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Byte Marks: Making Sense of New F.R.C.P. 37(e)

Charles Yablon

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Charles Yablon[*]

Abstract

New FRCP 37(e) limits severe, case ending sanctions for lost electronically stored information (ESI) to situations where a party acted with "intent to deprive" other parties of the use of that information. But it makes no change in existing preservation duties and never explains how "intent" is to be determined for the corporation and other entities likely to be parties in such litigation. The question is—does this Rule make any sense? This Essay seeks to make sense of Rule 37(e) in terms of its language, the stated goals of its drafters, and its role in the regulation of current litigation practice. It argues that Rule 37(e) is best understood as an attempt to clarify the risk assessments made by corporate agents supervising ESI preservation and discovery efforts. The Rule seeks to provide assurance that their actions (and inactions), if they are reasonable and without malevolent intent, will not subject the company to severe sanctions. This Essay also shows, however, that to provide the proper incentives, the Rule must also be interpreted to permit courts to impose severe sanctions for egregious and systematic ESI loss, even if caused by managerial inaction and even if proven circumstantially without direct evidence of culpable intent. It contains an extended analysis of *CAT3 LLC*, an important case decided under the new Rule, which illustrates some of these points. Finally, drawing from analogous corporate law cases involving managerial duties to monitor employee misconduct, this Essay argues that federal courts can and should, consistent with Rule 37(e), find that there is a duty on many corporate parties to implement and maintain a reasonable system of information governance and ESI retention, and that a conscious decision not to do so can give rise to severe penalties under the new Rule.

* Professor of Law and Faculty Director, Cardozo Data Law Initiative, Benjamin N. Cardozo School of Law, Yeshiva University. I want to thank Robert Felix, Judge James Francis, Richard Marcus, , and the participants in the faculty workshop at the University of South Carolina Law School for their helpful comments on an earlier draft of this piece.

INTRODUCTION

Like other procedural conflicts primarily affecting big asymmetric litigation,[1] the battle over new Federal Rule of Civil Procedure 37(e) was long, hard fought, and resolved in a way that allowed both sides to claim victory. Corporate defendants sought relief from what they decried as the ever-increasing burden of "over-preservation." Plaintiffs' representatives saw the proposed rule as an invitation to spoliate and pushed back hard. What resulted is a Rule that does not change existing obligations to preserve electronically stored information (ESI)[2] but restricts imposition of the most severe sanctions for lost ESI to cases where "the party acted with the intent to deprive another party of the information's use in the litigation."[3] Corporate defendants could claim victory because the new Rule resolved a serious circuit split in their favor and also provided an acknowledgment that "reasonable steps" to preserve suffice.[4] Plaintiffs' representatives could point to the fact that legal preservation duties remained unchanged and, although the severest sanctions were off the table, the Rule "preserved the rights of district court judges to remedy the negligent spoliation of evidence."[5]

When great partisan battles are taking place concerning the future of civil litigation, it sometimes behooves the careful legal analyst to emulate Switzerland—try to stay neutral and hide behind large mountains.[6] Litigation is one of the primary vehicles for regulating corporate conduct in contemporary America. Both plaintiffs' and defense attorneys play vital roles in threatening, pressuring, cajoling, and advising corporate managers to do the right (or at least the legal) thing. Accordingly, it is difficult to support procedural rule changes that make successful litigation against corporate defendants either too easy or too difficult to achieve. Rather than critique new Rule 37(e) as either doing too much or

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1. On the effect of asymmetric litigation on discovery rules, see Charles Yablon & Nick Landsman-Roos, *Discovery About Discovery: Sampling Practice and the Resolution of Discovery Disputes in an Age of Ever-Increasing Information*, 34 CARDOZO L. REV. 719, 726–27 (2012).

2. FED. R. CIV. P. 37(e) advisory committee's note to 2015 amendment ("Rule 37(e) . . . does not attempt to create a new duty to preserve.").

3. FED. R. CIV. P. 37(e).

4. CIVIL RULES ADVISORY COMM., MINUTES: APRIL 10–11, 2014, at 23 (2014), http://www.uscourts.gov/sites/default/files/fr_import/CV04-2014-min.pdf.

5. John W. Griffin Jr., *A Voice for Injured Plaintiffs*, 51 TRIAL 16, 20, 22 (2015).

6. The "mountains" in this case consist of prior case law.

not enough for its proponents, this Essay will focus on a more current and important question. Does new Rule 37(e) make any sense?

The problem, in a word, is intent. Rule 37(e) purports to draw a bright line between less and more sanctionable forms of ESI destruction based on the parties' intent. But the parties most likely to be subject to such sanctions are corporations and other business entities whose intent must be inferred from the thoughts and actions of their agents, and the legal rules for doing so are frequently obscure and inconsistent. This Essay aims to make sense of Rule 37(e) by articulating a clear and consistent framework for understanding "intent" in the context of business entities' ESI preservation and destruction, so Rule 37(e) is coherently applicable in accordance with its objectives.

Neither the Rule itself nor the Advisory Committee Note has much to say on this issue. The long, convoluted, but extremely interesting history of new Rule 37(e) is outside the scope of this Essay.[7] Suffice it to say that the Advisory Committee hotly debated the proposed revisions to the Rule and concluded with a surprise overnight change to the Rule at the April 10–11 Advisory Committee meeting in Portland, Oregon.[8] Professor Thomas Allman has described the revised and shortened Rule as a "rifle shot" aimed solely at rejecting prior case law that permitted the imposition of severe sanctions for negligently lost ESI.[9] The new Rule, which requires "intent to deprive," replaces prior drafts that required spoliative actions to be "willful or [in] bad faith."[10]

The purpose of new Rule 37(e), as actually enacted, remains obscure. The new Rule creates greater uniformity, but only with regard to ESI and only in prescribing when courts may impose the most severe sanctions. So is new Rule 37(e) a victory for corporate defendants in their continuing efforts to reduce the costs and dangers of litigation? Is it a pyrrhic victory, which gives corporate defendants some limited and largely illusory protection against the most severe sanctions but does not seriously change the status quo? Or is it just an incoherent mess?

This Essay seeks to make sense of Rule 37(e) in terms of its language, the stated goals of its drafters, and its role in the regulation of current

7. For a first-hand account of this history, see THOMAS Y. ALLMAN, THE 2015 CIVIL RULES PACKAGE AS APPROVED BY THE JUDICIAL CONFERENCE 3–4 (2015), http://www.americanbar.org/content/dam/aba/administrative/litigation/materials/2015-sac/written_materials/5_1_2015_summary_of_rule_package.authcheckdam.pdf (examining the history of Rule 37(e)).

8. The Committee approved the Rule with a note to be added later. Michele Lange, *FRCP Amendments: The Long and Winding Road*, EDISCOVERY BLOG (Apr. 21, 2014), http://www.theediscoveryblog.com/2014/04/21/frcp-amendments-long-winding-road/.

9. THOMAS Y. ALLMAN, RULE 37(E): THE REPORT FROM PORTLAND 1 (2014), http://www.lfcj.com/uploads/3/8/0/5/38050985/allman_rule_37e_the_report_from_portland_4.14.14.pdf.

10. ALLMAN, *supra* note 7, at 16–17.

litigation practice. It argues that Rule 37(e) is best understood as an attempt to clarify the risk assessments made by corporate agents supervising ESI preservation and discovery efforts. The Rule seeks to provide assurance that their actions (and inactions), if reasonable and without culpable intent, will not subject the company to severe sanctions.[11] To provide the proper incentives, however, the Rule must also be interpreted to permit severe sanctions for egregious and systematic ESI loss, even in cases of managerial inaction and even without direct evidence of culpable intent. Drawing upon analogous corporate law cases involving managerial duties to monitor employee misconduct, this Essay also argues that federal courts could, consistently with Rule 37(e), impose sanctions on corporate parties for failure to implement and maintain a reasonable system of information governance and ESI retention.

I. THE PROBLEM OF "OVER-PRESERVATION"

A stated reason for revising Rule 37(e) was the perceived problem of costly ESI "over-preservation."[12] It is unclear to what degree the new Rule, as actually enacted, seeks to address that problem. "Over-preservation" is a somewhat imprecise and loaded term that may refer to a number of different types of expenditures.[13] It is therefore useful to consider precisely what sorts of expenditures might be considered costs of "over-preservation."

A. *Storage Costs*

It is natural to think of preservation as the actual cost of storing old and otherwise unnecessary files, creating back-up tapes, and not erasing otherwise reusable ESI systems.[14] Yet the actual costs of ESI storage are small and getting smaller.[15] Accordingly, there is less and less need to

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11. CIVIL RULES ADVISORY COMM., *supra* note 4.

12. Memorandum from Judge David G. Campbell, Chair, Advisory Comm. on Fed. Rules of Civil Procedure, to Judge Jeffrey Sutton, Chair, Standing Comm. on Rules of Practice & Procedure (June 14, 2014), www.uscourts.gov/file/18218/download.

13. *Id.*

14. The advisory committee said "technical and business needs" required the "safe harbor" created by Rule 37(f) in 2006. FED. R. CIV. P. 37(f) advisory committee's note to 2006 amendment. The Advisory Committee's Note to the 2006 amendment included saving storage costs by using "programs that recycle storage media." Memorandum from Honorable Lee H. Rosenthal, Chair, Advisory Comm. on Fed. Rules of Civil Procedure, to Honorable David F. Levi, Chair, Standing Comm. on Rules of Practice & Procedure (May 27, 2005), http://www.uscourts.gov/file/14746/download.

