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Ignorance Is Not Bliss: Court Sanctions Client and Counsel for Unfamiliarity with Data Systems

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According to the U.S. Bankruptcy Court for the Southern District of New York, a lack of bad faith is no longer a defense to court sanctions for failure to produce documents in a timely manner. That court, in *In re A&M Florida Properties II,* recently awarded sanctions against both a party and its counsel for the counsel's failure to become familiar with the client's email and data-retention policies and systems—despite the absence of any bad faith or willful delay.[1]

In *A&M Florida*, the plaintiff, GFI Acquisition, LLC (GFI) had agreed to purchase four properties from the defendant, American Federated Title Corp. (American Federated) as part of a purchase and sale agreement. GFI alleged that American Federal had refinanced three of the four properties and failed to disclose "lock out" features of the loans prior to the sale. American Federated requested the production of documents related to the sale, particularly emails. GFI produced some emails, but American Federated grew suspicious when some emails that it had sent to GFI were not included in the production.

GFI was advised by its counsel to conduct a companywide email search. GFI's Chief Technology Officer conducted a search of active email folders, but did not search deleted files or archived emails. She did not inform GFI's outside counsel that GFI employees routinely archived emails and that the company maintained deleted folders and archived emails. This search resulted in the production of a few emails. The two parties subsequently agreed to jointly retain a computer forensics expert to conduct a search of GFI's email system. This search was conducted, but again did not include a search of deleted files or archived folders. A small number of additional documents were produced, but American Federated remained unsatisfied, as a March 22, 2007 email that should have turned up in the search was not produced.

At this point, the fact that deleted files and archived folders had not been searched became known by GFI and its outside counsel. The computer forensics expert was asked to do new searches on the additional data. These searches were broken down into two types: field searches and keyword searches. The former were to be produced to American Federated by the expert without any privilege review. The latter were to be given to GFI's outside counsel for privilege review prior to production. The expert provided CDs containing almost 10,000 emails to GFI's outside counsel. Counsel did not understand the difference

[1] *In re A&M Florida Properties II, LLC*, Bkrtcy. No. 09-15173, 2010 WL 1418861 (Bankr. S.D.N.Y. Apr. 7, 2010) (*A&M Florida*).

between the two searches, and apparently did not know that the documents had not already been produced to American Federated and thus, never reviewed or produced from the second search. Two months later, American Federated brought a motion to compel and for sanctions, claiming spoliation. GFI then produced more than 9,500 emails—including all emails that American Federated had alleged to have been destroyed. In its motion, American Federated requested the imposition of sanctions, including dismissal of the suit, an adverse inference instruction, and monetary penalties.

In its analysis, the court broke down each type of sanction. It pointed out that the granting of dismissal for spoliation is "harsh and rare."[2] In this case, the court found that the behavior of GFI and its counsel was not egregious enough to warrant a terminating sanction. An adverse inference instruction is warranted if (1) the moving party can establish that there was an obligation to produce in a timely manner by the other party, (2) the other party had a "culpable state of mind" in not producing evidence in a timely manner, and (3) the evidence is relevant to the present action.[3] Even ordinary negligence may rise to the level of culpability warranting such a sanction.[4]

In this case, the court found that even though all of the elements for an adverse inference instruction were present, the penalty would be too harsh for the situation. After all was said and done, American Federated received the emails in question and there was no evidence of bad faith on the part of GFI or its counsel. The bad behavior was simply a result of counsel's lack of knowledge about electronic discovery.

The court did, however, impose monetary sanctions. Although it found that the delays in production were not intentional or in bad faith, it determined that it was the responsibility of GFI's counsel to find all sources of relevant information in a timely manner. According to the court, it was not enough for counsel to request documents from a client; counsel must affirmatively act to communicate with the client to identify all sources of information and to "become fully familiar with [the] client's document retention policies . . . and data retention architecture."[5] If GFI and its outside counsel had lived up to their obligations, the archived emails and deleted folders would have been discovered, and the emails in question would have been produced much earlier in the process. There would have been no need to call in a computer forensics expert, or for motions to compel and for sanctions. Because of this fact, the court determined that the costs of the motions and the retention of the computer forensics expert should be borne entirely by GFI and its outside counsel.

Many electronic discovery headaches can be avoided entirely by good discovery planning and careful execution the first time around. Defensible and efficient discovery—which includes the avoidance of possible sanctions—requires effective planning, knowledge, and communication between counsel and client about record retention, IT infrastructure, and data-management practices. Electronic discovery has

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2 *See Update Art, Inc. v. Modiin Pub., Ltd.*, 843 F.2d 67, 71 (2d Cir. 1988); *Cine Forty-Second St. Theatre Corp. v. Allied Artists Pictures Corp.*, 602 F.2d 1062, 1064 (2d Cir. 1979); *The Pension Committee of the University of Montreal Pension Plan, et al. v. Banc of America Securities, LLC*, No. 05 Civ. 9016 (SAS), 2010 WL 184312, at *6 (S.D.N.Y. Jan. 15, 2010).

3 *Phoenix Four, Inc. v. Strategic Resources Corp.*, No. 05 Civ. 4837 (HB), 2006 WL 1409413, at *3 (S.D.N.Y. May 23, 2006); *Residential Funding Corp. v. DeGeorge Financial Corp.*, 306 F.3d 99, 107 (2d Cir. 2002); *Zubulake v. UBS Warburg LLC*, 220 F.R.D. 212, 220, 92 Fair Empl. Prac. Cas. (BNA) 1539 (S.D.N.Y. 2003).

4 *Residential Funding Corp.*, 306 F.3d at 1010; *Phoenix Four*, 2006 WL 1409413 at *4; *Zubulake*, 220 F.R.D. at 220; *Chan v. Triple 8 Palace, Inc.* No. 03 Civ. 6048 (GEL) (JCF), 2005 WL 1925579, at *6 (S.D.N.Y. Aug. 11, 2005).

5 *Zubulake v. UBS Warburg LLC*, 229 F.R.D. 422, 432, 94 Fair Empl. Prac. Cas. (BNA) 1, 85 Empl. Prac. Dec. P 41, 728 (S.D.N.Y. 2004).

become a highly specialized practice and requires both advanced technical knowledge and current and informed legal advice to avoid an outcome such as occurred in *A&M Florida.*

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