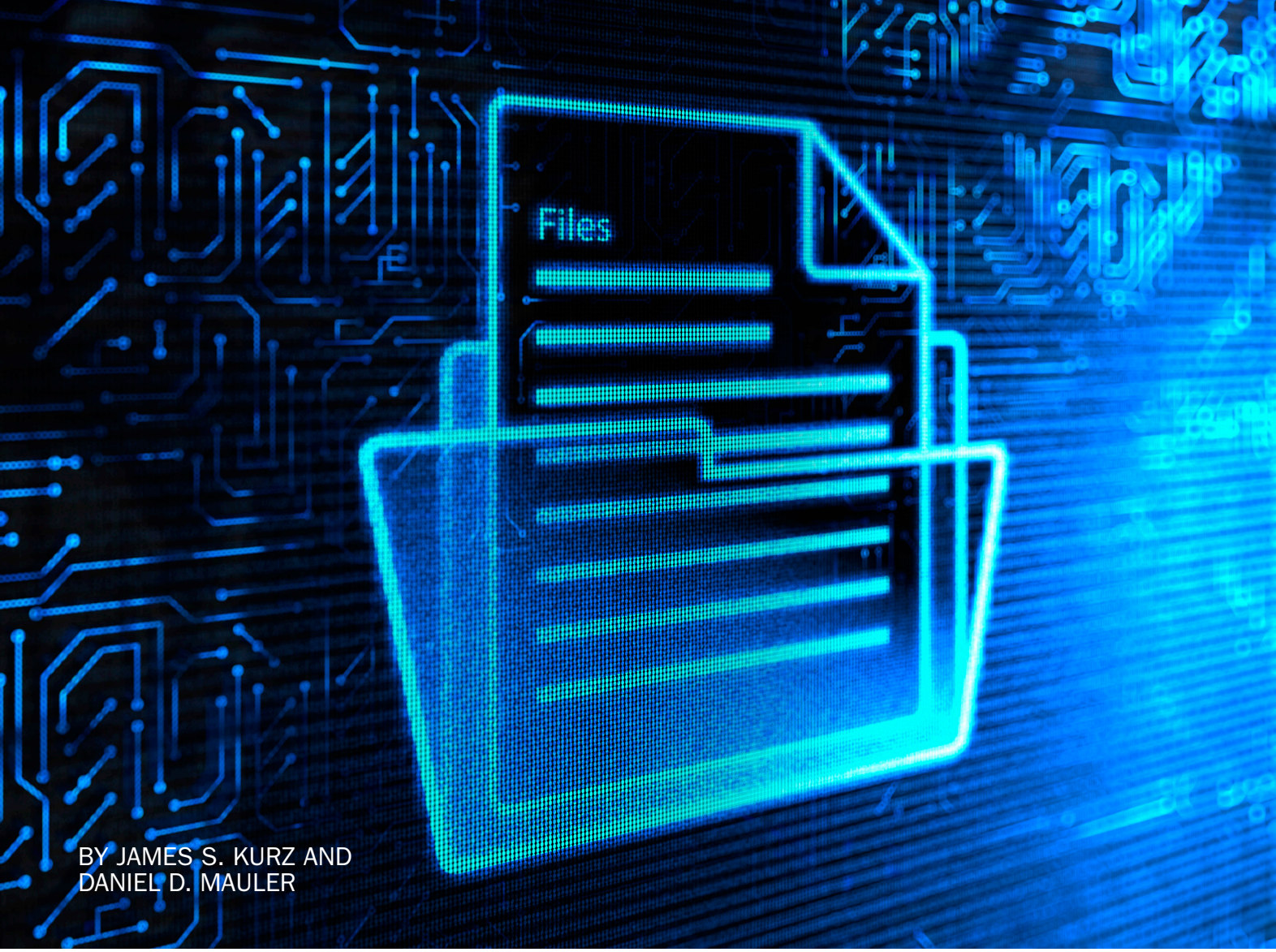

BY JAMES S. KURZ AND
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A Real Safe Harbor:

The Long-Awaited Proposed FRCP Rule 37(e), Its Workings, and Its Guidance for ESI Preservation

New Rule 37(e) is expected to go into effect Dec. 1 and promises to usher in a dramatic change to battles over electronically stored information that routinely plague commercial litigation in federal courts.

