If you have questions or would like additional information on the material covered in this Alert, please contact the authors:

Timothy J. Cornetti
Partner, Pittsburgh
+1 412 288 3169
tcornetti@reedsmith.com

Melissa M. Taylor
Associate, Pittsburgh
+1 412 288 7980
mmtaylor@reedsmith.com

…or the Reed Smith lawyer with whom you regularly work.

U.S. District Judge Imposes $10,000 Fine on Party as Sanction for Failure to Implement Litigation Hold in *Passlogix v. 2FA Technology, LLC*.

A recent ruling out of the Southern District of New York illustrates that failure to timely implement a litigation hold can have serious consequences, including substantial fines.

The Ruling

The Honorable Peter K. Leisure, U.S. District Judge for the Southern District of New York, recently addressed a plaintiff's spoliation and fraud on the court claims in an April 27, 2010 ruling and fined the defendant $10,000 as a sanction for spoliation of evidence.[1] During the course of a lawsuit, the plaintiff accused one of the principals of the defendant of committing fraud on the court by sending the plaintiff anonymous emails in order to procure a better settlement offer from the plaintiff, cause the plaintiff commercial harm, and obtain third-party discovery. The defendant's principal claimed that his IP address had been "spoofed;" in other words, that former employees of the plaintiff had doctored their IP addresses to appear to be that of the defendant's principal and sent the anonymous emails to the plaintiff.

The plaintiff accused the defendant and one of its principals of spoliation of three categories of evidence related to the fraud on the court claim. The defendant admitted that it failed to implement a litigation hold notice, and that it continued to delete emails and text messages regularly. The plaintiff requested three types of relief: (1) that an adverse inference be drawn that the deleted documents would be harmful to the defendant; (2) that the defendant be precluded from making arguments implicating the deleted documents; and (3) that the defendant be responsible for the costs of the plaintiff's investigation into the anonymous emails.

The *Passlogix* court noted that a party seeking sanctions for spoliation must establish (1) that the party having control over the evidence had an obligation to preserve it at the time it was destroyed; (2) that the records were destroyed with a "culpable state of mind" (i.e., that the destruction was negligent, grossly negligent, reckless, or intentional); and (3) that the destroyed evidence was relevant to the moving party's claims or defenses. The court observed that a party is on notice to preserve relevant documents when litigation is reasonably anticipated, regardless of whether there has been a specific request for the information. The court further noted that a party has a duty to preserve all documents that might lead to the discovery of admissible evidence or is reasonably likely to be requested during discovery, even if the documents themselves are not evidence. The court emphasized that once a party is on notice of litigation, the failure to issue a written litigation hold notice constitutes gross negligence.

The court held that the defendant had an obligation to preserve at least some of each of the three categories of evidence at issue, and that this obligation attached, at minimum, when the plaintiff filed its complaint. The court further held that because the defendant admittedly failed to implement a litigation hold, it was grossly negligent and therefore had a sufficiently culpable state of mind for sanctions with regard to all three types of evidence. The court determined that the defendant destroyed one category of evidence intentionally and in bad faith, believing that it falsely implicated a principal of the defendant as the sender of the anonymous emails. The court concluded that two out of the three categories of evidence were relevant to the claims and defenses in the case, and that the plaintiff was prejudiced by their destruction. Accordingly, the court held that the defendant was subject to sanctions as a result of its spoliation of the relevant written communications and the network and computer logs.

The court ultimately declined to impose any of the plaintiff's requested sanctions and instead fined the defendant $10,000, holding that a monetary fine best served to punish the defendant's spoliation and deter any future destruction of evidence by the defendant. The court reasoned that a fine of this

size was particularly appropriate in this case because it would impact the two principals directly (as the defendant is a small business entity and the two principals implicated in the spoliation were its sole principals and co-founders).

Practical Impact

The *Passlogix* court reaffirmed that a party's failure to implement a litigation hold notice constitutes gross negligence and exposes the party to the possibility of sanctions, including a monetary fine, even where the party is a small business. The *Passlogix* court emphasized that the $10,000 fine was the appropriate sanction for a small business like the defendant because a fine of that amount would greatly impact the defendant and its principals. It stands to reason, therefore, that a party with more resources could be subject to a significantly larger fine or even more drastic sanctions in order to punish the party for engaging in spoliation and to deter any further spoliation.

In order to avoid sanctions for the spoliation of evidence (including but not limited to monetary fines), a party should issue a comprehensive written litigation hold notice as soon as the party is on notice of pending litigation. The litigation hold should be issued immediately upon the filing of a complaint, or sooner if possible (i.e., if litigation has been threatened but not filed). The litigation hold should encompass not only emails and attachments but also all other types of electronic communication – text messages, instant messages, Skype records, etc. - used by the party. The litigation hold should err on the side of over-inclusion and should be broadly drafted to include all communications that are relevant to any claims or defenses in the impending litigation and all documents that might reasonably lead to the discovery of admissible evidence.

_____

[1] *Passlogix v. 2FA Technology, LLC, --- F. Supp. 2d ----, No. 08 Civ. 10986 (PKL), 2010 U.S. Dist. LEXIS 44182 (S.D.N.Y. Apr. 27, 2010).*

About Reed Smith

Reed Smith is a global relationship law firm with nearly 1,600 lawyers in 22 offices throughout the United States, Europe, Asia and the Middle East. Founded in 1877, the firm represents leading international businesses, from Fortune 100 corporations to mid-market and emerging enterprises. Its lawyers provide litigation and other dispute resolution services in multi-jurisdictional and other high-stakes matters; deliver regulatory counsel; and execute the full range of strategic domestic and cross-border transactions. Reed Smith is a preeminent advisor to industries including financial services, life sciences, health care, advertising, technology and media, shipping, energy trade and commodities, real estate, manufacturing, and education. For more information, visit reedsmith.com.

This *Alert* is presented for informational purposes only and is not intended to constitute legal advice.

© Reed Smith LLP 2010. All rights reserved.

"Reed Smith" refers to Reed Smith LLP, a limited liability partnership formed in the state of Delaware.

ReedSmith
The business of relationships.℠

NEW YORK
LONDON
HONG KONG
CHICAGO
WASHINGTON, D.C.
BEIJING
PARIS
LOS ANGELES
SAN FRANCISCO
PHILADELPHIA
PITTSBURGH
OAKLAND
MUNICH
ABU DHABI
PRINCETON
N. VIRGINIA
WILMINGTON
SILICON VALLEY
DUBAI
CENTURY CITY
RICHMOND
GREECE