Legal Backgrounder

Washington Legal Foundation
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2009 Massachusetts Ave., NW
Washington, D.C. 20036
202.588.0302

Vol. 17 No. 48 November 1, 2002

DOCUMENT MANAGEMENT POLICIES IN THE POST-ENRON ENVIRONMENT

by

Warren L. Dennis and Susan Brinkerhoff

The word is ***spoliation***. The term does not refer to the gratuitous destruction of horticultural products. It is the first cousin of criminal obstruction of justice and involves the destruction of evidence having potential evidentiary value.

Routine document destruction is an integral part of every document retention policy. Otherwise, the costs of cold storage for corporate archives — both paper and electronic — would be infinite. In addition, old documents could create liability when, years later, they cannot be put into context or can no longer be explained. A problem may arise, however, when documents are destroyed — even in keeping with a longstanding document destruction policy — when a party is on reasonable notice that litigation is likely to be commenced.

What Is Spoliation? The term derives from the legal maxim, *omnia praesumuntur contra spoliatorem*, meaning "all things are presumed against a despoiler or wrongdoer." BLACK'S LAW DICTIONARY, 1086 (6th ed. 1997). Under federal law, spoliation refers to the destruction or material alteration of evidence or failure to preserve property for another's use as evidence in pending or reasonably foreseeable litigation. *Silvestri v. General Motors Corp.*, 271 F.3d 583, 590 (4th Cir. 2001). Thus, spoliation involves two elements: a duty to preserve evidence, and the intentional destruction of that evidence. *Trigon Ins. Co. v. United States*, 204 F.R.D. 277, 286 (E.D. Va. 2001). The duty to preserve evidence arises when a party is put on notice, through discovery requests for example, that the evidence may be relevant to pending or threatened litigation. *Id.* at 287. The more difficult determination arises when litigation is merely threatened or implied and will depend on the facts of a given situation. For example, in *Computer Associates Int'l v. American Fundware*, 133 F.R.D. 166 (D. Colo. 1990), the court found that pre-litigation communications about a copyright dispute and settlement discussions between parties were enough to put a spoliator on notice that litigation was foreseeable and that the central issue in any eventual action would relate to the documents destroyed.

Courts may also look to the foreseeability of litigation, such as when a party has been faced with similar litigation in the past, or when it has dispatched its own investigators to gather information on an accident or other event. *Capitol Chevrolet v. Smedly*, 614 So. 2d 439 (Ala. 1993) Or when an action before an administrative agency has been initiated, such as a hearing, a court might find that litigation was reasonably foreseeable. *McGuire v. Acufex Microsurgical Inc.*, 175 F.R.D. 149 (D. Mass. 1997).

Sanctions. The right to impose sanctions for spoliation arises from the court's inherent power to control the judicial process and the underlying policy of the need to preserve the integrity of the judicial process in order to retain confidence that the process works to uncover the truth. *Id.* Where a party has acted in bad faith, a court may impose the harshest of sanctions — dismissal of the case or the entry of a default judgment against the spoliator. For such a remedy, a court must generally find bad-faith destruction, prejudice

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Warren L. Dennis is a partner, and **Susan Brinkerhoff** an associate, in the Litigation and Dispute Resolution Group at Proskauer Rose LLP's Washington, D.C. office.

to the aggrieved party, and the inadequacy of alternate sanctions. However, dismissal may also be warranted where negligent spoliation of critical evidence results in extraordinary prejudice to a party, rendering him incapable of adequately litigating his case. *Trigon*, 204 F.R.D. at 593-94.

Monetary damages are also sometimes awarded and may be severe. In *In re Prudential Ins. Co. of America Sales Practices Litigation*, 169 F.R.D. 598 (D.N.J. 1997), even though the court found that the respondent had not acted willfully in destroying data, the court imposed a sanction of $1,000,000 (plus attorneys' fees), for unnecessary consumption of the court's time and resources in the spoliation issue. Prudential had been sued by policyholders alleging deceptive sales practices. A year earlier, in response to a regulatory directive, the company had begun a process of destroying all unauthorized sales materials, and continued that policy long after commencement of litigation. Even after the court ordered the preservation of all relevant documents, senior management failed to adequately alert company employees of the necessity of retaining documents pursuant to the court order, and as a result, relevant documents were destroyed at several Prudential offices. The court noted, "While there is no proof that Prudential, through its employees, engaged in conduct intended to thwart discovery through the purposeful destruction of documents, its haphazard and uncoordinated approach to document retention indisputably denies its party opponents potential evidence to establish facts in dispute." *Id.* at 615.

