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FEDERAL E-DISCOVERY

'Orbit One' Ruling Furthers Discussion on Sanctions

By **H. Christopher Boehning**
And **Daniel J. Toal**

Earlier this year, we reviewed the landmark decision in *Pension Committee*,[1] in which Southern District Judge Shira Scheindlin suggested that her earlier *Zubulake* line of cases had imposed a set of presumptive duties on litigants with regard to electronic document preservation, and analyzed what violations of these duties would expose litigants to sanctions.

Judge Scheindlin prescribed a sanctions analysis that focuses largely, at times even exclusively, on the conduct and culpability of the spoliating party.

Her approach in *Pension Committee* raised the question whether a party's conduct in defiance or disregard of the document preservation expectations that she announced is in itself sanctionable. If so, then have spoliation sanctions morphed into sanctions for failing to adhere to "best practices" for document preservation? And may such sanctions be awarded even where no relevant information was in fact lost, destroyed or withheld?

A recent, notable decision by Magistrate Judge James C. Francis of the Southern District of New York answers these questions in the negative.

In *Orbit One Communications Inc. v. Numerex Corp.*,[2] Magistrate Judge Francis concluded that sanctions for spoliation must be premised on the loss of some information at least minimally relevant to the dispute. In his view, sanctions cannot arise exclusively based on a party's conduct, however culpable.

To be sure, Magistrate Judge Francis' opinion in *Orbit One* was by no means a wholesale rejection of Judge Scheindlin's work. In large part, *Orbit One* is a faithful recitation of the same principles

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announced by Judge Scheindlin in *Zubulake* and reiterated in *Pension Committee*. For example, both opinions make clear that sanctions may be imposed for spoliation resulting from negligent, grossly negligent, or willful conduct. And both rely on the U.S. Court of Appeals for the Second Circuit's decision in *Residential Funding Corp.* for the rule that, "Where a party destroys evidence in bad faith, that bad faith alone is sufficient circumstantial evidence from which a reasonable fact finder could conclude that the missing evidence was unfavorable to that party."[3]

However, Judge Scheindlin went further in *Pension Committee*, suggesting that culpability alone may warrant the imposition of certain sanctions. Thus, she wrote, "For less severe sanctions—such as fines and cost-shifting—the inquiry focuses more on the conduct of the spoliating party than on whether documents were lost, and, if so, whether those documents were relevant and resulted in prejudice to the innocent party."[4]

"[F]or more severe sanctions," she wrote, "the court must consider, in addition to the conduct of the spoliating party, whether any missing evidence was relevant and whether the innocent party has suffered prejudice as a result of the loss of evidence."

With this language, Judge Scheindlin seemed to open the door to the imposition of "less severe" spoliation sanctions on parties solely based on their conduct, without regard for whether any evidence was even lost.

Indeed, shortly after *Pension Committee* opened this door, at least one court in the jurisdiction approved of sanctions based exclusively on the defendant's conduct, in that case the failure to institute a formal litigation hold.[5] Relying on *Pension Committee*, the court in *Merck Eprova* imposed the "less severe" sanctions of a fine and an award of fees, even though the court acknowledged that it lacked any basis to conclude that any documents had been lost or that any prejudice had occurred.

Magistrate Judge Francis was not willing to go this far, "respectfully disagree[ing]" in *Orbit One* with the proposition that a party can be sanctioned for breach of its preservation obligations without regard to whether any relevant documents or information were actually lost. Thus, he declined to award sanctions to the defendant even while finding that the plaintiff had

H. CHRISTOPHER BOEHNING *and* DANIEL J. TOAL *are litigation partners at Paul, Weiss, Rifkind, Wharton & Garrison LLP.* RICHARD B. EISENBERG, *a litigation associate at the firm, assisted in the preparation of the article.*

in "numerous respects" failed to adhere to his document preservation obligations, including the failure to institute a formal litigation hold.

While the facts of *Orbit One* are not central to this discussion, they shed light on the pitfalls that would follow from a rigid application of the principles set forth in *Pension Committee* in all cases and, at least in part, explain why Magistrate Judge Francis reached a different conclusion.

Plaintiff David Ronsen founded Orbit One Communications Inc. in 2000. Located in Montana, Orbit One was a manufacturer of satellite-based tracking devices and a provider of satellite communications services, primarily to government agencies and contractors.

Defendant and counterclaimant Numerex is an Atlanta corporation that provides cellular and satellite-based communications services. On July 31, 2007, Numerex entered into an asset purchase agreement to acquire substantially all of the assets of Orbit One in exchange for approximately $5.5 million, payable to Ronsen and the other shareholders.

In that agreement, Numerex also agreed to make certain additional payments if the company met a series of revenue and earnings targets for 2007 through 2009. On the same date, Ronsen and the other Orbit One executives entered into employment agreements with Numerex in which they agreed to operate the new division of Numerex that formerly had been Orbit One.