15. Advances like cloud computing continue to reduce storage costs about 50% every eighteen months. AMIT KUMAR DUTTA & RAGIB HASAN, HOW MUCH DOES STORAGE REALLY COST?–TOWARDS A FULL COST ACCOUNTING MODEL FOR DATA STORAGE 1 (2013),

destroy data in order to recycle storage media like hard drives and back-up tapes. If companies are unhappy using software that automatically destroys or modifies their ESI, they can preserve that data with other technology or use different software. In any event, such costs are a business and technical expense that changes in discovery rules cannot substantially reduce.

B. *Costs of Preserving Documents for Subsequent Litigation*

Proponents of Rule 37(e) revisions use the term "over-preservation" primarily to refer to costs of paying lawyers, executives, and technicians to locate and preserve ESI that the companies would otherwise have modified or destroyed, but keep to avoid incurring possible judicial sanctions.[16] This preservation requires paying people to identify, preserve, and retrieve ESI scattered around the company that would otherwise be destroyed as part of ordinary computer operations.[17] The Committee Report expressly attributes the increased costs of preservation to judicial expansion of the duty to preserve ESI, particularly prior to filing of litigation.[18] Corporate entities themselves describe their current ESI preservation protocols as wasteful and unnecessary, and blame it on the courts.[19]

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https://www.bja.gov/bwc/pdfs/dutta-2013-full-cost-accounting-gecon.pdf; *see also 5 Ways Cloud-Integrated Storage Reduces Costs*, NASUNI, http://datastorageasean.com/sites/default/files/Nasuni-5-Ways-CiS-Reduces-Costs-wp.pdf (last visited Nov. 12, 2016) (describing current cost saving mechanisms that have led to a decline in ESI storage costs).

16. Memorandum from Judge David G. Campbell to Judge Jeffrey Sutton, *supra* note 12 (describing fear that failure to preserve ESI might expose business entities to "serious sanctions").

17. Letter from Bruce Kuhlik, Exec. Vice-President & Gen. Counsel, Merck & Co., Inc., to Comm. on Rules of Practice & Procedure (Feb. 11, 2014), http://www.regulations.gov/#!documentDetail;D=USC-RULES-CV-2013-0002-1073 ("Merck generates, collects, and retains information for specific *business*—rather than legal—reasons . . . . Documents and data responsive to discovery orders are frequently scattered across a number of systems, many of which are designed and maintained in different ways, and extracting these documents requires time, expertise, and money.").

18. *See* Memorandum from Judge David G. Campbell to Judge Jeffrey Sutton, *supra* note 12 (explaining that entities spend "millions of dollars" preserving documents for "litigation that may never be filed").

19. *See* Letter from Bruce Kuhlik to Comm. on Rules of Practice and Procedure, *supra* note 17. Merck's litigation hold system is "remarkably broad" and requires "significant resources." *Id.* Inconsistent legal standards "force[]" the company "to comply with the strictest—and most expensive—possible retention standard in an effort to avoid spoliation sanctions." *Id.*; *see also* Robert Levy et al., *The Proposed Rules: Light at the End of the E-Discovery Tunnel*, METROPOLITAN CORP. COUNSEL, Oct. 2013, at 1, 39 (noting companies must take "the most restrictive and extreme approach as to what needs to be preserved. The result is preservation of documents at great expense that are very unlikely to be used in litigation"); Letter from Lawyers for Civil Justice to Advisory Comm. on Civil Rules (Aug. 30, 2013), http://www.regulations.gov/#!documentDetail;D=USC-RULES-CV-2013-0002-0267 ("A New Preservation Rule is Urgently Needed.").

Recognizing that the costs of over-preservation are really the costs of companies trying to comply with current law on ESI preservation, the argument based on over-preservation is somewhat circular. Companies argue that the law mandates wasteful and unnecessary preservation of ESI, but what makes that preservation wasteful and unnecessary is their own assertion that the law on ESI preservation is unnecessarily broad. They could straightforwardly argue that the costs to them of current ESI preservation law substantially outweigh the benefits to plaintiffs or the civil litigation system.[20] That statement, however, is controversial and contestable, not least by the judges who created, enforced, and expanded the existing law of ESI preservation.[21]

Another way to attack current preservation standards is to note that much ESI preservation is done for "litigation that may never be filed."[22] But if the preservation obligation attaches whenever litigation is "reasonably anticipated," as it does under current case law, then some of these results are inevitable.[23] Not all "reasonably anticipated" events actually occur.[24] Any loosening of preservation standards would permit more ESI destruction in subsequently filed cases.

C. *Costs of Litigation Damage*

For corporate defendants, the litigation damage caused by preserved ESI may well be the hidden cost of "over-preservation." The U.S. Supreme Court has noted the legality and ubiquity of "[d]ocument retention policies" that destroy documents and are "created in part to keep

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20. To be fair, many of the proponents of the 2015 discovery reforms have argued precisely that. *See* Letter from Lawyers for Civil Justice to Advisory Comm. on Civil Rules, *supra* note 19. The Advisory Committee, however, took a more equivocal position in expressly refusing to change preservation law. *See* Memorandum from Judge David G. Campbell to Judge Jeffrey Sutton, *supra* note 12.

21. *See, e.g.*, Micron Tech., Inc. v. Rambus Inc., 645 F.3d 1311, 1320–21 (Fed. Cir. 2011) ("declin[ing] to sully the flexible reasonably foreseeable standard" with a "restrictive gloss"); Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC, 685 F. Supp. 2d 456, 461–62 (S.D.N.Y. 2010) ("[T]he courts have a right to expect that litigants and counsel will take the necessary steps to ensure that relevant records are preserved when litigation is reasonably anticipated, and that such records are collected, reviewed, and produced to the opposing party. . . . [W]hen this does not happen, the integrity of the judicial process is harmed . . . ."), *abrogated by* Chin v. Port Auth. of N.Y. & N.J., 685 F.3d 135 (2d Cir. 2012).

22. Memorandum from Judge David G. Campbell to Judge Jeffrey Sutton, *supra* note 12; *see also* Letter from Kaspar Stoffelmayr, Vice-President & Assoc. Gen. Counsel, Bayer Corp., to Comm. on Rules of Practice & Procedure (Oct. 25, 2013), http://www.regulations.gov/#!document Detail;D=USC-RULES-CV-2013-0002-0309 (pointing out the low percentage of ESI Bayer actually produced in pending litigation compared to the amounts preserved).

23. Memorandum from Judge David G. Campbell to Judge Jeffrey Sutton, *supra* note 12.

24. This sentence was written the day after the Carolina Panthers (favored by 10 points) lost to the Denver Broncos in Super Bowl 50.

certain information from getting into the hands of others."[25] Proponents of Rule 37(e) revisions rarely argued that their goal was to reduce damaging litigation disclosures, although they surely knew that was a likely result.[26] As a reason for revising Rule 37(e), however, the argument is an obvious non-starter. It plays into the view of the discovery rules as a zero-sum contest between plaintiffs' lawyers and corporate defendants, and it highlights the unsettling fact that intentional ESI destruction is perfectly legal before any preservation duty attaches but subject to severe penalties thereafter.

II. A RISK MANAGEMENT APPROACH TO RULE 37(E)

A coherent account of the purpose of Rule 37(e) must consider corporate agents and their relationship to risk, particularly the risk of disobeying the law. It is a matter of some theoretical dispute whether corporate managers ever have an obligation to break the law. Such agents have fiduciary duties that require them to act in the "best interests" of the corporation and its shareholders.[27] When substantial corporate benefits may come from bending or breaking the legal rules and the penalties for violations are small or the probability of detection is low, breaking the law may well appear to be a managerial obligation.[28]

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25. Arthur Andersen LLP v. United States, 544 U.S. 696, 704 (2005) (citing Christopher R. Chase, *To Shred or Not to Shred: Document Retention Policies and Federal Obstruction of Justice Statutes*, 8 FORDHAM J. CORP. & FIN. L. 721, 725 (2003) ("[O]ne of the best reasons for having a formal policy is that it reduces legal exposure through the destruction of possibly incriminating evidence.")).

26. Levy et al., *supra* note 19, at 39 ("Keep in mind that the U.S. Supreme Court has confirmed that it is appropriate to get rid of information as part of a records retention policy. . . . LCJ's argument is not based on a desire to hide information, but rather to facilitate normal business processes that are not going to be subject to the 'gotcha' game that often arises in litigation.").

27. *E.g.*, Aronson v. Lewis, 473 A.2d 805, 810–11 (Del. 1984); *see* MODEL BUS. CORP. ACT § 8.30(a) (2007).

