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Should New York Courts Consider Evolving Standards on ESI Sanctions?

By Kevin Schlosser
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New York commercial litigators are witnessing the formative development of state law relating to the remedies for failing to preserve and produce electronically stored information ("ESI"). The New York courts, particularly the New York County Commercial Division and Appellate Division, First Department, are finally catching up to their federal judicial counterparts in developing important standards and guidelines governing the preservation and production of ESI and sanctions for failing to do so.

In large measure, the New York courts addressing these issues are adopting the standards as pronounced by the federal courts in the U.S. Court of Appeals for the Second Circuit. However, just when the New York courts are, at last, getting an opportunity to refine these issues, there is a national movement to eradicate the precise standards set by Second Circuit caselaw. In all likelihood, the Federal Rules of Civil Procedure (FRCP) will be amended to implement a new rule concerning sanctions for ESI discovery failures that will explicitly reject and supersede the Second Circuit standard that is now serving as the foundation for the evolving New York jurisprudence.

New York courts, and specifically its Commercial Division, may very well be advised to consider the national movement that is underway to recast the entire manner in which ESI-related discovery is addressed.

The Proposed Federal Rules Changes

The governing bodies of the federal court system are in the process of considering and proposing the most comprehensive changes to the FRCP in many years. Among these changes is a proposed new rule that will specifically address ESI discovery sanctions. After many public comments (a total of 2,345!), the Advisory Committee revamped its initial proposal and recommended the following amendment to FRCP 37(e):

Rule 37. Failure to Make Disclosures or to Cooperate in Discovery; Sanctions

(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 it, and it cannot be restored or replaced through additional discovery, the court may:

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

(2) only upon 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; or

(C) dismiss the action or enter a default judgment.

As noted by the Advisory Committee in its report, in the federal courts, there is a split in the circuits as to what type of failure to preserve ESI justifies imposing significant sanctions, including adverse inference jury instructions. The Second Circuit has ruled in *Residential Funding Corp. v. DeGeorge Fin. Corp.*, 306 F.3d 99 (2d Cir. 2002) that courts are authorized to impose such sanctions if the ESI was not adequately produced through "ordinary negligence" as well as gross negligence or willful conduct. While the Second Circuit in *DeGeorge* added that the party seeking such a sanction must still prove that the "destroyed evidence" was "relevant" to the claims or defenses, "where a party seeking an adverse inference adduces evidence that its opponent destroyed potential evidence (or otherwise rendered it unavailable) in bad faith or through gross negligence (satisfying the 'culpable state of mind' factor), that same evidence of the opponent's state of mind will frequently also be sufficient to permit a jury to conclude that the missing evidence is favorable to the party (satisfying the 'relevance' factor)."

The Second Circuit's standard has been followed and elaborated upon by the Federal District Courts in New York. *See, e.g.*, *Sekisui American Corp. v. Hart*, 945 F. Supp. 2d 494 S.D.N.Y. 2013); *Pension Comm. of Univ. of Montreal Pension Plan v. Banc of America Secs.*, LLC, 685 F.Supp.2d 456, 465 (S.D.N.Y. 2010), *abrogated on other grounds*, *Chin v. Port Auth. of New York & New Jersey*, 685 F.3d 135 (2d Cir. 2012), *cert. denied*, 133 S. Ct. 1724 (U.S. 2013); *Zubulake v. UBS Warburg LLC*, 229 F.R.D. 422 (S.D.N.Y. 2004)("In this circuit, a 'culpable state of mind' for purposes of a spoliation inference includes ordinary negligence. When evidence is destroyed in bad faith (i.e., intentionally or willfully), that fact alone is sufficient to demonstrate relevance. By contrast, when the destruction is negligent, relevance must be proven by the party seeking the sanctions.")(footnotes omitted). Other circuits, like the Tenth, require a showing of bad faith in order to impose more severe sanctions such as an adverse inference instruction. *See, e.g., Turner v. Pub. Serv. Co. of Colorado,* 563 F.3d 1136, 1149-50 (10th Cir. 2009).

As indicated in the Advisory Committee comments, the proposed new FRCP 37(e) *expressly* rejects the Second Circuit approach and requires the court to find that "the party acted with the intent to deprive another party of the information's use in litigation" before the court may even (a) consider presuming that the lost information was unfavorable to the party; (b) instructing the jury that it may or must presume the information was unfavorable; or (c) dismissing the action or entering a default judgment. This new approach has been warmly received by those who believe that expanding and far-reaching discovery of ESI has caused unnecessary and avoidable expense and spawned unduly severe strictures on counsel and their clients in their efforts to comply with the demanding (and at times unforgiving) ESI discovery rules imposed by courts (often using "20-20 hindsight").

New York's Developing Law on ESI Sanctions

In the meantime, New York state courts have recently begun to follow and rely upon the strict Second Circuit approach, at least by recognizing that sanctions can conceivably be imposed based upon the loss of ESI through ordinary negligence. The First Department has clearly taken the lead in developing New York state law on point, as explained in the decisions *Ahroner v. Israel Disc. Bank of New York,* 79 A.D.3d 481, 482, 913 N.Y.S.2d 181 (1st Dep't 2010) and *VOOM HD Holdings LLC v. EchoStar Satellite L.L.C.*, 93 A.D.3d 33, 45, 939 N.Y.S.2d 321 (1st Dep't 2012), which followed Judge Shira Scheindlin's decisions in *Zubulake* and *Pension Comm.*, which in turn followed the Second Circuit's standard as announced in *DeGeorge*.