Orbit One's revenues for fall 2007 failed to meet projections, however, and Ronsen's employment relationship with Numerex quickly soured. Ronsen and Orbit One sued Numerex in New York state court in January 2008, arguing that Numerex had interfered with Ronsen's ability to manage the new division and, thereby, interfered with Ronsen's ability to receive the performance-based compensation provided for under the asset purchase agreement.

Numerex removed the case to the Southern District of New York and filed counterclaims, and the case was subsequently consolidated with related actions filed by Numerex and other executives of the company.

Computer Use

Prior to Orbit One's sale to Numerex, Ronsen had used two computers—a personal desktop and a company laptop—both linked to Orbit One's network of servers. The network included an exchange server for e-mail, as well as a shared server.

Both of Ronsen's computers were automatically synchronized with the company's shared server, such that any files that Ronsen saved to a folder on the shared drive would automatically be saved on the server as well. The servers in turn were backed up to disks on a daily basis, and the disks were preserved for a two-week period. Monthly and yearly backups were also created. However, there was no backup system for local hard drives.

Beginning in August 2007, Orbit One's information technology officer, Christopher Dingman, began requesting that Orbit One's executives make certain changes to their information management systems in order to improve computer performance and increase available storage space.

This included instructions to remove personal data from the company's servers, archive e-mail dated prior to 2007, and remove their personal desktop computers from the company's network.

> In 'Orbit One,' a Southern District magistrate judge concluded that sanctions for spoliation must be premised on the loss of some information at least minimally relevant to the dispute. In his view, sanctions cannot arise exclusively based on a party's conduct, however culpable.

Although Ronsen was meeting with his attorneys about possible litigation against Numerex by November 2007, and sent a letter threatening litigation to Numerex in December 2007, Ronsen, with Dingman's assistance, archived more than six gigabytes of data in December 2007 and stored the archived files on an external hard drive.

Around the same time, Ronsen also deleted files, including at least some business e-mails predating the acquisition by Numerex, although Ronsen later insisted that duplicate copies of most of these e-mails existed on the server. Also pursuant to a request from Dingman, Ronsen removed his personal desktop from the company's server. Ronsen brought the desktop to his home and subsequently sent it out to a technician to be refurbished, including replacement of the hard drive.

After the complaint was filed in January 2008, counsel for Numerex sent Ronsen's counsel a letter demanding implementation of a litigation hold. Dingman responded to that request by taking several then-current backup disks out of circulation and storing them in a safe in Ronsen's office. Ronsen subsequently took those disks home.

In spring 2008, Ronsen informed Dingman that he was having difficulties with his laptop and asked Dingman to replace the hard drive, which he did.

During discovery, Numerex's forensic expert conducted an analysis of the data obtained from Ronsen and noted that although Ronsen's laptop contained his e-mail file, it included few if any user-created word processing documents.

The expert also compared the contents of the January 2008 backup disk with the contents of the laptop and shared servers and concluded that there were more than 2,000 unique files on the backup disk that did not exist on any of the active files, even though this was after a litigation hold presumably should have been in effect.

Failures Identified

Magistrate Judge Francis chronicled this history and identified "numerous respects in which Mr. Ronsen and Orbit One failed to adopt appropriate preservation procedures."[6]

These included (1) the apparent failure to impose "any formal litigation hold"; (2) the failure to inform Dingman of the pendency of this and other litigation; (3) placing primary responsibility for safeguarding information with Ronsen, "the very individual with the greatest incentive to destroy evidence harmful to Orbit One and to his own interests"; and (4) "cavalier" treatment by Ronsen of information within his control, such as removing computer hardware from the company's premises, giving material to third parties outside of his control, and failing to document his archiving practices.

Numerex filed an application for sanctions, seeking an adverse inference instruction against Ronsen and Orbit One based on these document preservation failures.

Magistrate Judge Francis denied the motion for sanctions, finding that Numerex had failed "to demonstrate that relevant information has in fact been destroyed."

He wrote:

> [P]rior to assessing whether a party has breached a preservation obligation, whether it did so with a culpable state of mind, and whether the lost information would have been helpful to the innocent party, a court considering a sanctions motion must make a threshold determination whether any material that has been destroyed was likely relevant even for purposes of discovery.
>
> No matter how inadequate a party's efforts at preservation may be, sanctions are not warranted unless there is proof that some information of significance has actually been lost.

As Magistrate Judge Francis acknowledged, this "threshold determination" whether any likely relevant material was destroyed seems to contradict Judge Scheindlin's *Pension Committee* decision.

Magistrate Judge Francis acknowledged the "implication" in *Pension Committee* that "at least some sanctions are warranted as long as any information was lost through the failure to follow proper preservation practices, even if there ha[s] been no showing that the information had discovery relevance, let alone that it was likely to have been helpful to the innocent party."

He wrote, "If this is a fair reading of *Pension Committee*, then I respectfully disagree."

