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Document Preservation Strategies for Creditors in a World with Changing Discovery Rules

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Over the last decade, thousands of articles have been written on the subject of electronic discovery, including the requirements to preserve and produce electronically stored information. As the judicial conference and its advisory committee consider comments to the proposed amendments to the Federal Rules of Civil Procedure (FRCP) — and by extension, the Federal Rules of Bankruptcy Procedure (FRBP) — it is a good time to consider the status quo and the potential impact of the coming rule changes on creditors' document-retention practices,[1] including when a creditor's obligation to preserve documents begins and the potential sanctions that a creditor may face for failing to preserve discoverable information.

The Trigger of a Creditor's Duty to Preserve

A party's duty to preserve evidence commences with its "reasonable anticipation of litigation."[2] Accordingly, although a party must begin preserving potentially relevant evidence upon the commencement of litigation, a party's duty may begin prior to the filing of a complaint. For example, if a party receives a demand letter prior to the service of a complaint, reasonable anticipation of litigation and the obligation to preserve evidence will arise.[3] The word "reasonable" suggests an objective standard, which should be based on a litigant's good-faith efforts and a court's reasonable evaluation of all relevant facts and circumstances at issue.[4] This standard may include an evaluation of the sophistication of a party or the type of claim at issue.[5]

The standard for determining the commencement of a defendant's duty to preserve documents relevant to an avoidance action seems relatively straightforward, subject to some caveats. Like other litigation, a defendant must preserve documents once it has been served with the complaint, at the very latest.[6] A defendant's duty may arise sooner than the date of service depending on when it should have reasonably anticipated being sued. The common practice of sending a demand letter in advance of a complaint should trigger the creditor's obligation to preserve documents.[7] However, a creditor's name on a list of potential avoidance actions in the middle of a lengthy disclosure statement is, without more, unlikely to be a sufficient basis to impose an obligation to preserve evidence, particularly if the creditor has a limited interest in the bankruptcy case. A court considering whether a defendant should have preserved documents in anticipation of

1 The ABA Electronic Discovery in Bankruptcy Working Group of the Bankruptcy Court Structure and Insolvency Process Committee published the "Best Practices Report on Electronic Discovery (ESI) Issues in Bankruptcy Cases," 68 *Bus. Law* 1130 (August 2013), which is instructive and addresses a host of issues related to electronic discovery in bankruptcy.

2 *See, e.g., Zubulake v. UBS Warburg LLC*, 220 F.R.D. 212 (S.D.N.Y. 2003). While courts throughout the nation have issued numerous opinions that address preservation and spoliation, *Zubulake* remains the leading case that analyzes when a party is obligated to preserve potential evidence.

3 *See Trask-Morten v. Motel 6 Operating LP*, 534 F.3d 672, 681 (7th Cir. 2008) (indicating that receipt of demand letter would trigger reasonable anticipation of litigation).

4 *See* "Commentary on Legal Holds: The Trigger and the Process," 11 *Sedona Conf. J.* 265, 270, 276 (Fall 2010). For example, a duty to preserve may arise based on certain types of incidents that will trigger litigation. *See, e.g., Taylor v. City of New York*, 293 F.R.D. 601, 610-11 (S.D.N.Y. 2013) (finding that based on prior litigation arising from inmate-on-inmate assaults, Department of Corrections should have reasonably anticipated litigation after prisoner was assaulted while in custody); *In re Semrow*, 2011 WL 1304448, at *3 (D. Conn. March 31, 2011) (holding that occurrence of fatalities was sufficient to put defendant on notice of future litigation).

5 Guideline Four of the Sedona Conference specifically states that courts may consider certain factors in determining whether litigation should be reasonably anticipated. Among those factors is the experience of the industry and whether the company has learned of similar claims. Guideline Four also suggests that the particular factors to be considered may depend on the nature of the organization. *See* "Commentary on Legal Holds: The Trigger and the Process," 11 *Sedona Conf. J.* at 276.

6 *See* "Commentary on Legal Holds: The Trigger and the Process," 11 *Sedona Conf. J.* at 270, 271.

7 *See Trask-Morten v. Motel 6 Operating LP*, 534 F.3d at 681.

preference litigation must consider the full circumstances of each case and the parties.

A creditor's preservation obligation in the context of claim litigation should be consistent with its obligation in other litigation. A bankruptcy court's initial analysis of the sufficiency of a creditor's execution of its preservation obligations arising out of claim litigation will be to determine when the creditor's duty to preserve first arose. Fed. R. Bankr. P. 3001 requires creditors to include supportive documentation with their proof-of-claim filings.[8] However, even if a creditor's supportive documentation satisfies Fed. R. Bankr. P. 3001, the information may not be sufficient to resolve issues raised by a debtor or trustee in some objection to be filed later.