Several other New York lower court decisions, primarily in New York County, have followed this approach as well. *See, e.g.*, *Roberts v. Corwin*, 2013 NY Slip Op 51637 (Sup. Ct., NY Co. Oct. 3, 2013)("The requisite culpable state of mind can be demonstrated through intentional or willful conduct, gross negligence, or ordinary negligence."); *Energy Eiac Capital Ltd. v. Maxim Group LLC*, 2013 WL 2282276, at *4 (Sup. Ct, NY Co. May 22, 2013) ("A 'culpable state of mind,' for purposes of a spoliation sanction, includes ordinary negligence (Voom HD Holdings LLC v EchoStar Satellite LLC 93 AD 3d 33, 45 [1st Dept 2012])."); *Labat v. H&M Hennes & Mauritz LP*, 2014 WL 986773, at *1 (Sup. Ct. NY Co. Mar. 12, 2014)("The requisite culpable state of mind can be demonstrated through intentional or willful conduct, gross negligence, or ordinary negligence."); *Stern v. DMG World Media (USA) Inc., GLM, LLC*, 2013 WL 6919400, at *8-9 (Sup. Ct., NY Co. Dec. 16, 2013)(same); *Hameroff and Sons, LLC v. Plank, LLC*, 36 Misc.3d 1229(A), 959 N.Y.S.2d 89 (Sup. Ct., Albany Co. Aug. 13, 2012)(same).

The latest decision by the First Department on the issue was rendered on June 5, in *Pegasus Aviation I, Inc. v. Varig Logistica S.A.*, 2014 N.Y. Slip Op. 04047, 2014 WL 2522717 (1st Dep't June 5, 2014), and could very well show why the new proposed FRCP 37(e) is a more workable and practical guide to ESI sanctions.

In *Pegasus*, in an unusual split of the court, with one opinion concurring in part and dissenting in part, and another opinion dissenting, the panel reversed Justice Barbara Kapnick's order granting plaintiffs' motion for an adverse inference instruction at trial against defendants as a sanction for spoliation of ESI. The panel agreed and endorsed the First Department's reliance upon *VOOM* and its incorporation of the Second Circuit's approach to imposing sanctions for lost ESI. The majority opinion and partial dissent also agreed that "ordinary negligence may provide a basis for the imposition of spoliation sanctions." 2014 WL 2522717, at *5.

The majority opinion found that where "'the destruction of evidence is merely negligent, … relevance [of the lost material] must be proven by the party seeking spoliation sanctions,'" citing *VOOM*, but ruled, contrary to the dissents, that plaintiff had not made such a required showing. The partial dissent would have remanded the case to the court below to determine the extent to which plaintiffs had been prejudiced by loss of the evidence and the sanction if any to be imposed. The other dissenting justice found that the trial court had properly determined that the defendant's conduct in failing to preserve the ESI amounted to "gross negligence" – where the relevance of the missing data was presumed. *Id.* at *5.

The *Pegasus* case, with all of its differing majority, concurring and dissenting opinions, is a stark sign that courts will struggle in determining when sanctions should be imposed under the Second Circuit standards. Questions the courts are grappling with, such as whether the conduct amounts to "negligence" or "gross negligence," or whether the relevance of the missing ESI has been adequately established to impose significant sanctions where only "negligence" is found, are likely to be eliminated in the determination of such sanctions under the new FRCP 37(e).

Should New York Consider the Changing National Tide?

Insofar as the standards applied by the First Department in *Pegasus* are clearly based upon Second Circuit caselaw arising from *DeGeorge*, the question remains whether New York state courts should continue to develop the intricacies of ESI sanction standards based upon caselaw that is likely to be superseded by the new FRCP 37(e). Although the new FRCP 37(e) cannot be implemented before December 2015 under federal rules enabling procedure, should New York State courts continue to follow precedent that the federal courts nationwide are evidentially going to be compelled to reject? Is New York currently heading in the wrong direction and against the national tide?

In the same vein, should special rules concerning ESI sanctions be considered and implemented in the New York Commercial Division? The Commercial Division has received abundant, well-deserved praise for its sophisticated, specialized handling of business litigation. It has rivaled the Delaware Court of Chancery as a premier forum for resolving high stakes and complex commercial disputes. As New York continues to adopt special rules of practice to make its Commercial Division more inviting to corporate litigation, perhaps it is time to join the national movement to control and more practically manage ESI discovery by implementing a rule of practice similar to the proposed FRCP 37 (e). Let the debate begin.

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Kevin Schlosser is a partner and Chair of the Litigation Department at Meyer, Suozzi, English & Klein, P.C., in Garden City, and the Chair of the Commercial Litigation Committee of the Nassau County Bar Association. He can be reached at kschlosser@msek.com.