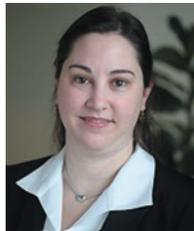


Reproduced with permission from Digital Discovery & e-Evidence, 14 DDEE 52, 01/30/2014. Copyright © 2014 by The Bureau of National Affairs, Inc. (800-372-1033) <http://www.bna.com>

BNA INSIGHT

Terminating Sanction for Destroying Files to Avoid Suit Raises Concern for Document Retention Practices



BY DAVID D. CROSS AND RACHEL L. TALBOT

In a rare turn of events, the court entered summary judgment for the plaintiffs based on spoliation committed by the defendant in *Slep-Tone Entertainment v. Granito*, 2014 BL 4257D. Ariz., CV 12-298 TUC DCB, 01/08/14. The defendant was accused of using counterfeit duplicates of trademarked karaoke tracks. *Id.* The court acknowledged that this was a “drastic” sanction, but nonetheless concluded that the facts of the case warranted it. *Id.* at *6.

The court’s reasoning raises potential concerns for common document retention practices. Companies struggling to manage ever-increasing volumes of electronically stored information (ESI) often require the routine destruction of certain ESI for a variety of reasons, including reducing or even avoiding possible litigation risk and expense. The *Granito* decision suggests that such practices potentially could lead to severe sanctions if the destroyed ESI proves relevant to future litigation that was, at the time of the destruction, a mere possibility.

The Facts. At first glance, this case seems like a spoliation slam-dunk. The defendant admitted to destroying the hard drives allegedly containing the counterfeit tracks, and there is no question that the hard drives were highly relevant to the plaintiffs’ claims and that their destruction severely prejudiced Plaintiffs. *Id.* at *2, *4, *8.

In fact, the defendant himself moved for summary judgment “because Plaintiffs have no evidence of any unauthorized counterfeit duplicates of karaoke accompaniment tracks.” *Id.* at *6. Of course, this apparently was because, as the court put it, “the Defendant destroyed all the possible evidence relevant to establish whether or not he had infringing karaoke discs on his computer.” *Id.* at *8.

Duty to Preserve and State of Mind. But there were questions as to the defendant’s state of mind when he wiped the hard drives and whether a duty to preserve the hard drives had attached at that time. He claimed that he had purchased tens of thousands of dollars in discs from the plaintiffs during his years as a karaoke jockey and that he was unaware of the “industry standard” prohibiting karaoke jockeys from making more than one digital copy of legally purchased tracks. *Id.* at *2.

The defendant claimed that when he heard that the plaintiffs were suing other karaoke jockeys for making illegal copies of tracks, he wiped his hard drives clean—before the lawsuit was filed against him—in order to comply with the industry standard and avoid being sued. *Id.* at *4.

Specifically, the defendant admitted “he deleted all of the files off of his drives that were not in compliance using special software to make file recovery difficult, if not impossible.” *Id.* at *2. He “acted further to destroy the computers by rebuilding, repurposing them or discarding them as defective.” *Id.* at *4. He then purchased another computer with the trademarks at issue removed. *Id.* at *3.

The defendant nevertheless argued that he acted in good faith because he merely was trying to comply with the “industry standard” once he learned about it, and to avoid being sued by the plaintiffs. *Id.* The court was not persuaded.

The court rejected the defendant’s claim of good faith, finding that it was “self-serving and not supported by any extrinsic evidence.” *Id.* at *4. The court also emphasized that, in light of his use of a specialized wiping

tool and subsequent purchase of a computer without the trademarks, the defendant's good faith claim rang hollow. *Id.*

Determination of Appropriate Sanction. The court weighed the following factors in assessing whether a lesser sanction than summary judgment was appropriate:

- (1) the public's interest in expeditious resolution of the litigation;
- (2) the court's need to manage its docket;
- (3) the risk of prejudice to the party seeking sanctions;
- (4) the public policy favoring disposition of cases on their merits; and
- (5) the availability of less drastic sanctions. *Id.* at *6.