The FRBP do not require a creditor to preserve documents beyond what is filed with a proof of claim, and the FRBP indicate that claims litigation is commenced with an objection to a proof of claim.[9] Courts should be reluctant to find that a creditor had an obligation to preserve documents based solely on its filing of a proof of claim.[10] Such an outcome makes sense because claimants do not necessarily anticipate that their claim will be the subject of a future objection, but where the creditor should have reasonably anticipated that the claim would be the subject of an objection, it should preserve relevant evidence.[11]

Contemplated Changes to Civil Rules

In May 2014, the Judicial Conference Advisory Committees on Bankruptcy and Civil Rules[12] proposed amendments to their respective rules and forms, and requested that the proposals be circulated to the bench, bar and public for comment. Such comments were due by Feb. 17, 2015. As compared to the current version, proposed Fed. R. Civ. P. 26(b) provides:

> Scope in General. Unless otherwise limited by court order, the scope of discovery is as follows: Parties may obtain discovery regarding any nonprivileged matter that is relevant to any party's claim or defense ~~including the existence, Description, nature, custody, condition, and location of any documents or other tangible things~~ and proportional to the needs of the ~~identity and location of persons who know of any discoverable matter. For good cause~~case, considering the ~~court may order discovery of any matter relevant to~~ amount in controversy, the ~~subject matter involved~~ importance of the issues at stake in the action, ~~Relevant information need not be admissible at the trial if~~, the parties' resources, the importance of the discovery in resolving the issues, and whether the burden or expense of the proposed discovery ~~appears reasonably calculated to lead to the~~ outweighs its likely benefit. Information within this scope of discovery ~~of~~ need not be admissible in evidence to be discoverable. ~~All discovery is subject to the limitations imposed by Rule 26(b)(2)(C).~~

Regardless of the requirements of the proposed amendments ... creditors are often best served by preserving documents as soon after the bankruptcy filing as possible.... [D]efendants' best defenses are likely based on documents and correspondence that might be automatically destroyed pursuant to ordinary course record-retention policies.

Although the Rules apply only after litigation commences, courts rely on Fed. R. Civ. P. 26 to determine the scope of documents to have been preserved when subsequently evaluating whether a party complied with its pre-litigation preservation obligations. The proposed modifications would eliminate the "subject matter," "good cause" and "discovery reasonably calculated to lead to the discovery of admissible evidence" provisions. Instead, the limitations of discovery would be expressly based on proportionality, including the amount in controversy, importance of the issues at stake, the parties' resources, and the burden and expense of the discovery relative to its likely benefit. These proposed changes do not seem to be a significant departure from the existing case law; rather, they reflect a codification of what courts already require upon the triggering of a party's duty to preserve and produce evidence, subject to the concept of proportionality.

Potential Sanctions for Failure to Preserve

While Fed. R. Civ. P. 26 addresses the limitations of the scope of discovery, Fed. R. Civ. P. 37(e) addresses the consequences of a failure to preserve discoverable informa-

8 *See, e.g., Caplan v. B-Line LLC (In re Kirkland)*, 572 F.3d 838, 841 (10th Cir. 2009) (failing to provide any support for claim will lead to disallowance of claim). Although creditors must provide some support for their claims, there is no clear standard for the amount of detail that must be included with a proof of claim. Thus, a creditor asserting a claim of $1 million based on delivered goods could include every invoice, purchase order and bill of lading as support; however, the claim could also be supported by a spreadsheet detailing the invoice number, invoice date, and the amount and date of each delivery.

9 While Fed. R. Bankr. P. 3007 — not Fed. R. Bankr. P. 7001, *et seq.* — applies to claims objections, a party's obligation to retain documents and other evidence does not change. Advisory Committee Note to Fed. R. Bankr. P. 3007 states that "the filing of an objection to a claim initiates a contested matter governed by ... Rule 9014, unless a counterclaim is joined with the objection to the claim." In turn, Fed. R. Bankr. P. 9014 applies Fed. R. Bankr. P. 7026.

10 At least one court has analogized the filing of a proof of claim by a creditor to a complaint. However, that was solely in the context of the issue of notice. *See, e.g., In re Lomas Fin. Corp.*, 212 B.R. 46, 55 (Bankr. D. Del. 1997). More broadly though, case law suggests that plaintiffs, who decide when and whether to commence litigation, have a clearer view on the reasonable anticipation of litigation. *See Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec. LLC, et al.*, 685 F. Supp. 2d 456, 466 (S.D.N.Y. 2010) ("A plaintiff's duty is more often triggered before litigation commences, in large part because plaintiffs control the timing of litigation.")). In the context of bankruptcy, the filing of a bankruptcy petition — or even a proof of claim — is unlikely to be such a triggering event, as neither triggers a contested matter under either Fed. R. Bankr. P. 7001 or Fed. R. Bankr. P. 9014. Accordingly, for purposes of document-preservation obligations, the filing of a claim objection is more akin to filing a complaint.

