

## E-ALERT | E-Discovery

January 21, 2010

### INVESTORS SANCTIONED FOR FAILING TO PRESERVE ESI IN SECURITIES FRAUD ACTION

Last week, Judge Shira Scheindlin of the U.S. District Court for the Southern District of New York sanctioned 13 plaintiff investors for failing to preserve and produce electronically stored information (ESI) in a securities fraud action. Her lengthy opinion applies several principles she previously addressed in the *Zubulake* decisions she issued in 2003 and 2004, which have been cited and relied upon by many other courts in the past six years. The new decision illustrates the perils of incomplete, untimely, or sloppy efforts to preserve and collect ESI.

In 2003, two offshore hedge funds run by Lancer Management Group (“Lancer”) collapsed and were placed in receivership. In February 2004, aggrieved plaintiffs – principally a group of investment fund entities – sued Lancer and Citco Fund Services (“Citco”), which had served as administrator for the bankrupt hedge funds. Discovery in the case was stayed until early 2007 during the pendency of a motion to dismiss.

Gaps in the plaintiffs’ document productions became apparent during discovery, and Citco filed an omnibus sanctions motion. After a detailed survey of the law establishing the plaintiffs’ discovery obligations, and the facts concerning each plaintiff’s compliance efforts, Judge Scheindlin granted the motion in part. She assessed monetary sanctions against all of the 13 plaintiffs targeted by the motion. In addition, with respect to the five plaintiffs she deemed grossly negligent, she will instruct the jury at trial that it may infer that the destroyed evidence would have been favorable to Citco.

Practical guidance can be gleaned from Judge Scheindlin’s blow-by-blow analysis of some of the discovery mis-steps by the plaintiffs in this case:

- **Timeliness of Document Preservation Efforts.** Plaintiffs’ counsel were faulted for not focusing their efforts on discovery until after the discovery stay expired, three years after the case was commenced. A written document hold notice should be issued as soon as a party reasonably anticipates litigation. A plaintiff’s duty is more often triggered before litigation commences, since plaintiffs control the timing of litigation.
- **Scope of Preservation Instructions.** Some of the investors in the case apparently collected paper documents, but did not take sufficient steps to preserve e-mails and other ESI. Document hold communications should indicate clearly that preservation and collection efforts should cover both ESI and hard copy documents.
- **From Whom Should Documents Be Collected?** Judge Scheindlin criticized some of the plaintiffs for not collecting documents from all personnel who had “some involvement” in investments with Lancer. It was not enough, in her view, to limit collection efforts to “a number of key players” or to the “key decision makers.” This aspect of her holding underscores the potential value of early efforts to reach an agreement with opposing counsel on the custodians whose files should be searched for relevant information.

- **Supervision of the Collection Process by Counsel.** Some of the plaintiffs were found to have been grossly negligent because they delegated document collection responsibilities to poorly trained employees, and/or because the collection process was not actively monitored and supervised. In one case, the employee tasked with ESI collection “had no experience conducting searches, received no instructions on how to do so, had no supervision during the collection, and no contact with Counsel during the search.” In another case, employees were asked to search their own computers and files without any supervision by management or counsel.
- **Scope of Collection.** The briefing on the sanctions motion revealed several unexcused failures to search media that were likely to contain relevant information. One investor searched a sub-file entitled “Lancer” instead of searching the entire server on which the sub-file was hosted. Another investor failed to search a key employee’s Palm Pilot for relevant e-mail. Another investor searched only one of several hard drives that were likely to contain pertinent ESI. Another investor failed to search back-up tapes that were known to be available.

Two other themes in Judge Scheindlin’s opinion warrant mention. First, in several instances, Citco was able to demonstrate the inadequacy of a particular entity’s preservation and collection efforts by producing e-mails to or from personnel at that entity that only appeared in the document productions of other parties. One gets the sense from reading Judge Scheindlin’s opinion that this evidence made a strong impression on her. Second, several of the plaintiffs lost credibility with the court during the discovery process that Judge Scheindlin authorized relating to the sanctions motion itself. The court ordered each plaintiff to submit an affidavit from a knowledgeable employee concerning that plaintiff’s preservation and collection efforts. Each plaintiff complied, but in subsequent depositions, many of the affiants were forced to admit that discovery compliance efforts were not as comprehensive as suggested in their affidavits, or that they did not really have first-hand knowledge about those efforts. The court might have been more willing to give the investors the benefit of any doubts had they been more candid in reporting about their own conduct.

The analysis in the new decision may reflect only the views of one judge in one federal district court, and ESI spoliation disputes tend to be very fact specific. Judge Scheindlin acknowledged that the sanctions analysis is “inherently subjective” and often turns on the court’s “gut reaction,” based on its experience, as to how hard a party has worked to comply with its discovery obligations. However, her decision shows the dangers of inadequate ESI preservation and collection, and could encourage more ESI-related sanctions motions in the SDNY given the significant potential upside for the movant.

The new decision is *Pension Committee of the University of Montréal Pension Plan v. Banc of America Securities LLC*, S.D.N.Y. Case No. 05 Civ. 9016, Order dated Jan. 11, 2010.

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