The court found that only the fourth factor weighed against summary judgment under the circumstances there, but that factor "alone is not enough to outweigh the other factors." *Id.* at *8.

In considering the fifth factor, the court reasoned that an adverse inference jury instruction was effectively unavailable because "the spoliation would force [plaintiffs] to rely on incomplete and spotty evidence at trial." *Id.*

Did Spoliation Occur? Even before reaching these five factors, though, the court first considered the factors for determining whether spoliation had even occurred. *Id.* at *3-6. After all, the mere fact that a party destroys something that would have been relevant in litigation does not necessarily constitute *spoliation*. The court correctly observed:

A party seeking sanctions for spoliation of evidence must prove the following elements: 1) the party having control over the evidence had an obligation to preserve it when it was destroyed or altered, 2) the destruction or loss was accompanied by a 'culpable state of mind,' and 3) the evidence that was destroyed or altered was relevant to the claims or defenses of the party that sought the discovery of the spoliated evidence. *Id.* at *3.

As already discussed, the third element was really not in question. But the other two were.

Regarding the first element, the court held: "Defendant's admission that he was taking measures in February to avoid being sued for infringement, including wiping his computers, reflects that any reasonable person should have known, and the Defendant knew, the evidence might be relevant to 'anticipated' or 'reasonably foreseeable' litigation." *Id.* at *5. The court's reasoning here raises a potential concern.

The court essentially concluded that litigation was "anticipated" or "reasonably foreseeable" because the defendant took efforts to shield himself from being sued and, failing that, from being held liable were he sued. *Id.*

Putting aside for the moment whether his intentions constitute good faith, it is not entirely clear—nor does it seem to necessarily follow—that such intentions support the conclusion that litigation was anything more than a *mere possibility* at the time the defendant wiped the hard drives. And even the *Granito* court noted that the "mere existence of a potential claim or the distant possibility of litigation" is not enough to trigger a preservation duty. *Id.* at *5.

Future Pitfalls? The court's reasoning could present significant problems for parties that see similarly situated individuals and entities get sued and who then take steps to avoid the same fate for themselves at a time when litigation against them is no more than a mere possibility. The *Granito* decision suggests that their intentions could be held against them, not simply to assess their state of mind, but also to assess whether they had a preservation duty to begin with.

The fact that an individual or entity was sued does not mean by itself, however, that litigation against a similarly situated individual or entity that engages in conduct similar to that at issue in the litigation is anything more than merely possible. The *Granito* court appears to have concluded otherwise, based on the decision.

Even if a party acted in bad faith to the extreme detriment of another party in litigation but did so before a duty to preserve arose, there can be no finding of spoliation and no sanction imposed.

So what about state of mind? Does that tip the scale toward a finding of spoliation if a party destroyed information in bad faith? No—it cannot. Because, as the *Granito* court recognized, the duty to preserve is a distinct element that must be met. *Id.* at *3. Therefore, even if a party acted in bad faith to the extreme detriment of another party in litigation but did so *before* a duty to preserve arose, there can be no finding of spoliation and no sanction imposed. Period.

Additionally, it is also unclear that the defendant's admitted intentions necessarily constitute bad faith. Destroying relevant evidence to weaken the other side's case or strengthen one's own *after* a duty to preserve that evidence has arisen unquestionably constitutes bad faith. But is it bad faith to do so when litigation is nothing more than a mere possibility?

Implications for Retention Policies. An arguably logical extension of the *Granito* court's reasoning presents potentially significant implications for effective document retention policies. Indeed, one of the most compelling reasons for companies to adopt policies with short retention periods and automatic deletions is to minimize litigation expense and exposure *at a time when the company bears no legal duty to preserve that information*—i.e., when litigation is no more than a mere possibility. The less ESI a company preserves, the less risk it produces some "smoking gun" document in unanticipated litigation and the less expense it incurs in discovery in such litigation.