The Federal Rules of Civil Procedure (FRCP) rule-makers sent to the U.S. Judicial Conference for consideration in September 2014 their electronically stored information (ESI) preservation rule, known as proposed Rule 37(e). Judge David Campbell, the chair of the Advisory Committee on Federal Rules of Civil Procedure, has said that "[Rule] 37(e) is the most challenging task any of us on the committee have ever undertaken."

The proposed rule sets forth a uniform process and standard that will resolve the split among the circuits on the availability of the most serious ESI spoliation sanctions. Proposed Rule 37(e) will replace entirely the current Rule 37(e), and as stated in the Committee Note, "forecloses reliance on inherent authority or state law to determine when certain [curative or sanctioning] measures should be used." The new standard will allow the most serious sanctions only when there is proof of "intent to deprive" the harmed party of the use of the ESI in its case.

The new Rule 37(e) will also be the only civil rule that speaks, albeit indirectly, to the duty to preserve ESI. The rule-makers provide for the first time a genuine safe harbor for those who take timely "reasonable steps" to preserve ESI. While this may appear to be only abbreviated guidance, the chosen wording taps into current case law and literature that offer substantial guidance that businesses should follow to perform reasonable (and affordable) ESI preservation.

The Proposed ESI Preservation Rule

The U.S. Judicial Conference Committee on Rules of Practice and Procedure (Standing Committee) approved in late May 2014 the proposed Rule 37(e). The Advisory Committee's Judge Campbell explained that the proposal sent to the Standing Committee "moved toward a more simple and modest rule."

Given the complexity of the challenge facing the Standing Committee, the rule on its surface is surprisingly simple—the accompanying graphic maps the decision tree for the rule in three stages.

First, rather than generally deal with lost evidence, the proposed rule addresses only lost ESI. The rule applies only when a three-part test is met, essentially providing a (real) safe harbor. Second, if there is a finding of prejudice because the ESI has been lost, then a court may impose remedies to cure the prejudice, but no more. And third, the most serious remedies may only be utilized after a finding of "intent to deprive" the use of the lost ESI. Parts two and three are separate—a litigant does not have to satisfy the "prejudice" finding necessary for a finding of "intent to deprive."

The Road to the Proposed Rule and the Way Ahead

Understanding the challenge of addressing ESI spoliation begins with recognizing that the volume of ESI files expands at warp speed. Businesses must manage their ESI or else be buried in their data. Routine deletion of ESI has become an accepted part of the ESI management process. The U.S. Supreme Court in *Arthur Andersen LLP v. United States* recognized that these processes "which are created in part to keep certain information from getting into the hands of others, including the Government, are common in business," and that it is "not wrongful for a manager to instruct his employees to comply with a valid document retention policy under ordinary circumstances."[1]

Proposed Federal Rule 37(e)

FAILURE TO PRESERVE ELECTRONICALLY STORED INFORMATION

If electronically stored information that should have been preserved in the anticipation or conduct of litigation is lost because a party failed to take reasonable steps to preserve the information, and the information cannot be restored or replaced through additional discovery, the court may:

(1) Upon a finding of prejudice to another party from loss of the information, order measures no greater than necessary to cure the prejudice

(2) Only upon a finding that the party acted with the intent to deprive another party of the information's use in the litigation