28. Legal scholars have taken varying views on this issue. Progressive academics cite it as a fundamental problem, encouraging corporate managers to adopt the perspective of the Holmesian "bad man." *See, e.g.*, KENT GREENFIELD, THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS & PROGRESSIVE POSSIBILITIES 73–74 (2006); Jill E. Fisch, *The "Bad Man" Goes to Washington: The Effect of Political Influence on Corporate Duty*, 75 FORDHAM L. REV. 1593, 1593–94 (2006). Many law and economics scholars, in contrast, view such cost–benefit analyses as part of the wealth-maximizing role of the modern business corporation. *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Antitrust Suits by Targets of Tender Offers*, 80 MICH. L. REV. 1155, 1168 n.36 (1982) ("Managers have no general obligation to avoid violating regulatory laws, when violations are profitable to the firm, because the sanctions set by the legislature and courts are a measure of how much firms should spend to achieve compliance."). Others have tried to carve out an intermediate position. *See, e.g.*, Stephen L. Pepper, *Counseling at the Limits of the Law: An Exercise in the Jurisprudence and Ethics of Lawyering*, 104 YALE L.J. 1545, 1609–10. (1995). For an overview of this debate, including its application to corporate

There is no doubt many real-world corporate managers adopt a cost–benefit approach in determining whether to violate legal rules. There appear to be "widespread" corporate violations of the labor laws mandating overtime pay and prohibiting employment of undocumented immigrants.[29] The recent rapid growth of regulatory compliance departments within corporations has further validated these strategies. Just as document retention policies require consideration of what documents to destroy,[30] corporate compliance policies require corporate managers to consider how much money, time, and effort should be spent on promoting and enforcing various types of compliance.[31] These managers must assess at least three different risks: (1) that a violation of law will occur, (2) that the violation will be detected, and (3) the probable penalty that will be imposed.[32]

Imagine an associate general counsel in charge of supervising the company's "information governance" system[33] and ESI preservation efforts. The last few years have not been easy. With the proliferation of smartphones, Facebook pages, and employees uploading their files onto the Cloud and then working at home (on who knows what device), the amount of potentially relevant ESI being created and destroyed outside the company's formal document retention system is large and growing, and with that comes an increasing likelihood of serious violations of ESI preservation obligations. Plaintiffs' lawyers are getting more sophisticated about technology and making sure their discovery requests cover smartphones and tweets and are even hiring legal tech firms.[34] The

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document retention policies, see Daniel T. Ostas, *Legal Loopholes and Underenforced Laws: Examining the Ethical Dimensions of Corporate Legal Strategy*, 46 AM. BUS. L.J. 487, 488 (2009).

29. Ostas, *supra* note 28, at 491–93.

30. *See, e.g.*, APPLIED DISCOVERY, LEXISNEXIS, DOCUMENT RETENTION & DESTRUCTION POLICIES FOR DIGITAL DATA 2 (2004), http://www.lexisnexis.com/applieddiscovery/lawlibrary/whitePapers/ADI_WP_DocRetentionDestruction.pdf.

31. Ostas, *supra* note 28, at 499–500 ("If economics drives the corporate decision, then resources will be employed only up to a point where the marginal cost of compliance equals the marginal benefit resulting from fewer instances of unlawful behavior, but not beyond. In other words, there may be 'efficient' breaches even when the firm is committed to 'compliance.'" (footnote omitted)).

32. Ostas, *supra* note 28, at 501.

33. For a definition and description of such systems, see Philip J. Favro, *Getting Serious: Why Companies Must Adopt Information Governance Measures to Prepare for the Upcoming Changes to the Federal Rules of Civil Procedure*, 20 RICH. J.L. & TECH. 1, 25–39 (2014).

34. At least twenty state bars have adopted Rule 1.1 of the Model Rules of Professional Conduct, requiring lawyers to keep abreast of changes in the law, including "relevant technology." Robert Ambrogi, *23 States Have Adopted Ethical Duty of Technology Competence*, LAW SITES (Mar. 16, 2015), http://www.lawsitesblog.com/2015/03/11-states-have-adopted-ethical-duty-of-technology-competence.html.

likelihood of detection of such violations is substantial and increasing. Finally, the courts are being uncooperative by refusing to define, in any clear and predictable way, precisely when ESI preservation duties commence. If a general counsel guesses wrong, a judge (frequently but not exclusively a federal judge in a court within the Second Circuit)[35] can declare with 20–20 hindsight that the corporate client's work was negligent and sock that client with sanctions that substantially increase its cost to settle the case. The general counsel accordingly spends increasing amounts of time and money preserving ESI, erring, as the cost–benefit calculus and a lawyerly sense of caution demands, on the side of ever greater monitoring and preservation. Senior executives of the company complain that the legal department's costs are increasing every year without any improvement in actual litigation results.

For lawyers facing such dilemmas, new Rule 37(e) will appear as a mild improvement in their situation. They no longer have to worry quite so much if the litigation hold notice is a few days late or if some employees fail to understand exactly what it means. They can take longer lunch breaks, stop obsessing over every dispute that might turn into a lawsuit, and spend a little less money and effort ensuring that the company fully and completely meets its ESI preservation obligations.

Or, as the economists might put it, by reducing the penalty a company is likely to receive for negligent or grossly negligent ESI preservation, the drafters of new Rule 37(e) have lowered the price of this behavior.[36] Companies will still try to prevent unlawful ESI destruction, of course. It is still subject to less severe sanctions, harmful to the company's general litigation posture, and likely to anger the judge, but as rational wealth maximizers, corporate agents will not have the same incentive to engage in the costly and zealous efforts they have come to think of as "over-preservation." On this view, new Rule 37(e) is a small but significant victory for corporate defendants, one that reduces their preservation obligations *in practice*, and one that will lead to somewhat less ESI being preserved. The drafters of Rule 37(e) likely contemplated this result.[37] Lawmakers frequently attempt to adjust the deterrent effect of regulations

35. *See* SHIRA A. SCHEINDLIN ET AL., ELECTRONIC DISCOVERY AND DIGITAL EVIDENCE 570–75 (2d ed. 2012).

36. *Cf.* Uri Gneezy & Aldo Rustichini, *A Fine Is a Price*, 29 J. LEGAL STUD. 1, 15–16 (2000) ("Fines . . . are decided in a larger context, which for convenience we may define as a game. . . . People . . . bring to it a perception of the strategic situation they are facing.").

37. FED. R. CIV. P. 37(e) 2015 advisory committee's note to 2015 amendment. Prior law caused litigants to expend "excessive effort and money on preservation in order to avoid the risk of severe sanctions if a court finds they did not do enough."

by raising or lowering penalties for controversial activities.[38] Yet certain aspects of new Rule 37(e) make it unique and require further discussion.

Most legal changes that lower the price of prohibited conduct reflect a revised assessment that the harm of such conduct is not as great as previously thought.[39] However, because Rule 37(e) is a trans-substantive rule of procedure, it is very difficult to predict the harm that will result from lowering the penalties for negligent destruction of ESI. That harm, or lack thereof, was a prominent part of the debate over Rule 37(e). Corporate defendants sought to characterize the additional ESI being preserved as marginal and implied that most of the cases calling for it were nuisance suits.[40] Plaintiffs groups pointed out the devastating effect that loss of critical evidence could have in major employment discrimination, toxic tort, or products liability cases.[41] Because the Federal Rules apply to an enormous number of different types of cases, both characterizations are likely to be sometimes true.

One response might have been to provide for case-by-case analysis, permitting judges to impose severe sanctions for especially harmful ESI destruction in "exceptional circumstances," as old Rule 37(e) did.[42] But even the small probability of a big sanction upsets the *ex ante* risk assessments that new Rule 37 seeks to address. Accordingly, there is no "exceptional case" exception. Rather, the Rule describes a bright line between the conduct for which courts may impose severe sanctions and that for which they may not. But the question of the amount of harm ESI destruction can cause remains controversial and unresolved.[43] As we will

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38. *See, e.g.*, Tina Moore et al., *NYPD to Stop Arresting for Minor Marijuana Possession, Will Issue Tickets Instead*, N.Y. DAILY NEWS, (Nov. 11, 2014, 9:36 AM) http://www.nydailynews.com/new-york/nyc-crime/nypd-stop-arrests-low-level-marijuana-charges-source-article-1.2005222.

39. *Id.* Many argue that laws prohibiting conduct causing serious non-compensable harm should not be subject to cost–benefit analysis at all. *See, e.g.*, Easterbrook & Fischel, *supra* note 28, at 1168 n.36 (explaining how courts should not apply this analysis to laws involving "violence or other acts thought to be *malum in se*").

40. *See* Letter from Lawyers for Civil Justice to Advisory Comm. on Civil Rules, *supra* note 19 (describing cases like Silvestri v. General Motors Corp, 271 F.3d 583 (4th Cir. 2001), a products liability case in which failure to preserve non-ESI evidence led to substantial harm and substantial sanctions as "rare" and "one-in-a-million").

41. *See, e.g.*, Letter from Michael R. Hugo, First Vice-Chair, Am. Ass'n of Justice, to Advisory Comm. on Civil Rules (Feb. 18, 2014), https://www.regulations.gov/document?D=USC-RULES-CV-2013-0002-2178.

42. There was perhaps a nod to these same concerns in the "proportionality" factor that appeared in the Advisory Committee's original version of revised Rule 37(e). ADVISORY COMM. ON CIVIL RULES, MEETING OF THE ADVISORY COMMITTEE ON CIVIL RULES APRIL 11–12, 2013, at 153–55 (2013), http://www.uscourts.gov/sites/default/files/fr_import/CV2013-04.pdf.