Destroying information to avoid litigation or to avoid, or reduce, liability in litigation when that litigation is a mere possibility is *not* bad faith—it is an entirely reasonable practice. Yet the *Granito* decision could be read to suggest that such intentions might give rise to findings of a preservation duty and culpability when the destruction occurred.

Fed. R. Evid. 407. Arguably, the court’s reasoning runs afoul of the policy underlying Federal Rule of Evidence 407, which excludes evidence of subsequent remedial measures for establishing certain legal elements, including culpability. Rule 407 applies to “measures [that] are taken that would have made an earlier injury or harm less likely to occur.”

The courts have applied the principle underlying Rule 407 “to exclude evidence of subsequent repairs, installation of safety devices, changes in company rules, and discharge of employees, and the language of the present rule is broad enough to encompass all of them.” Fed. R. Evid. 407 advisory committee’s notes. (It is worth noting that companies are perhaps more likely to take remedial measures when they see similarly situated businesses sued for conduct they themselves engage in or conditions present at their own facilities.)

Arguably, the court’s reasoning runs afoul of the policy underlying Federal Rule of Evidence 407, which excludes evidence of subsequent remedial measures for establishing certain legal elements, including culpability.

Wiping the offending files from the defendant’s hard drives arguably was a measure that would have made the preceding harm less likely to occur since the harm allegedly arose from the presence and use of those files on the hard drives. If one credits the defendant’s testimony that he was trying to remedy his prior conduct, which he had only just learned was unlawful, and to comply with the “industry standard” (*before* he was sued), then his “remedial” conduct arguably should not be considered in assessing his culpability, per Rule 407.

Yet the court evidently considered his conduct for that very purpose.

The tipping point for the court appears to have been that the defendant used specialized software to wipe the hard drives and then destroyed the hard drives, which apparently made it impossible to determine whether they were wiped before or after the plaintiffs filed their lawsuit against Granito. *Id.* at *5.

The court also clearly was troubled by the defendant’s admission that he subsequently purchased a hard drive that contained counterfeit tracks with the trademark logos removed because he understood that he could not be sued for using tracks without logos. *Id.* But, again, these actions—even if nefarious—are of no import if the defendant bore no preservation duty when he took them.

Prejudice. The court also obviously was deeply troubled by the substantial prejudice to the plaintiffs. The decision reads as if the court felt that the impact of the defendant’s destruction was so great that fairness demanded dismissal. And although it may be unfair to require a plaintiff to prosecute its claims where the defendant destroyed critical evidence needed to do so, any such unfairness—no matter how great—cannot support spoliation sanctions where the destruction occurred before a preservation duty arose.

Final Thoughts. This case exemplifies the old saying that “bad facts make bad law.” Rarely does a party admit to destroying evidence for the very purpose of avoiding a legal action. If restricted to the narrow and rather unique facts of the *Granito* case, the decision presents little to fear for reasonable litigants.

But if its reasoning is extended, sound policies and practices aimed at destroying information when litigation is just a mere possibility for generally the same purposes that the defendant admitted in that case—namely, to avoid litigation or liability in litigation—could land a litigant in hot water. Hopefully, this decision does not become meaningful precedent beyond its unusual facts.

David D. Cross is Co-Chair of the E-Discovery & Information Management Group and a member of the Antitrust and Litigation Groups in Crowell & Moring LLP’s Washington, D.C. office. Mr. Cross has extensive experience advising clients on matters regarding electronically stored information (ESI), including developing comprehensive litigation readiness plans and negotiating electronic discovery orders for Fortune 250 companies. Mr. Cross’s practice includes antitrust, intellectual property, health care, securities, and general commercial litigation, representing both plaintiffs and defendants in federal and state courts as well as arbitration.

Rachel L. Talbot is an associate in the Washington, D.C. office of Crowell & Moring, LLP. She is a member of the firm’s Antitrust and Litigation Groups. Ms. Talbot received her J.D. from the George Mason School of Law and her undergraduate degree from George Washington University.