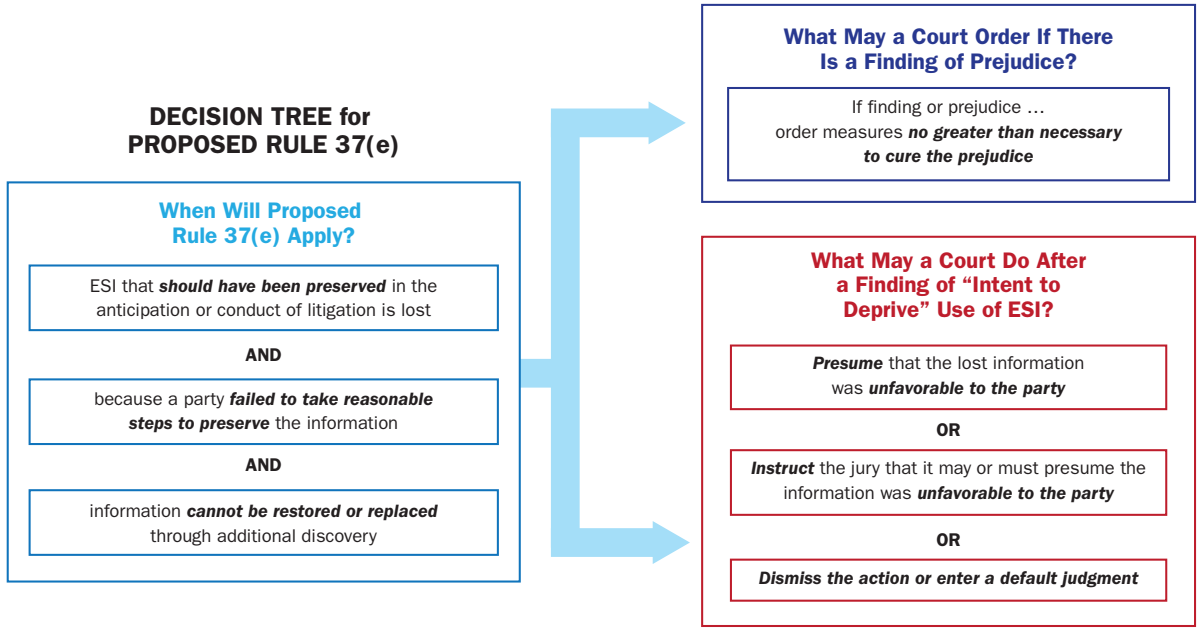
(a) presume that the lost information was unfavorable to the party

(b) instruct the jury that it may or must presume the information was unfavorable to the party

(c) dismiss the action or enter a default judgment

But one party may view the opposing party's ESI management as the destruction of relevant evidence. A consequence of this conflict, coupled with legal uncertainties as to the resolution, has produced a series of high-stakes, high-cost spoliation battles. The ESI Preservation Rule must referee these battles—and hopefully defuse them.

During the consideration of the 2006 FRCP amendments, the fight over how to handle ESI preservation and spoliation was the greater part of the debate. As the debate raged on, the rule-makers appreciated that, while they could defer the issue for several years, eventually they would have to tackle the ESI preservation and spoliation issues. Following the 2010 Duke Conference (which was convened primarily to start the process towards promulgation of a revised Preservation Rule) and a 2012 Dallas mini-conference, a package of proposals, including the proposed Rule 37(e), was



published in August 2013. Since publication, these proposals have attracted more than 2,300 written comments—the most public comments for a FRCP rule change in recent memory.

The Advisory Committee met in April 2014 in Portland, Oregon, to consider the revised rules package. An earlier version of proposed Rule 37(e) in the Agenda Book was bypassed on day one of the meetings. This soon-to-be-discarded version employed the terms "bad faith" and "willful," which had become hot-button words in the debate, and offered a list of factors a court might consider. A substantially rewritten and shortened proposal appeared the next morning. It is this rewritten proposed rule with a later-added Committee Note that emerged from the Portland conference.

The revised proposed Rule 37(e) went before the Standing Committee in late May 2014. The Standing Committee approved the proposed rule with few changes to the Committee Note. The proposal was then considered by and approved by the Judicial Conference in September 2014. On April 29, 2015, the U.S. Supreme Court approved proposed Rule 37(e) and transmitted the text to Congress. If Congress leaves the proposed amendments untouched, the amendments will become effective Dec. 1.

Proposed Rule 37(e) Parsed

The rule-makers see proposed Rule 37(e) as the single rule for dealing with lost ESI. As confirmed in the Committee Note, the proposed rule is intended to replace entirely current Rule 37(e) and eliminate analysis of ESI spoliation issues grounded on a court's inherent authority.

The rule will resolve the current circuit split regarding when to enforce the most serious sanctions for loss of ESI. It explicitly rejects the leading Second Circuit's position favoring adverse-inference instructions upon a showing of mere negligence (but not intentional bad faith conduct), as shown in this Committee Note: "It rejects cases such as *Residential Funding Corp. v. DeGeorge Financial Corp.*, 306 F.3d 99 (2d Cir. 2002), that authorize the giving of adverse-inference instructions on a finding of negligence or gross negligence."

