapting to the new regime. ▲

unfair competition corner

McDonald's Obesity Lawsuit Continues. The lawsuit charging fast-food giant McDonald's with contributing to children's health problems has been waved into the express lane by a Southern District of New York court. The case, which was brought over four years ago by a putative class of parents on behalf of their children who allegedly became obese and suffered other health problems including hypertension as a result of "super-sizing" it at McDonald's, had been dismissed twice by Judge Sweet. Both times, the Second Circuit reversed and sent the case back. Now, Judge Sweet has ruled that the plaintiffs' Second Amended Complaint is adequate and has ordered McDonald's to answer. The case is based, in part, on New York's consumer protection statute, General Business Law § 349, which bars deceptive acts or practices in the conduct of any business. Section 349 is a favorite of the plaintiffs' bar and has been the basis of many consumer fraud class actions in New York in recent years. *Pelman v. McDonald's Corp.*

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The firm has offices in New York, Chicago, Connecticut, Newark, Philadelphia, and Washington, DC

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PENNSYLVANIA UPDATE

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Preparing You For Success

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Electronic Discovery—A Pennsylvania Perspective

By MICHAEL CONLEY AND DARIN J. McMULLEN

On December 1, 2006, the Federal Rules of Civil Procedure will be amended to require litigants to discuss electronic discovery matters at the inception of litigation. This change in the rules acknowledges the seismic shift in how we communicate, recognizing that it is now largely a digital world. While the changes to the federal rules only apply to cases pending in federal courts, undoubtedly state courts will look to the federal system for guidance in handling electronic discovery matters.

Preparation Begins With Preservation

In Pennsylvania, our discovery rules not only allow for the discovery of written materials through document requests, but Pennsylvania Rules of Civil Procedure 4009.31-33 also allow for the entry upon property for inspection, which would include inspection of computers. As such, even before litigation is initiated, efforts should be made to preserve relevant evidence. These efforts should include not only preserving your evidence, but also putting the opposing party on notice that it should preserve all potentially relevant information, i.e., the "litigation hold." As set forth in the attached article, the changes to the federal rules include a "safe harbor" for documents destroyed pursuant to routine computer practices. When it is apparent that litigation may ensue, a litigation hold letter should be sent to the

opposing side to reduce the chance that relevant information may be destroyed.

In addition, every organization should have a plan in place to ensure that relevant internal computer-stored information is not inadvertently, or deliberately, deleted. While it goes without saying that you want to preserve evidence to assist in either the prosecution or defense of a case, you also need to protect against potential employee misconduct. This is particularly the case in employment-related matters where e-mails have increasingly been the center of attention. By way of example, an employee who has a discrimination charge made against him may mistakenly believe that when he hits delete, an e-mail is actually deleted. While this attempt at destruction of evidence is, in and of itself, a serious problem, the attempt may also give the employee a false sense of security leading the employee to be less than truthful when confronted about the underlying charge. For those of us who practice employment law, the production of a damaging e-mail from the opposing side, coupled with evidence that the management employee attempted to destroy that same e-mail, can be disastrous. In employment law, as in most areas of the law, to properly defend

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a supplement to

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a case, all of the facts, good and bad, must be known. The destruction of evidence can lead not only to surprises, but also shows intent to cover up the facts, which can be critically damaging in front of a jury.

A "Select" Lesson on the Importance of Preservation

One interesting recent case dealt with the potential ramifications that can result if computer information is destroyed. In *Select Medical Corp. v. Hardaway*, 2006 WL 859741 (E.D.Pa., 2006), the plaintiff, Select Medical Corporation (Select) filed suit against defendant, William Hardaway, a former Select regional vice-president, for violation of a confidentiality and non-compete agreement. Select moved for a temporary restraining order (TRO) and the court granted the TRO in part, and gave the parties 45 days to complete expedited discovery. Prior to the preliminary injunction hearing, Select filed a motion for spoliation. The spoliation motion was based upon Select's assertion that Hardaway "intentionally destroyed records of [its] confidential and proprietary information on the hard drive of his home computer." Select claimed that it had been prejudiced by Hardaway's actions because his home computer was the "best evidence" of the scope of proprietary information in Hardaway's possession. Hardaway contended that a spoliation inference was improper because his conduct was not fraudulent or done for the purposes of avoiding discovery. In his response, Hardaway claimed to have deleted the files to ensure that he no longer had access to Select's information after he resigned his employment. Spoliation is generally the destruction or significant alteration of evidence, or the failure to preserve property for another's use as evidence in pending or reasonably foreseeable litigation. Evidence of spoliation may give rise to sanctions, such as an adverse inference against the party found to have destroyed or altered evidence, commonly referred to as the spoliation inference. The evidentiary rationale for the spoliation inference is the recognition that a party who proceeds to destroy evidence relevant to litigation, is more likely

“ Spoliation is generally the destruction or significant alteration of evidence ... [which] may give rise to sanctions ... ”

to have been threatened by that evidence. In *Select*, the court found that the record did not support a spoliation inference because the court concluded that Hardaway intended to comply with his non-disclosure agreement, not violate it. However, what actually was deleted is not clear, and the outcome may have been different had a litigation hold letter been sent at the commencement of the litigation.

Electronic discovery issues will increasingly be the focus of discovery disputes and, as such, litigants need to be knowledgeable about not only the information available from opponents, but also how their own information is stored and maintained. The storage and preservation of such information can have a dramatic impact not only on pretrial discovery but also, in the case of a spoliation inference, on the merits of a claim. ▲



Michael Conley

Darin J. McMullen

Michael Conley and **Darin J. McMullen** are attorneys in the Philadelphia office of Anderson Kill & Olick, P.C. Mr. Conley is a shareholder and head of Anderson Kill's Philadelphia business group. He has extensive

commercial litigation experience including breach of contract and abuse of process. Mr. McMullen's practice concentrates in the area of business litigation, with an emphasis on labor and employment.

Michael Conley
mconley@andersonkill.com
(267) 216-2707

Darin J. McMullen
dmcmullen@andersonkill.com
(267) 216-2708

About the Philadelphia Office:

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Anderson Kill & Olick, P.C.
1600 Market Street, Suite 2500, Philadelphia, PA 19103
Phone: (267) 216-2700
www.andersonkill.com