43. In effect, new Rule 37(e) offers corporate managers a choice of three ESI retention/destruction strategies: reasonable but not perfect (no sanctions), negligent (some less severe sanctions), or intentional (severe sanctions). The drafters of the Rule likely assumed that

see, it is likely to re-emerge as judges seek to assess the egregiousness of a party's conduct in determining whether to infer intent in a particular case.

Rule 37(e)'s bright line is also unusual because it does not prescribe different penalties for different conduct, but for the same conduct taken with different states of mind. This means that the assurance Rule 37(e) offers corporate managers engaged in ESI preservation is necessarily limited and tentative. With respect to certain tasks, like making sure the company widely distributes the litigation hold notice and employees adequately understand it, a manager can have confidence that reasonable effort is all that the law requires and even mistakes will not invoke severe sanctions. With respect to other preservation issues, this is far less clear.[44] Some managers may believe Rule 37(e) protects their company from severe sanctions so long as they do not send out a "smoking e-mail" explicitly ordering ESI destruction. Others may worry that any low-level employee who intentionally destroys ESI will subject the company to severe sanctions. As we will see, these beliefs are both likely wrong.

The biggest problem with a bright-line rule based on intent is determining how it applies to entities that have no actual intent. Nothing in Rule 37(e) nor the Advisory Committee Note sheds light on this issue. Yet "[a]scertaining a party's intent is one of the most difficult determinations that a judge makes. Imputing intent to an organization is doubly problematic."[45] Making sense of Rule 37(e) requires making sense of the intent requirement, particularly with respect to corporate organizations.

III. THE PROBLEM OF CORPORATE INTENT

Consider the following scenarios, all of which involve intentional destruction of ESI and all of which occur within a corporate organizational context:

I. General Counsel of Megacorp receives a letter from a former sales employee alleging she was fired due to gender discrimination and

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most corporate managers would choose to avoid sanctions altogether by adopting the first option. But for some companies, the added ESI destruction entailed by negligent retention policies would be sufficiently beneficial to the company's litigation posture to outweigh the cost of lesser sanctions. Of course, one might consider conscious adoption of a policy of negligent ESI retention an intentional act, but that is a question for the following Section.

44. Suppose counsel, confused by contradictory case law, tells employees they may continue destroying relevant ESI because she believes preservation duties have not yet attached. If a judge subsequently disagrees, will he find she made her prior order with culpable "intent," or was it a merely negligent mistake? For an answer, see *infra* note 131 and accompanying text.

45. Letter from James C. Francis IV, U.S. Magistrate Judge, United States Dist. Court for the S. Dist. of N.Y., to Comm. on Rules of Practice & Procedure (Jan. 10, 2014), http://www.lfcj.com/uploads/3/8/0/5/38050985/frcp_usdc_southern_district_of_new_york__james_francis_1_10_14.pdf (commenting on the Advisory Committee's original draft Rule 37(e)).

threatening suit. General Counsel immediately issues a litigation hold notice informing all sales department employees of the potential lawsuit and ordering them to cease destruction and preserve all documents and ESI relevant to the former employee, her employment performance, and her termination. A salesperson in that department (not the former employee's boss or supervisor) receives the notice, realizes he has e-mails on his office computer and smartphone that are potentially relevant, embarrassing to him personally, and potentially damaging to the corporation in any lawsuit. In direct contravention of the General Counsel's instructions, the salesperson deletes and overwrites the e-mails so they cannot be recovered.

II. Same scenario as I, except before the salesperson destroys any ESI, he discusses his plans for ESI destruction with a colleague. The colleague sends an anonymous e-mail to the General Counsel stating, "One of the salespeople may be misconstruing your notice about evidence preservation. He thinks it is really an instruction to destroy bad evidence before the case is filed. Please clarify." The General Counsel, believing her notice was clear and distrusting anonymous e-mails, does nothing. The salesperson subsequently deletes and overwrites the e-mails.

III. General Counsel receives the same letter as I but does not immediately issue a litigation hold notice. Rather, aware that the law regarding when preservation duties attach is complex, she asks outside counsel to prepare a detailed memorandum of law discussing how the courts might deal with this issue in the three jurisdictions where the former employee is most likely to sue. After receiving that memo, she spends another week reading it and many of the cases it cites. During this time, she is aware that routine corporate document retention policies are causing potentially relevant ESI to be destroyed. After four weeks, the General Counsel issues the litigation hold, but due to her "somewhat purposeful sluggishness," relevant ESI is lost.

IV. Littleco, a small but growing firm in the high tech sector, has no consistent or routine document retention policies. The CEO has refused to follow the advice of various legal tech and outside law firms that a well planned and consistently applied program of information governance would reduce Littleco's potential litigation costs and help protect the company in the event of a major lawsuit. The CEO thinks these sales pitches are mostly hype and prefers to save costs and encourage "creativity" by letting each department head make her own judgments about ESI retention and destruction. When Littleco is sued for patent infringement, its lawyers send out a timely litigation hold notice, but distribution and enforcement within the firm is disorganized and haphazard and relevant ESI is destroyed.

In all of these cases, there are plausible arguments under prior case law[46] that the actions taken (or not taken) by corporate agents were taken with "intent to deprive another party of the information's use" in anticipated litigation.[47] Yet none involves a single culpable spoliator whose intent may be readily attributed to the corporation.

The first scenario presents the straightforward question whether intentional acts of an employee, taken within the scope of his employment, can be attributed to the employer corporation even if those intentional acts are unauthorized or in violation of express instructions. If the rogue employee's actions were treated as an ordinary common law tort, intentional but unauthorized actions would very likely give rise to corporate liability. The basic principle of *respondeat superior* states that "[a]n employer is subject to vicarious liability for a tort committed by its employee acting within the scope of employment."[48] This rule generally applies to intentional as well as negligent torts, even where the employee's intentional actions violate express policies of the corporate employer.[49] "Scope of employment" is the critical issue, and courts generally do not find it where the employee is acting out of purely personal motives. But in situations like Scenario I, where the employee believes himself to be acting for the benefit of both himself and the corporation, courts generally deem this conduct to be within the scope of employment.[50]

A number of cases have applied these principles to alleged spoliation claims. In *Nucor Corp. v. Bell*,[51] Nucor sued its former employee, claiming that when Bell left its employment for a job with SeverCorr LLC, also a defendant, he misappropriated Nucor's trade secrets.[52] Bell had intentionally destroyed or overwritten two forms of ESI: (1) a USB drive he allegedly used to transfer Nucor files to his SeverCorr laptop; and (2) data on his SeverCorr laptop itself.[53] Holding that "[o]rdinary agency principles govern a party's responsibility for spoliation committed by its employees," the Court held that destruction of the USB drive was done outside the scope of Bell's employment and could not be attributed to SeverCorr but the ESI destruction on the SeverCorr laptop

46. *See infra* notes 48–52 (Scenario I), 69–73 (Scenario II), 76–81 (Scenario III), and 104–114 (Scenario IV) and accompanying text.

47. FED. R. CIV. P. 37(e)(2).

48. RESTATEMENT (THIRD) OF AGENCY § 7.07(1) (AM. LAW INST. 2006).

49. *See, e.g.*, Phillips v. JCM Dev. Corp., 666 P.2d 876, 882–83 (Utah 1983) (finding fraud by employee created vicarious liability of corporate employer although employee's actions were "in complete violation of [the corporate defendant's] established policies and practices").

50. *See* RESTATEMENT (SECOND) OF AGENCY § 228(1)(c) (AM. LAW INST. 1958).

51. 251 F.R.D. 191 (D.S.C. 2008).

52. *Id.* at 193.

53. *Id.* at 194–95.

could.[54] Many other reported cases involve parties found culpable after their agents destroyed relevant evidence, sometimes in violation of express instructions to preserve.[55]

Yet in some cases, particularly involving federal statutory torts, courts have interpreted the statutes in ways that limit application of *respondeat superior*.[56] Similarly, most federal courts applying the sanctions provisions of FRCP 37(e)[57] do not impute the intent of every spoliating employee to the corporation, but look to the status and role of the corporate agent involved. In *Dupont v. Kolon Industries*[58] for example, although there was clear and largely undisputed evidence of intentional ESI spoliation by corporate employees acting within the scope of their employment, the Eastern District Court of Virginia did not base its finding of corporate "bad faith" exclusively or even primarily on that fact.[59] It inquired further, noting that the spoliators were "key employees" and one was in charge of the corporate division that was the subject of the litigation.[60] It also found fault with the diligence with which those in charge of ESI preservation had carried out their duties.[61] In the recent case of *GN Netcom, Inc. v. Plantronics, Inc.*,[62] decided under new Rule 37(e), the Delaware District Court found "bad-faith intent" by Plantronics based on the actions of one "top-level Plantronics executive" who deleted his own e-mails and instructed other employees to do so as well, despite directly contradictory preservation instructions from other Plantronics top executives and legal advisors.[63]

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54. *Id.* at 196. The court ultimately gave a jury instruction permitting but not requiring adverse inferences with respect to both defendants. *Id.* at 204.

55. *See, e.g.*, Silvestri v. Gen. Motors Corp, 271 F.3d 583, 585 (4th Cir. 2001); Bowman v. Am. Med. Sys., Inc., No. CIV. A. 96-7871, 1998 WL 721079, at *4–6 (E.D. Pa. Oct. 9, 1998).