The Second Circuit's negligence analysis represents one end of the spectrum on the requisite showing to support an adverse inference instruction. In contrast, the Tenth Circuit rejects this approach, requiring proof of bad faith loss of the information.[2]

Regarding reliance on a court's "inherent authority" as an alternative basis for imposing sanctions, the Committee Note reads: "It therefore forecloses reliance on inherent authority or state law to determine when certain measures should be used. The rule does not affect the validity of an independent tort claim for spoliation if state law applies in a case and authorizes the claim."

A court's inherent authority has become, for some courts, the source of the authority to deal with ESI spoliation, including the authority for imposing even the most serious spoliation sanctions. For example, in *The Pension Committee of the University of Montreal Pension Plan v. Banc of America Securities LLC*,[3] Judge Shira Scheindlin wrote that the "right to impose sanctions for spoliation arises from a court's inherent power to control the judicial process and litigation." According to Judge Scheindlin, the court's inherent authority to punish spoliation arises from "the need to preserve the integrity of the judicial process in order to retain confidence that the process works to uncover the truth." The rule-makers would eliminate entirely this "inherent authority" basis for spoliation sanctions.

The proposed rule has three parts: (1) the three-step test for when the rule will apply, (2) "prejudice" and the middle-ground remedies, and (3) proof of "intent to deprive" as the only route to the most serious sanctions.

When Will Proposed Rule 37(e) Apply?

ESI that ***should have been preserved*** in the anticipation or conduct of litigation is lost

AND

because a party ***failed to take reasonable steps to preserve*** the information

AND

information ***cannot be restored or replaced*** through additional discovery

When Does the Rule Apply? Is This the Safe Harbor Missing From the Current Rule?

The proposed rule addresses only lost ESI. Earlier versions of a replacement rule attempted much broader coverage. But on Day 2 of the Portland meetings, the proposal narrowed to just ESI, and later narrowed again to only ESI lost because a party "failed to take reasonable steps to preserve." The rule begins with the three-step test shown in the accompanying graphic.

1. ***ESI Preservation Duty and Trigger.*** The inquiry begins with the preservation trigger event. The proposed rule applies only to ESI "that should have been preserved in the anticipation or conduct of litigation." The Committee Note confirms that this does not create a new duty to preserve but draws on the existing common law duty: "Many court decisions hold that potential litigants have a duty to preserve relevant information when litigation is reasonably foreseeable. Rule 37(e) is based on this common-law duty; it does not attempt to create a new duty to preserve. The rule does not apply when information is lost before a duty to preserve arises."
2. ***Reasonable Steps to Preserve.*** The proposed rule next limits its application to ESI that was lost "because a party failed to take reasonable steps to preserve the information." The Committee Note explicitly identifies that only "reasonable steps" should be required: "This rule recognizes that 'reasonable steps' to preserve suffice; it does not call for perfection." "Reasonable steps" stands as the safe harbor from spoliation sanctions that was heralded in the 2006 e-discovery amendments, but which turned out to be an illusion. The pursuing party must show that ESI has been lost and that the other party was on notice to preserve. The defense then likely centers, as least initially, on the preservation steps taken. If the defending party demonstrates that it took reasonable steps to preserve ESI, then the spoliation claim should fail. The Committee Notes then adds proportionality as a factor: "Another factor in evaluating the reasonableness of preservation efforts is proportionality." By softening preservation requirements to what may be pro-

portional to the stakes of the litigation, the rule-makers ratcheted downward the practical preservation requirements for routine litigation, including most employment cases. In the rule as drafted heading into the Portland meetings, proportionality was one of five factors in assessing a party's conduct. The current proposed rule makes no mention of proportionality; coverage is relegated to the Committee Note. The Note also recognizes that the party's sophistication should be considered when a court analyzes whether a party should have realized what should have been preserved.

3. ***Will Curative Measures Remedy the ESI Loss?*** A court should not go any further in the analysis if the ESI loss can be "restored or replaced through additional discovery." The Committee Note repeats this point: "Rule 37(e) directs that the initial focus should be on whether the lost information can be restored or replaced through additional discovery. … If the information is restored or replaced, no further measures should be taken."