Importantly, in *Orbit One*, Magistrate Judge Francis drew a distinction between "discovery relevance" and "assistive relevance." Material is "relevant" for purposes of discovery under the federal rules so long as it "appears reasonably calculated to lead to the discovery of admissible evidence." On the other hand, "assistive relevance" refers to "something more than sufficiently probative to satisfy Rule 401 of the Federal Rules of Evidence."

When information that is discovery-relevant has been lost or withheld, Magistrate Judge Francis said, then it is proper to consider the conduct and culpability of the spoliating party and, if that party acted in bad faith, to impose a presumption that the missing material would have been helpful to the innocent party.

Burden-Shifting

But the magistrate judge argued that this burden-shifting presumption "is a far cry from presuming that evidence is discovery-relevant merely because it has been destroyed as the result of a party's failure to abide by recommended preservation practices."

He argued that nothing in law or logic justifies a presumption of discovery relevance, even in cases of bad faith or other egregious conduct. He emphasized that the burden on the moving party to establish discovery relevance of the missing data is not difficult to meet: For example, it could be satisfied merely by showing that relevant documents that must "surely" have existed, such as records taken in the ordinary course of business, seem to have disappeared.

And he said that the "consequences of omitting any requirement that a party seeking sanctions demonstrate the loss of discovery-relevant information could be significant," given "the likelihood that some data will be lost in virtually any case. …In order to avoid sanctions, parties would be obligated, at best, to document any deletion of data whatsoever in order to prove that it was not relevant or, at worst, to preserve everything."

In *Orbit One*, there was no showing that discovery-relevant information had been lost through Ronsen's conduct.

With respect to his removal of information from the e-mail server, he had archived that information on an external hard drive, and there was no showing that any information was lost in that process.

With respect to Ronsen's removal of his desktop computer and replacement of its hard drive, Ronsen successfully retrieved the original hard drive and provided a complete copy to counsel for Numerex.

And with respect to the replacement of the hard drive on Ronsen's laptop, Dingman had testified that he synched the contents of the hard drive with the company's server both before and after the replacement, so it should not have lost any data.

In short, while it was "possible" that some relevant documents were removed or lost at some point, there was no evidence that was the case. As a result, Ronsen and Orbit One were not liable for spoliation sanctions.

When information that is discovery-relevant has been lost or withheld, Magistrate Judge Francis said, then it is proper to consider the conduct and culpability of the spoliating party and, if that party acted in bad faith, to impose a presumption that the missing material would have been helpful to the innocent party.

The extent of Magistrate Judge Francis' departure from Judge Scheindlin's framework should not be overstated. So long as the sanction-seeking party makes a threshold showing that discovery-relevant information has been lost, the analysis of whether a particular sanction is appropriate is substantially the same under either approach, and that analysis remains largely focused on the conduct of the spoliating party.

Key Difference

The key difference is that, in Magistrate Judge Francis' view, the party seeking imposition of sanctions always bears the initial burden of showing that discovery-relevant data has been lost or withheld.

Finally, it is worth noting that Magistrate Judge Francis also took issue with Judge Scheindlin's "guidance" in *Pension Committee* that appears to set rigid rules as to conduct that constitutes gross negligence in the document preservation context.

He seemed to agree that Judge Scheindlin's recommendations were appropriate preservation policies in most cases, but he disapproved of any presumption that failure to adhere to those standards necessarily would constitute gross negligence. For example, he criticized a categorical rule requiring issuance of a formal, written litigation hold, saying,

> in a small enterprise, issuing a written litigation hold may not only be unnecessary, but it could be counterproductive, since such a hold would likely be more general and less tailored to individual records custodians than oral directives could be. Indeed, under some circumstances, a formal litigation hold may not be necessary at all.

The magistrate judge went on to say that "[r]ather than declaring that the failure to adopt good preservation practices is categorically sanctionable, the better approach is to consider such conduct as one factor, and consider the imposition of sanctions only if some discovery-relevant data has been destroyed."

1. *Pension Committee of the University of Montreal Pension Plan v. Banc of America Securities, LLC*, 685 F.Supp. 2d 456 (S.D.N.Y. 2010).

2. *Orbit One Communications Inc. v. Numerex Corp.*, Nos. 08 Civ. 0905, 08 Civ. 6233, 08 Civ. 1195(LAK)(JCF), 2010 WL 4615547 (S.D.N.Y. Oct. 26, 2010).

3. *Residential Funding Corp. v. DeGeorge Fin. Corp.*, 306 F.3d 99, 109 (2d Cir. 2002); see *Pension Committee*, 685 F.Supp. 2d at 467; *Orbit One*, 2010 WL 4615547, at *9.

4. *Pension Committee*, 685 F.Supp. 2d at 467.

5. See *Merck Eprova AG v. Gnosis S.P.A.*, No. 07 Civ. 5898(RJS), 2010 WL 1631519, at *4 (S.D.N.Y. April 20, 2010).

6. *Orbit One*, 2010 WL 4615547, at *10.