56. Some federal courts have rejected application of *respondeat superior* to 10b-5 securities claims. *See, e.g.*, *In re* Fidelity/Micron Sec. Litig., 964 F. Supp. 539, 544 (D. Mass. 1997); Converse, Inc. v. Norwood Venture Corp., No. 96 CIV. 3745 (HB), 1997 WL 742534, at *3 (S.D.N.Y. Dec. 1, 1997); *In re* Prudential Ins. Co. of Am. Sales Practices Litig., 975 F. Supp. 584, 612–13 (D.N.J. 1996). The principle also does not apply to claims under 42 U.S.C. § 1983 (2012). Monell v. Dep't of Soc. Servs., 436 U.S. 658, 691 (1978).

57. Rule 37(e) is, for most purposes, the equivalent of a federal statute. *See* 28 U.S.C. § 2072 (2012); Hanna v. Plumer 380 U.S. 460, 462–64 (1965).

58. 803 F. Supp. 2d 469 (E.D. Va. 2011).

59. *Id.* at 508.

60. *Id.* at 501.

61. *Id.* at 504–05; *see also* Selectica, Inc. v. Novatus, Inc., No. 6:13-cv-1708-Orl-40TBS, 2015 WL 1125051, at *7 (M.D. Fla. Mar. 12, 2015) (finding the bad faith of a corporate employee was not attributed to the corporation, but rather the corporation's culpability was based on "failure to adequately instruct its employees to preserve evidence"); Apple Inc. v. Samsung Elecs. Co., 881 F. Supp. 2d 1132, 1147 (N.D. Cal. 2012) (finding of culpable conduct by corporate defendant not based on employees' failing to preserve ESI as instructed, but on Samsung failing to verify that its "employees were actually complying with the detailed instructions").

62. No. 12-1318-LPS, 2016 WL 3792833 (D. Del. July 12, 2016).

63. *Id.* at *6–7, *13.

This more nuanced approach to *respondeat superior* makes sense in interpreting new Rule 37(e). A Rule designed to protect reasonable but not perfect preservation efforts and reduce penalties for negligent preservation would be severely undercut if the intent of any rogue employee were automatically imputed to the corporate defendant. However, unless the intent of *some* human agents can be attributed to the corporate defendant, Rule 37(e) would absolutely bar imposing severe sanctions on them. Both logic and prior case law suggest that the intent of high-level corporate officers,[64] as well as any agent supervising ESI retention or discovery,[65] is likely to be deemed corporate intent.[66]

Scenario II presents a stronger case for severe sanctions. Not only is the same rogue employee violating clear preservation instructions, but the corporate agent supervising ESI preservation has chosen to ignore a "red flag" warning that spoliation is imminent.[67] There is little doubt the General Counsel's decision was mistaken and negligent, but was it made with intent "to deprive another party of the information's use in the litigation"?[68] On the facts as stated, the answer is no. General Counsel asserts she made a bad call because she thought her preservation notice was clear and she dislikes anonymous e-mails. But she would say that, wouldn't she? A suspicious plaintiffs' lawyer would argue that under these facts (ignoring the general counsel's self-serving rationale), the general counsel's more likely motivation for doing nothing was that she wanted to deprive plaintiff of the use of the information.

This raises an important question. Must the requisite intent under new Rule 37(e) be proven directly by, for example, testimony or prior e-mails of the relevant employees, or can it be inferred from circumstantial facts like selective destruction or the use of "scrubbing software"? The Rule

64. *See* Philips Elecs. N. Am. Corp. v. BC Tech., 773 F. Supp. 2d 1149, 1156 (D. Utah 2011) (explaining actions of "largely upper management and executives"); Victor Stanley, Inc. v. Creative Pipe, Inc., 269 F.R.D. 497, 531 (D. Md. 2010) (explaining bad faith of CEO imputed to corporation).

65. *See* NuVasive, Inc. v. Madsen Med., Inc., No. 13cv2077 BTM(RBB), 2015 WL 4479147, at *2 (S.D. Cal. July 22, 2015) (finding that corporate party "did not take adequate steps to make sure that its employees complied with the litigation hold"), *vacated on reconsideration by* 2016 WL 305096 (S.D. Cal. Jan. 26, 2016); Orbit One Commc'ns, Inc. v. Numerex Corp., 271 F.R.D. 429, 437–38 (S.D.N.Y. 2010) (explaining the preservation duty ascribed to counsel supervising discovery and managers of the business).

66. *See* Sekisui Am. Corp. v. Hart, 945 F. Supp. 2d 494, 499, 506 (S.D.N.Y. 2013) (demonstrating court considered deletion ordered by head of Human Resources to be corporate intent); Connor v. Sun Trust Bank, 546 F. Supp. 2d 1360, 1376–77 (N.D. Ga. 2008) (explaining intentional ESI deletion by plaintiff's supervisor imputed to defendant corporation).

67. *See supra* p. 582.

68. FED. R. CIV. P. 37(e)(2).

and Advisory Committee Note provide no guidance,[69] but case law is fairly clear. Even among those courts that previously required "intentional destruction indicating a desire to suppress the truth,"[70] this desire could be established indirectly by examination of the circumstances surrounding the destruction of evidence, even when the party claimed to be acting from more innocent purposes.[71] It is likely these cases will continue to be good precedent in determining intent under new Rule 37(e).

The general counsel also cannot claim that she failed to "act with intent" because her inaction rather than action resulted in ESI destruction.[72] Substantial case law holds that once a duty to preserve arises, failure to carry out that duty effectively can give rise to sanctions.[73] The problem is finding evidence of intent. Prior cases generally involve negligent or grossly negligent failures to preserve, perhaps because it is very difficult to prove that a failure to act was intentional.[74] Yet here too there must be circumstances under which ignoring "red flags" can give rise to an inference of culpable intent.[75] If one anonymous e-mail is not

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69. These authorities specify that prejudice from lost ESI can be inferred only from a finding of intentional ESI destruction. However, they say nothing about whether the requisite intent can be inferred from the nature and method of ESI destruction.

70. Stevenson v. Union Pac. R.R., 354 F.3d 739, 746 (8th Cir. 2004).

71. *See id.* at 748 (explaining that the selective preservation of evidence would give rise to indirect examination); Blinzler v. Marriott Int'l, Inc., 81 F.3d 1148, 1158–59 (1st Cir. 1996); Am. Builders & Contractors Supply Co. v. Roofers Mart, Inc., No. 1:11–CV–19 (CEJ), 2012 WL 2992627, at *4 (E.D. Mo. July 20, 2012) (intent inferred from timing of ESI destruction); Ameriwood Indus., Inc. v. Liberman, No. 4:06CV524-DJS, 2007 WL 5110313, at *6 (E.D. Mo. July 3, 2007) (describing use of scrubbing software as part of indirect examination). One can view these cases as the application to ESI destruction of the well-established tort rule that intent can be inferred from the natural consequences of an act. *See* RESTATEMENT (SECOND) OF TORTS § 8A cmt. a (AM. LAW INST. 1965).

72. *See supra* p. 582. Rule 37(e)(2) requires finding that a party "acted" with the requisite intent, and some prior cases hold an element of proving bad faith is "an affirmative act causing the evidence to be lost." Calixto v. Watson Bowman Acme Corp., No. 07–60077–CIV, 2009 WL 3823390, at *16 (S.D. Fla. Nov. 16, 2009). Yet conscious decisions not to act can be described as "actions" of a sort. It is particularly difficult to distinguish between action, inaction, and intermediate degrees of "sluggishness" when analyzing ESI preservation and discovery efforts. Accordingly, it is unlikely courts will rely much on an action/inaction distinction.

73. *See, e.g.*, Chin v. Port Auth. of N.Y. & N.J., 685 F.3d 135, 162 (2d Cir. 2012); NuVasive, Inc. v. Madsen Med., Inc., No. 13cv2077 BTM(RBB), 2015 WL 4479147, at *1–3 (S.D. Cal. July 22, 2015), *vacated on reconsideration by* 2016 WL 305096 (S.D. Cal. Jan. 26, 2016); Orbit One Commc'ns, Inc. v. Numerex Corp., 271 F.R.D. 429, 441 (S.D.N.Y. 2010); Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Secs., 685 F. Supp. 2d 456, 466 (S.D.N.Y. 2010), *abrogated by Chin*, 685 F.3d 135.

74. It is hard to believe someone "scrubbed" a hard drive by accident, *see Ameriwood*, 2007 WL 5110313, at *6 (explaining that scrubbed hard drive can show evidence of bad faith), but not implausible that someone negligently failed to respond to an e-mail, *see supra* p. 582.

75. *See supra* note 71 and accompanying text.

enough, what about three? What about a signed e-mail by the employee's supervisor? Under sufficiently egregious circumstances, even inaction by a relevant agent will give rise to an inference that the agent (and therefore the corporation) acted with the requisite intent.

New Rule 37(e) effectively raises the bar for inferring intentional dereliction of preservation duties. In practice, courts will confront a variety of circumstances where corporate agents failed effectively to carry out their preservation duties with varying degrees of egregiousness. In virtually all these cases, the corporate agent will deny acting intentionally, and courts will have to draw difficult lines between various types and degrees of misconduct, subjecting only the worst to severe sanctions.