In many ESI cases, this third part will end the inquiry. What may appear to be lost often can be located elsewhere. For instance, a custodian's emails deleted from a Microsoft Exchange database might be found on other backups or possibly in another custodian's files. Before a court explores prejudice and searches for appropriate remedies, it must consider the possibility that seemingly lost ESI can be restored or replaced.

If There Is a Finding of Prejudice, What May a Court Order?

Only if the three-step test described above is met does a court continue with its analysis. The question in subpart (e)(1) of proposed Rule 37(e) is whether there is a "finding of prejudice." If so, then a court may reach into its bag of remedies, but it may "order measures no greater than necessary to cure the prejudice." The remedies available at this stage do *not* include the most serious sanctions, such as the adverse inference instruction or dismissal. These sanctions may be imposed only under subpart (e)(2).

What May a Court Order If There Is a Finding of Prejudice?

If finding or prejudice …
order measures ***no greater than necessary to cure the prejudice***

The Committee Note emphasizes that the proposed rule is purposefully vague on which party has the burden of proving or disproving prejudice: "The rule does not place a burden of proving or disproving prejudice on one party or the other."

As to the available remedies, Judge Campbell explains that "one of our intentions is to preserve broad remedial powers for judges in (e)(1)." The Committee Note provides: "The rule leaves judges with discretion to determine how best to assess prejudice in particular cases."

The available remedies are not listed, but the trend of case law identifies financial penalties, payment of attorneys' fees, evidentiary limitations, and deemed admission of certain facts. A close reading of the proposed rule and the Committee Note identifies these actions as remedies, not "sanctions."

A Court May Give an Adverse Inference Instruction or Enter Default Judgment Only After a Finding of "Intent To Deprive."

The center of the ongoing debate within e-discovery circles has been the showing necessary before a court orders an adverse inference jury instruction or enters a default judgment. As noted above, some courts have required proof of intentional, dark-hearted destruction of ESI, while the Second Circuit has authorized an adverse inference instruction based on a mere finding of negligence.

What May a Court Do After a Finding of "Intent to Deprive" Use of ESI?

Presume that the lost information was ***unfavorable to the party***

OR

Instruct the jury that it may or must presume the information was ***unfavorable to the party***

OR

Dismiss the action or enter a default judgment

The rule-makers intend a uniform standard across the nation, and they reject the Second Circuit's approach.

The Committee Note could not be clearer on this: "It is designed to provide a uniform standard in federal court for the use of these serious measures when addressing failure to preserve electronically stored information. It rejects cases such as *Residential Funding Corp. v. DeGeorge Financial Corp.*, 306 F.3d 99 (2d Cir. 2002), that authorize the giving of adverse-inference instructions on a finding of negligence or gross negligence."

The chosen test of proposed Rule 37(e) centers on proof of "an intent to deprive" and limits the most serious remedies "only upon a finding that the party acted with the intent to deprive another party of the use of the information in the litigation." If there is any confusion in this language, the Committee Note emphasizes the restriction: "Subdivision (e)(2) limits the ability of courts to draw adverse inferences based on the loss of information in these circumstances, permitting them only when a court finds that the information was lost with the intent to prevent its use in litigation."

The Practical Side: The "Reasonable Steps" Safe Harbor

If enacted, proposed Rule 37(e) will be the only federal civil rule that speaks to the scope of a party's duty to preserve. While the rule might appear threadbare, the debate history and literature provide guidance on the meaning of "reasonable steps" to preserve ESI. Key in this history is the Sedona Conference's 2010 "Commentary on Legal Holds: the Trigger and the Process."[4]

The rule-makers chose to provide only general directions for ESI preservation instead of detailed rules. The comments from the 2010 Duke Conference reveal that the committee considered three approaches to answering the preservation issue. One was an explicit preservation rule that detailed when and how ESI must be pre-

served. A second option considered a general preservation rule, but still a front-end solution including fairly explicit directions for the ESI preservation process. The third option, a back-end approach, focused on the availability of a genuine safe harbor and the consequences for failures to preserve. The rule-makers pursued this last option, stating that a party should not be sanctioned if it has taken "reasonable steps to preserve the information."