11 There might be circumstances that would suggest that a creditor has a duty to preserve evidence that arose long before the filing of a claim objection, including when the underlying claim was the subject of pre-petition litigation or such litigation could have been reasonably anticipated prior to the petition date. Although there is a paucity of case law regarding a creditor's duty to preserve documents in connection with its proof of claim, *In re Kmart Corp.*, 371 B.R. 823 (N.D. Ill. 2007), is instructive. In *Kmart*, a claimant filed a motion for sanctions against the debtor for, among other things, failing to preserve evidence following the claimant filing a detailed administrative expense for more than $25 million. *Id.* at 830. The *Kmart* court granted the motion, in part, finding that the trigger date of the debtor's duty to preserve was on or shortly after the filing of the administrative expense. While acknowledging the huge number of claims that were filed in the debtor's bankruptcy case, the court considered the size of the claim, the fact that the claim asserted an administrative priority (and therefore sought payment in full, rather than on a *pro rata* basis), and the level of detail of the allegations. Based on the facts and circumstances, the court concluded that "it should not have taken long [for the debtors] to identify this claim as one which was likely to be litigated." *Id.* at 843-46.

12 The new amendments will also provide new limits on depositions (Fed. R. Civ. P. 30 and 31), interrogatories (Fed. R. Civ. P. 33) and requests for admission (Fed. R. Civ. P. 36). Under the new rules, the limits may be expanded or limited with the court's permission.

tion. As compared to the current version, proposed Fed. R. Civ. P. 37(e) provides:

> Failure to ~~Provide Electronically Stored~~ Preserve Discoverable Information. ~~Absent exceptional circumstances, a court may not impose sanctions under these rules on a party for failing to provide electronically stored information lost as a result of the routine, good-faith operation of an electronic information system.~~
>
> (1) Curative measures; sanctions. If a party failed to preserve discoverable information that should have been preserved in the anticipation or conduct of litigation, the court may:
>
> (A) permit additional discovery, order curative measures, or order the party to pay the reasonable expenses, including attorney's fees, caused by the failure; and
>
> (B) impose any sanction listed in Rule 37(b)(2)(A) or give an adverse-inference jury instruction, but only if the court finds that the party's actions:
>
> (i) caused substantial prejudice in the litigation and were willful or in bad faith; or
>
> (ii) irreparably deprived a party of any meaningful opportunity to present or defend against the claims in the litigation.

Although a creditor's size, sophistication and experience might play a major role in when and to what extent a creditor decides to preserve documents, the proposed amendments to Fed. R. Civ. P. 37 do not appear to provide the court with the latitude to consider such factors when weighing the extent and appropriateness of a creditor's document-preservation efforts. Rather, this proposed amendment would authorize courts to impose sanctions if a party has not preserved discoverable information in anticipation or conduct of litigation. Thus, the commencement of the obligation to preserve evidence is the fulcrum of the analysis under the proposed amendments. It is likely that the interpretation of the proposed amendments will not substantially or substantively deviate from the long-established case law of sanctioning parties only to the extent of the offending party's culpability.[13]

Best Practices

Regardless of the requirements of the proposed amendments to the FRCP and FRBP, creditors are often best served by preserving documents as soon after the bankruptcy filing as possible. In preference litigation, for example, defendants' best defenses are likely based on documents and correspondence that might be automatically destroyed pursuant to ordinary course record-retention policies. By the time preference litigation has commenced, which might be as much as two years after the petition date, any effort to preserve or restore relevant records may be too late to be effective. Similarly, a creditor filing a proof of claim may have the same preservation concerns: If a creditor waits for the debtor to object to its claim before preserving bills of lading, it may have unwittingly destroyed the only evidence that the goods in question were actually delivered to the debtor. Even without applying the "reasonable anticipation of litigation" standard and regardless of the supportive evidence filed with a claim, it would be prudent for a creditor to maintain all relevant records related to any filed claim in case of a future objection.

The costs of preserving evidence can be painful to all creditors, regardless of size, but counsel needs to be involved in shaping the scope of the litigation hold, including having protocols that are introduced and maintained, sooner rather than later. The proposed amendments may limit discoverable evidence to be preserved with a new emphasis on proportionality; however, creditors' interests may be best served by preserving documents earlier than when the reasonable anticipation of litigation arises and in a scope that exceeds the lowest limit required by the proposed amendments. If counsel instructs their clients that they need to only meet the lowest standards of proportionality included in the proposed amendments, their clients will likely be protected from future spoliation sanctions. However, by implementing a proactive litigation hold early in a bankruptcy case, a client's greatest benefit will be the ability to support its claims and defenses. abi

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13 Although case law varies among the circuits as to appropriate sanctions, courts generally consider the following when determining an appropriate sanction: (1) the degree of fault and personal responsibility attributable to the party who altered or destroyed the evidence; (2) the degree of prejudice that has been suffered by the opposing party; and (3) whether a lesser sanction would avoid substantial unfairness to the opposing party and serve to deter such conduct by others. Generally speaking, failures to preserve relevant evidence "occur along a continuum of fault — ranging from innocence through the degrees of negligence to intentionally." *Reilly v. Natwest Markets Grp. Inc.*, 181 F.3d 253, 267 (2d Cir. 1999). While sanctions are often tailored for remedial purposes, the greater the willfulness of the spoliating party, the greater likelihood that the sanctions being imposed will be more severe. *See Stanley Inc. v. Creative Pipe Inc.*, 269 F.R.D. 497, 529-30 (D. Md. 2010), including the helpful chart attached as Exhibit A thereto addressing spoliation sanctions by circuit.