This leads to Scenario III, where the general counsel, while ostensibly carrying out her preservation duties, did so with "somewhat purposeful sluggishness."[76] The phrase is from *Residential Funding Corp. v. DeGeorge Financial Corp.*, the case new Rule 37(e) expressly overruled.[77] The district court held that such production was not grossly negligent nor in bad faith.[78] The Second Circuit reversed, holding that such delays might well meet either culpability level.[79] Prior to new Rule 37(e), many courts did not bother to fine tune their determinations of corporate culpability, rather setting a floor such as "at a minimum, grossly negligent"[80] or hovering between two culpability

76. *See supra* p. 582.

77. 306 F.3d 99, 110 (2d Cir. 2002), *superseded by rule*, FED. R. CIV. P. 37(e), *as recognized in* CAT3, LLC v. Black Lineage, Inc., 164 F. Supp. 3d 488 (S.D.N.Y. 2016). The Second Circuit cited *Residential Funding* approvingly in its recent opinion reinstating Tom Brady's suspension in the famous "deflategate" case. Nat'l Football League Mgmt. Council v. Nat'l Football League Players Ass'n, 820 F.3d 527, 544 (2d Cir. 2016) (citing *Residential Funding*, 306 F.3d at 106–07). Some have criticized the court for doing so, but the court's citation there was perfectly appropriate. *See* Zach Warren, *5 Cases That Address the E-Discovery FRCP Amendments from Spring 2016*, LEGALTECH NEWS (June 1, 2016), http://www.legaltechnews.com/id=1202758952712. The issue in *NFL Management* was, in part, whether Tom Brady was subject to suspension under the National Football League (NFL) players' agreement for, among other things, failure to cooperate with the NFL's investigation. *Nat'l Football League*, 820 F.3d at 542. The court cited Brady's purposeful destruction of his cell phone as an example of his failure to cooperate. *Id.* at 544. In that context, the court did cite *Residential Funding* for the proposition that "the law permits a trier of fact to infer that a party who deliberately destroys relevant evidence . . . did so in order to conceal damaging information from the adjudicator." *Id.* at 544 (citing *Residential Funding*, 306 F.3d at 106–07). This statement is still true in that Rule 37(e)(2), while it does not require such a finding, does permit it when the circumstances surrounding the deliberate destruction provide clear and convincing evidence of such an intent. Moreover, the court in that case was not construing Rule 37, but the NFL players' agreement adopted in 2014. *Id.* at 539. In that context, *Residential Funding* provides good evidence of conduct that was, at the time, considered highly uncooperative.

78. *Residential Funding*, 306 F.3d at 105.

79. *Id.* at 110–12.

80. Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Secs., 685 F. Supp. 2d 456, 477 (S.D.N.Y. 2010), *abrogated by* Chin v. Port Auth. of N.Y. & N.J., 685 F.3d 135 (2d Cir. 2012); *see also* Connor v. Sun Trust Bank, 546 F. Supp. 2d 1360, 1377 (N.D. Ga.

determinations.[81] Under new Rule 37(e), this imprecision will no longer be feasible since so much turns on precise culpability findings.[82]

CAT3, LLC v. Black Lineage, Inc.,[83] one of the first cases decided under new Rule 37(e), provides insight into how courts will approach these issues. In that trademark infringement case, discovery revealed irregularities in e-mails produced by the plaintiffs, three limited liability companies (LLCs).[84] This led to an investigation by defendant's forensic analyst, who found that relevant e-mails had been altered to substitute false e-mail addresses and domain names.[85] The originals were then deleted.[86] Forensic analysis detected the lost originals and concluded that "the presence of the deleted emails is the result of intentional human action, and not of an automatic or inadvertent computer process."[87] Defendant moved for sanctions.[88] Magistrate Judge James Francis held that new Rule 37(e) would be applicable to that motion.[89] Recognizing that corporate intent was central to the sanctions issue and that this intent was largely an evidentiary issue, he held that Rule 37(e)(2) required "clear and convincing" evidence of the prohibited intent.[90] This is the first

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2008) (finding that corporate defendant "at least minimally culpable"); *In re* NTL, Inc. Secs. Litig., 244 F.R.D. 179, 198–99 (S.D.N.Y. 2007) (finding conduct "at least grossly negligent").

81. *See Residential Funding*, 306 F.3d at 110–12.

82. *See* Matthew Enter., Inc. v. Chrysler Grp., No. 13-cv-04236-BLF, 2016 WL 2957133, at *1, *3, *5 (N.D. Cal. May 23, 2016), where, although the plaintiff had a duty to preserve yet "made no effort to preserve communications from customers or internal emails" and continued to allow an outside vendor to automatically delete these documents, defendants only sought and the court only ordered spoliation sanctions pursuant to F.R.C.P. 37(e)(1). This appears to reflect an absence of any evidence sufficient to establish 37(e)(2) intent. In *Fiteq Inc. v. Venture Corp.*, No. 13-cv-01946-BLF, 2016 WL 1701794, at *3 (N.D. Cal. Apr. 28, 2016), the court did not decide whether the spoliation justified 37(e)(1) or (e)(2) sanctions because plaintiff failed to prove that the ESI was not "restored or replaced through additional discovery."

83. CAT3, LLC v. Black Lineage, Inc., 164 F. Supp. 3d 488 (S.D.N.Y. 2016).

84. *Id.* at 491–92.

85. *Id.* at 492.

86. *Id.*

87. *Id.* at 493.

88. *Id.*

89. *Id.* at 496. Judge Francis also stated that the court had inherent authority to sanction plaintiff's alleged conduct even if Rule 37(e) did not apply. *Id.* at 498, 501. This observation seems to be in some tension with the statement of the Advisory Committee that new Rule 37(e) "forecloses reliance on inherent authority or state law to determine when certain measures should be used." FED. R. CIV. P. 37(e) advisory committee's note to 2015 amendment. The positions could be reconciled by interpreting the Rule to permit courts to use inherent authority to impose sanctions other than those expressly limited by Rule 37(e). Since Judge Francis held that the Rule was also applicable in this case, the court never directly addressed the issue.

90. *CAT3, LLC*, 164 F. Supp. 3d at 498–99 (recognizing that courts had been "divided" as to the appropriate proof standard to apply to spoliation claims, Judge Francis based his holding on three lines of precedent that applied higher evidentiary standards for sanctions (1) based on

interpretation of burdens of proof under new Rule 37(e), and it is a significant one.[91] Judge Francis is clearly seeking to establish a uniform evidentiary standard for inferring intent in all Rule 37(e)(2) cases, and his choice of the clear and convincing standard, while not mandated by either the Rule or prior case law, is reasonable and consistent with those authorities. The drafters of the Rule sought a high bar for imposing severe sanctions and to prevent their capricious or inconsistent application.[92] The stringent intent requirement was their chosen device for limiting judicial discretion in this regard. A uniform clear and convincing standard of proof helps realize those goals.

However, Judge Francis also understood that corporate intent regarding lost ESI can, and in most cases will have to, be inferred from objective but circumstantial evidence.[93] This was certainly the case in *CAT3, LLC*, where the principal agents of the plaintiffs all denied they had engaged in or knew of any attempts to tamper with the phony e-mails and suggested the alterations were an unexpected result of switching to a different e-mail system.[94] Judge Francis, noting that circumstantial evidence may be accorded "equal weight" with direct evidence and can be sufficient to meet any level of proof, independently analyzed the evidence regarding the altered e-mails.[95] He found the conclusions of defendant's forensic analyst to be "well-supported" while the alternative account of plaintiffs' witnesses was "less than compelling."[96]

Although it clearly imputes the intent of their agents to the plaintiff LLCs, *CAT3, LLC* does not explain the basis of that imputation and

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inherent judicial power, (2) that were punitive or case-ending, and (3) that required a finding of bad faith).

91. The Advisory Committee Note leaves the determination of prejudice from lost ESI to case-by-case determination by individual judges and gives them discretion in applying the burden of proof on that issue. FED. R. CIV. P. 37(e)(2) advisory committee's note to 2015 amendment. With respect to a finding of intent under 37(e)(2), however, where such a finding gives rise to a presumption of prejudice, both the Rule and Notes are silent as to the appropriate burden of proof.

92. *See* FED R. CIV. P. 37(e)(2) advisory committee's note to 2015 amendment (stating that courts should "exercise caution" in imposing Rule 37(e)(2) sanctions); *infra* notes 138–140 and accompanying text.

93. *CAT3, LLC*, 164 F. Supp. 3d at 500.

94. *Id.* at 493–95.

95. *See id.* at 499–501. Because the e-mail alteration in *CAT3, LLC* was relatively sophisticated and hard to detect, both the forensic analyst and the court concluded it could not have occurred inadvertently. *Id.* at 501. This illustrates a dilemma for future spoliators. If they use sophisticated techniques for eliminating harmful ESI, they have greater likelihood of escaping detection, but also greater likelihood that if the lost ESI is detected, culpable intent will be inferred. Risk-averse spoliators may choose to "play dumb," allowing ESI to be lost through routine and easily detectable deletion, which gives them plausible deniability in claiming the loss was inadvertent.