The critical question then becomes what are the reasonable steps contemplated in the rule? The Sedona "Commentary" includes guidelines for defensible preservation processes. From these guidelines it is a fairly small step to designing processes that provide an ESI preservation solution that should meet the proposed Rule 37(e) "reasonable steps" standard.[5]

The Sedona "Commentary" distills the requirements to "reasonableness and good faith" with recognition of proportionality. According to Sedona's "Commentary,"

> The keys to addressing these issues, as with all discovery issues, are *reasonableness and good faith.* Where ESI is involved, there are also practical limitations due to the inaccessibility of sources as well as the volume, complexity and nature of electronic information, which necessarily implicates the proportionality principles, found in Rule 26(b)(2)(C)(iii).

If the "Commentary" stopped after this recitation, then the assistance would be far too general. The "Commentary" goes on to offer its guidelines for a sufficient legal hold process, documentation of that preservation processes, and regular review of the process.[6]

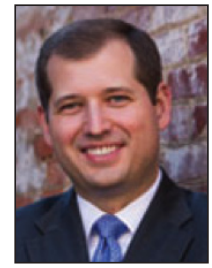
The "Commentary," and in particular guidelines eight, nine, and 10, should be seen as the "reasonable steps" identified in proposed Rule 37(e). In other words, implementing and following the Sedona "Commentary" guidelines will show that a party has taken the reasonable steps to navigate to the safe harbor described in the rule.

Summary

The process leading to proposed Rule 37(e) began with the 2010 Duke Conference. If the amendment process stays on course, the new rule will become effective Dec. 1, 2015.

Proposed Rule 37(e) has an appearance of simplicity. This design is so the proposed rule will be the sole authority for federal courts to impose ESI spoliation remedies or sanctions; the court's "inherent authority" as a basis for spoliation sanctions is pushed aside. In practice, the proposed rule may well be relatively simple to apply. But appreciation of the rule comes only with an understanding of the issues, the history, and the ongoing debate.

Unlike most procedural rules, this proposed rule has substantial business implications. As demands to manage ESI increase, businesses are seeking guidance on what must be preserved to avoid spoliation claims and sanctions. The circuit split and vague directions have led to costly over-preservation. Proposed Rule 37(e) will be the single rule to provide ESI preservation guidance, including at least the identification of the "reasonable steps" that define a real safe harbor. ⊙



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Endnotes

[1]544 U.S. 696 (2005).

[2]*See, e.g., Aramburu v. Boeing Co.*, 112 F.3d 1398, 1407 (10th Cir. 1997) ("The adverse inference must be predicated on the bad faith of the party destroying the records. Mere negligence in losing or destroying records is not enough because it does not support an inference of consciousness of a weak case.").

[3]685 F. Supp. 2d 456, 464 (SDNY 2010).

[4]The Sedona Conference published a 2007 version of the "Commentary" that was revised in 2010, *available at* thesedonaconference.org/download-pub/470.

[5]As an example of a real-world solution designed based on the "Commentary" guidelines, the article turns to J. Kurz, *A Trial Lawyer's Wish List: A Legal Hold and Data Preservation Management Solution*, *available at* www.rpb-law.com/images/whitepaper2014.pdf.

[6]Guidelines 8, 9, and 10 from the 2010 Sedona "Commentary" read:

Guideline 8

In circumstances where issuing a legal hold notice is appropriate, such a notice is most effective when the organization identifies the custodians and data stewards most likely to have relevant information, and when the notice:

(a) Communicates in a manner that assists persons in taking actions that are, in good faith, intended to be effective

(b) Is in an appropriate form, which may be written

(c) Provides information on how preservation is to be undertaken

(d) Is periodically reviewed and, when necessary, reissued in either its original or an amended form, and

(e) Addresses features of relevant information systems that may prevent retention of potentially discoverable information.

Guideline 9

An organization should consider documenting the legal hold policy, and, when appropriate, the process of implementing the hold in a specific case, considering that both the policy and the process may be subject to scrutiny by opposing parties and review by the court.

Guideline 10

Compliance with a legal hold should be regularly monitored.