96. *Id.* at 499.

makes no finding as to who actually altered the e-mails.[97] Implicit in the court's findings of fact, however, were determinations that the altered e-mails were the result of intentional action (not inaction) by someone with knowledge of and some supervisory authority over plaintiffs' ESI production.[98] These conclusions appear reasonable in *CAT3, LLC*, where the parties concerned were small LLCs whose executive officers supervised ESI production.[99]

Scenario IV presents a situation where ESI is lost through inaction and negligence rather than intentional action.[100] The executive's decision not to spend money on information governance seems a far cry from any sort of intent to deprive parties of the use of information. Yet implicit in this scenario is the question whether certain parties have a legal duty to adopt information governance and routine document retention policies, and whether a failure to accept and act in accordance with that duty might, in the most egregious circumstances, justify severe sanctions. While the argument is far from a slam dunk, there are good reasons to think it might.

For the last ten years, the Federal Rules have sought to encourage potential litigants to adopt these systems.[101] The Rule adopted in 2006 provided a powerful incentive by creating a safe harbor for ESI lost through "routine, good-faith operation of an electronic information system."[102] While that language is absent from the current Rule, the safe

97. *See id.* at 499–502.

98. *Id.* at 499–500.

99. *See* Second Amended Complaint at 2, *CAT3, LLC*, 164 F. Supp. 3d 488 (No. 1:14-cv-05511(AT)(JF)), 2015 WL 6697844. All three LLCs shared a single address. *Id.* Their Director of Information Technology (and 30(b)(6) witness) testified "that he would have been aware of any such manipulation by others." *CAT3, LLC,* 164 F. Supp. 3d at 494. The court subsequently dismissed the case based on a stipulation of the parties under which plaintiffs withdrew their complaint and defendants withdrew their motion for sanctions and acknowledged that "neither Plaintiffs nor any of their owners or agents engaged in any discovery misconduct or wrongdoing." Joint Stipulation of Dismissal at 1, *CAT3, LLC*, 164 F. Supp. 3d 488 (No. 14-cv-05511), 2016 WL 1584011, at *1.

100. *See supra* pp. 583.

101. A recent survey found that 85% of respondents have a "records management program" and that 80% of such programs include ESI. ROBERT F. WILLIAMS ET AL., COHASSET ASSOCS. & ARMA INT'L, RECORDS MANAGEMENT AND GOVERNANCE OF ELECTRONICALLY STORED INFORMATION (ESI) 7 (2012), http://www.cohasset.com/retrievePDF.php?id=14. Out of the 950 records management professionals conducted in this survey, only 76% stated that they perform records management within their organization. *Id.* at 2, 32. Since the survey was conducted among members or participants in records management organizations, it likely undercounts those companies with no records management personnel. *Id.*; *see also* Passlogix, Inc. v. 2FA Tech., LLC, 708 F. Supp. 2d 378, 414 (S.D.N.Y. 2010) (discussing that the company had no "litigation hold/document preservation policy").

102. FED. R. CIV. P. 37(e) (2006) (amended 2015); *see also* Doe v. Norwalk Cmty. Coll., 248 F.R.D. 372, 378 (D. Conn. 2007) (finding that safe harbor is not available when no routine system is in place).

harbor is not completely gone. Sanctions of any sort are only permitted for ESI lost "because the party failed to take reasonable steps to preserve the information," and the Note makes it clear that "the routine, good-faith operation of an electronic information system would be a relevant factor" in determining whether the preservation efforts were reasonable, as would a party's "sophistication" and familiarity with litigation.[103] For most managers of solvent businesses with good legal counsel, particularly those frequently engaged in litigation, the advantages of having a modern, well-run information governance system will be clear. A business without such a system, or with a severely malfunctioning one, is likely both to lose more ESI and to be exposed to 37(e)(1) sanctions for failure to take reasonable preservation steps.[104] But 37(e)(1) sanctions are likely to be relatively light, and rational wealth-maximizing managers of some business entities could decide that the benefits of having ESI sometimes disappear inexplicably might outweigh the costs.

The decision not to adopt or maintain an information governance system may be an intentional act *not* to do something. Can such intent subject a party to 37(e)(2) sanctions? There are some good reasons to think it might. We have seen that egregious failures to carry out preservation duties can give rise to an inference that the party is deliberately seeking to prevent the opposing party from obtaining ESI.[105] But what about before any preservation duty attaches? Can a party do whatever it wants with respect to information governance, even if it knows it is likely to face preservation obligations in the near future? Is there a minimal pre-preservation obligation, at least for sophisticated parties likely to be subject to future litigation, to at least preserve their ability *to respond effectively* when preservation duties arise? If so, a company that intentionally sabotages its ability to respond effectively may have engaged in intentional action sanctionable under 37(e)(2). Any contrary rule would encourage sloppy information management and contravene the spirit and intent of contemporary e-discovery rules and practice.

A 2016 case decided under new Rule 37(e) comes very close to reaching precisely this conclusion. *O'Berry v. Turner*[106] involved a

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103. FED. R. CIV. P. 37(e) advisory committee's note to 2015 amendment.

104. Courts have rejected arguments that mere failure to follow an express document retention policy can constitute culpable conduct absent an independent legal duty to preserve. *See, e.g.*, Johnson v. Liberty Mut. Fire Ins. Co., 648 F.3d 1162, 1164–65 (10th Cir. 2011).

105. *See supra* notes 71–74 and accompanying text. Indeed, those cases involving failures to preserve or make timely production can be viewed as indirectly punishing the failure to have an effective information governance system.

106. Nos. 7:15-CV-00064-HL, 7:15-CV-00075-HL, 2016 WL 1700403 (M.D. Ga. Apr. 27, 2016).

collision between a car and tractor-trailer truck.[107] Plaintiffs sought discovery from the defendant truck owner, which consisted of both the driver's logs and ESI regarding the truck's speed, location, and other information that could be downloaded from a service called PeopleNet.[108] There was testimony that when an accident occurred, defendant's practice was to make one copy of the driver's log, print out any relevant information from PeopleNet, and then place both in a manila folder.[109] Although defendant received a notice of the lawsuit and preservation notice shortly after the accident, this manila folder was subsequently lost when the custodian of that file moved to a different building.[110] Although there was no claim that the loss of the file itself was intentional, the court found that "it is simply irresponsible to print a single paper copy of information which one has a duty to preserve under Fed. R. Civ. P. 26."[111] Furthermore, defendant ADM Trucking "had no written policy on the proper procedure for preserving information that may be relevant in foreseeable litigation."[112] The judge held that this failure to have reasonable document preservation policies in place required the conclusion that defendants "acted with the intent to deprive Plaintiff of the use of this information at trial" and that sanctions under 37(e)(2) were therefore warranted.[113] One can argue that *O'Berry* involved sanctions for failing to safeguard the "single paper copy" once the litigation became foreseeable and the preservation duty attached and is therefore distinguishable from Scenario IV. However, the court's concern clearly extended to the information preservation system in place even before notice of the potential litigation was received.[114] Accordingly, *O'Berry* illustrates the kind of reasoning that could lead a court to impose sanctions simply for failure to maintain a reasonable information governance system.

IV. Corporate Intent Under *Caremark*

Although prior case law and legislative history provide some help in interpreting new Rule 37(e)(2), difficult questions remain. Among them: (1) whether conscious dereliction of a known duty to preserve or produce ESI can constitute sanctionable "intent"; (2) if so, what kinds of conduct leading to lost ESI can give rise to such an inference; and (3) are there duties, before any particular litigation is reasonably foreseeable, to create

107. *Id.* at *1.
108. *Id.*
109. *Id.* at *2.
110. *Id.*
111. *Id.* at *4.
112. *Id.*
113. *Id.* at *4.
114. *See id.*

and maintain an effective information governance system and can intentional failure to fulfill such duties give rise to 37(e)(2) sanctions?

This Essay looks to an unusual source for further insight into these issues—Delaware corporate law, particularly cases dealing with managerial duties to prevent wrongdoing by corporate employees. While such cases are obviously not binding on federal courts, looking to them for guidance is surprisingly helpful. Determining intent under Rule 37(e)(2) is largely a matter of analyzing the actions of corporate agents, a subject on which Delaware courts are extremely knowledgeable. Moreover, the specific problem these cases address, under what circumstances courts can hold corporate management responsible for wrongdoing by lower level employees, is similar to the 37(e) problem of assessing culpability of managers for spoliation by lower level employees. Finally, because of certain intricacies of Delaware corporate law, in most cases courts can only hold corporate management liable for failure to prevent employee wrongdoing in situations where courts deem these managers to be acting in "bad faith," a standard that parallels the intent requirement of Rule 37(e)(2).[115]

The seminal Delaware case is *In re Caremark International Inc. Derivative Litigation*.[116] In *Caremark*, directors of the company allegedly breached their fiduciary duty by failing to detect wrongdoing by lower level employees that ultimately led to corporate felony prosecutions and payment of over $250 million.[117] In evaluating the strength of plaintiffs' derivative claims, Chancellor William T. Allen considered whether there could be director liability for "a loss [that] eventuates not from a decision but, from unconsidered inaction."[118] These losses are most likely to occur, he noted, from failing to monitor the enterprise to ensure compliance with the law.[119] Although prior case law had suggested there could be no managerial liability where managers neither knew nor had reason to suspect wrongdoing, Chancellor Allen rejected that blanket rule.[120] He noted that both Delaware and federal law, particularly the federal Sentencing Guidelines, "offer powerful incentives for corporations today to have in place compliance programs to detect violations of law" and for directors to be sufficiently informed to carry out their supervisory duties.[121] Directors therefore needed to create "information and reporting systems . . . that are reasonably designed to

115. *See* DEL. CODE ANN. tit. 8, § 102(b)(7)(ii) (2015).
116. 698 A.2d 959 (Del. Ch. 1996).
117. *Id.* at 960–61.
118. *Id.* at 968.
119. *See id.* at 969–70.
120. *Id.* at 969.
121. *Id.* at 969–70.

provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board . . . to reach informed judgments concerning both the corporation's compliance with law and its business performance."[122] Losses caused by failure to institute such a system could give rise to managerial liability.[123]

Chancellor Allen stated that the standard for liability in these actions was "quite high," requiring a "sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system" exists, but that such failure would establish "lack of good faith."[124]

Discovery law also creates "powerful incentives" for corporate parties to monitor and supervise their ESI retention through information governance policies,[125] much like the incentives to institute compliance programs in *Caremark*.[126] An "utter failure" to assure a reasonable policy of ESI governance and retention could similarly constitute "bad faith" or culpable intent under Rule 37(e)(2).[127] As in *Caremark*, the standard for imposing such liability would be high, requiring a "sustained or systematic failure" to institute such a policy or to effectively implement it.

122. *Id.* He goes on to note that the board has broad discretion in designing a policy, and in language highly reminiscent of the Advisory Committee Note, warns that no compliance policy will "remove the possibility" that corporate managers may "sometimes be misled or otherwise fail reasonably to detect acts material to the corporation's compliance with the law." *Id.* All that is required is a "good faith judgment" that the information system adopted is sufficient to satisfy managerial responsibilities. *Id.*

123. *Id.*

124. *Id.* at 971.

125. *See* Favro, *supra* note 33, at 6; Charles R. Ragan, *Information Governance: It's a Duty and It's Smart Business*, 19 RICH. J.L. & TECH. 1, 7, 34 (2013); Dean Gonsowski, *Inside Experts: Information Governance Takes the Stage in 2012*, INSIDE COUNS. (Jan. 27, 2012), http://www.insidecounsel.com/2012/01/27/inside-experts-information-governance-takes-the-st.

126. Skeptics might note that, unlike a compliance program, which is designed to detect and prevent wrongdoing, an information governance policy can be used to destroy ESI as well as preserve it. But the real hallmark of both types of programs is to develop effective information and communication within the organization, so that the company can effectively carry out its legal obligations.

127. *In re Caremark*, 698 A.2d at 971. Prior case law dealing with badly planned or administered ESI preservation policies generally find them to constitute gross negligence, but not to '"rise to [an] egregious level,"' or the level of bad faith. Passlogix, Inc. v. 2FA Tech., LLC, 708 F. Supp. 2d 378, 414 (S.D.N.Y. 2010) (alteration in original) (quoting Toussie v. Cty. of Suffolk, No. CV01-6716(JS)(ARL), 2007 WL 4565160, at *8 (E.D.N.Y. Dec. 21, 2007)); *see* Brigham Young Univ. v. Pfizer Inc., 282 F.R.D. 566, 571 (D. Utah 2012). Yet this language of rising "levels" clearly presupposes that a complete and utter breakdown of these efforts could meet that higher level of egregiousness.

Because the claim in *Caremark* involved "inattention" by the board, that case also provides insight into the problem of managerial inaction.[128] *Caremark* holds that failure to stop wrongdoing can give rise to liability, but only from a "sustained or systematic" failure, not the result of a single mistake.[129] Inaction can also give rise to a finding of "bad faith" or culpable intent, but only when it is sufficiently egregious to infer that management has made a conscious choice not to act and has not merely been lazy or neglectful.[130] This also parallels Rule 37(e)(2)'s limitation of severe sanctions to intentional conduct.[131]

Cases applying *Caremark* suggest two types of situations where managerial inaction can give rise to liability.[132] The first is failure to act where managers have actual or constructive knowledge of specific "red flags" indicating wrongdoing by lower level employees. These might be detailed, third-party reports "suggesting potential accounting improprieties"[133] or warning statements by governmental authorities.[134] One case even discusses how visible the "red flags" must be to senior management.[135] The other potential basis for liability is failure to create a managerial group to monitor employee misconduct or "patently inadequate" performance by such a group.[136] Federal courts applying Delaware law have also found actionable claims based on such managerial inaction.[137]

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128. *In re Caremark*, 698 A.2d at 971.

129. *Id.*

130. *See* O'Berry v. Turner, Nos. 7:15-CV-00064-HL, 7:15-CV-00075-HL, 2016 WL 1700403, at *4 (M.D. Ga. Apr. 27, 2016).

131. This also resolves the prior hypothetical about the lawyer who makes a mistake in ascertaining the trigger date. *See supra* note 44. So long as it is not a sustained and systematic failure to preserve relevant ESI, it would not give rise to severe sanctions.

132. Indeed, after finding that its existing standard for determining when derivative cases could proceed without making a demand on the board was inadequate to deal with cases where there was an "absence of board action," the Delaware Supreme Court created another standard in *Rales v. Blasband*, 634 A.2d 927, 933–34 (Del. 1993), which is applicable to cases of managerial inaction. Most of the cases cited in this Section apply the *Rales* standard.

133. *In re* China Auto. Sys. Inc. Derivative Litig., No. 7145–VCN, 2013 WL 4672059, at *8 (Del. Ch. Aug. 30, 2013) (quoting Ash v. McCall, No. Civ.A. 17132, 2000 WL 1370341, at *15 (Del. Ch. Sept. 15, 2000)).

134. *See In re* Abbott Labs. Derivative S'holders Litig., 325 F.3d 795, 806 (7th Cir. 2003) (discussing the failure to act after senior management received two Warning Letters from the FDA).

135. *In re* Citigroup Inc. S'holders Litig., No. 19827, 2003 WL 21384599, at *2 (Del. Ch. June 5, 2003) (finding that red flags must be "visible to the careful observer").

136. *In re* China Agritech Inc. S'holder Derivative Litig., C.A. No. 7163–VCL, 2013 WL 2181514, at *17–18 (Del. Ch. May 21, 2013) (discussing defendant's "systematic lack of oversight"); *In re China Auto.*, 2013 WL 4672059, at *7–8 (discussing defendants' inadequate oversight of accounting practices); *see also* Guttman v. Huang, 823 A.2d 492, 507 (Del. Ch. 2003) (discussing bases for liability under *Caremark*).

137. *In re Abbott Labs.*, 325 F.3d at 808–09; McCall v. Scott, 239 F.3d 808, 817 (6th Cir. 2001); *see also In re* Am. Apparel, Inc. S'holder Derivative Litig., No. CV10–06576 MMM

Under Delaware law, corporate managers are often exempt from monetary damages for claims involving negligent or even grossly negligent misconduct but are subject to damages if the wrongdoing involves intentional misconduct or actions taken in bad faith.[138] In *Stone ex rel. AmSouth Bancorporation v. Ritter*,[139] the Delaware Supreme Court applied these principles to claims of inadequate board supervision.[140] Endorsing the basic *Caremark* framework, the Court stated that in the absence of "red flags," *Caremark* liability could only be imposed when "(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[141] The court made clear that this liability involves a "conscious disregard" by managers of their responsibilities, a "showing that the directors knew that they were not discharging their fiduciary obligations."[142] A similar showing that corporate agents or managers knew they were not meeting the company's ESI preservation responsibilities would constitute the requisite culpable intent under Rule 37(e).

Applying these concepts to determination of intent under Rule 37(e) would create an evidentiary standard under which claims for lost ESI seeking severe sanctions, while potentially available, would rarely succeed. These claims would require a showing that senior executives or those supervising discovery had either failed to act while having actual or constructive knowledge of "red flags"—credible warnings that corporate preservation duties were being violated—or that they "utterly failed" to set up a system for ESI retention and preservation or exhibited a "sustained and systematic" failure to effectively utilize that system. These claims will be difficult to impossible to prove against a well-advised corporate party who adopts and maintains a reasonably effective policy of information governance and ESI retention.

(RCx), 2012 WL 9506072, at *25 (C.D. Cal. July 31, 2012) ("[T]he critical inquiry is whether board members had actual or constructive knowledge of the unlawful conduct in question, and failed to take the steps to rectify it.").

138. *See* DEL. CODE ANN. tit. 8, § 102(b)(7)(ii) (2015) (permitting exculpatory provisions eliminating director liability for money damages for breach of fiduciary duty but not "for acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law"); *see also In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 64–67 (Del. 2006) (explaining the distinction between "gross negligence" and "bad faith," and citing the intentional failure "to act in the face of a known duty to act, demonstrating a conscious disregard for [one's] duties" as a "nonexculpable, nonindemnifiable" example of bad faith).

139. 911 A.2d 362 (Del. 2006).

140. *Id.* at 369–70.

141. *Id.* at 370, 373.

142. *Id.* at 370.

That, of course, is precisely the point. The Delaware law of managerial oversight is designed not only or even primarily to punish egregiously misbehaving corporate managers. It is also designed to set minimal standards of conduct for corporate managers who are trying to carry out their supervisory duties conscientiously and reasonably fear litigation. The most important enforcement of these laws takes place not in courts but in corporate lawyers' offices, as they explain to their clients what needs to be done to minimize the danger of such lawsuits. Rule 37(e) will make sense if it encourages corporate counsel and ESI managers to adopt reasonable standards for ESI preservation and to respond effectively to e-discovery obligations.