Courts may also instruct jurors on the common-law rule that "the trier of fact may draw an inference from the intentional spoliation of evidence that the destroyed evidence would have been unfavorable to the party that destroyed it." *Beers v. Bayliner Marine Corp.*, 236 Conn. 769, 775 (1996). Generally, however, more than negligence is needed to permit an adverse inference. As the Fourth Circuit has noted, "An adverse inference about a party's consciousness of the weakness of his case . . . cannot be drawn merely from his negligent loss or destruction of evidence; the inference requires a showing that the party knew the evidence was relevant to some issue at trial and that his willful conduct resulted in its loss or destruction." *Vodusek v. Bayliner Marine Corp.*, 71 F.3d 148, 156 (4th Cir. 1995).

Arthur Andersen: A Case Study in Criminal Spoliation, a/k/a Obstruction of Justice. Earlier this year, Arthur Andersen faced a felony charge of obstruction of justice when it was accused of trying to block an SEC investigation into Enron's financial disclosures by destroying documents related to the accounting firm's audits of Enron. Obstruction of justice is often used as the basis for punishing spoliation, as provided in the criminal code:

> Whoever knowingly . . . [and] corruptly persuades another person, or attempts to do so, . . . with intent . . . to cause or induce any person to withhold . . . a record, document, or other object from an official proceeding, [or] alter, destroy, mutilate, or conceal an object with intent to impair the object's integrity or availability for use in an official proceeding . . . . shall be fined under this title or imprisoned not more than ten years, or both.

18 U.S.C. § 1512(b).[1]

The Andersen jury was instructed that the government must prove two elements for it to find the company guilty: first, that Andersen corruptly persuaded or attempted to corruptly persuade another person(s);

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[1]Another section of the criminal code may also be used as the basis for an obstruction of justice charge. 18 U.S.C. § 1505, "Obstruction of proceedings before departments, agencies, and committees," provides:

> Whoever, with intent to avoid, evade, prevent, or obstruct compliance, in whole or in part, with any civil investigative demand duly and properly made under the Antitrust Civil Process Act, willfully withholds, misrepresents, removes from any place, conceals, covers up, destroys, mutilates, alters, or by other means falsifies any documentary material, answers to written interrogatories, or oral testimony, which is the subject of such demand; or attempts to do so or solicits another to do so; . . . Shall be fined under this title or imprisoned not more than five years or both.

  ISBN 1056 3059

and second, that Andersen acted knowingly and with intent to cause or induce another person(s) to withhold a document from an official proceeding or alter, destroy, mutilate, or conceal an object with intent to impair the object's availability for use in an official proceeding. *United States v. Arthur Andersen, LLP*, Crim. No. H-02-121, jury instructions at 9 (S.D. Tex. 2002).

At trial, the government produced evidence that on October 9, 2001, Andersen's in-house lawyers had become aware of Enron's unfolding financial crisis. During a telephone conference about Enron that day, Nancy Temple, an Andersen attorney, jotted down the phrase, "Highly probable some SEC inquiry." Jonathan Weil and Alexei Barrionuevo, *In the Balance: As Trial Nears End, Andersen Proves Surprisingly Tough*, WALL ST. J., June 4, 2002, at A1. She also wrote that Andersen could be charged with violating an order it signed earlier in the year to settle a suit by the SEC over its audits for Waste Management, Inc. *Id.* Under that order, the company had agreed it could be held in contempt of court if it violated securities laws in the future. *Id.*

Three days later, Temple e-mailed the head of the Houston audit practice, attaching the company's document destruction policy, and noting that it "might be helpful" to consider reminding the Enron team to make sure that they have complied with the policy. *Id.* That e-mail was later forwarded to David Duncan, Andersen's chief Enron auditor. *Id.* Twenty-one minutes after sending the original e-mail, Temple filed an internal memo stating that Enron planned to take a major charge to earnings and might have to issue a financial restatement. *Id.* In the next several days, Temple sent similar e-mail reminders of the document destruction policy to others in the firm, some of whom responded by deleting Enron-related e-mails and disposing of old files. *Id.* Duncan waited until October 23 before initiating the massive shredding and deletion of Enron documents and e-mails. *Id.*

After ten days of deliberations, the jury found Andersen guilty of obstructing justice and unanimously agreed on the identity of at least one "corrupt persuader." *Id.*; Jonathan Weil, *Andersen: Called to Account: Jury Cuts Off an Andersen Appeals Route*, WALL ST. J., June 17, 2002, at C13. In post-verdict interviews, jurors named Temple the "corrupt persuader."[2]

Interestingly, the Andersen jurors said that they did not focus on Temple's October 12 e-mail reminders to comply with the company's document-retention policy, but instead cited an e-mail from Temple to Duncan asking him to alter a memo he had written for his files about the way Enron characterized its losses in public statements. Carrie Johnson and Peter Behr, *Andersen Guilty of Obstruction: Accounting Firm Will End Audit Work*, WASH. POST, June 16, 2002, at A1. However, the Andersen case, as well as other corporate accounting scandals that had emerged, had ramifications extending well beyond the actual verdict and the rationale behind it. On July 30, 2002, President Bush signed the Sarbanes-Oxley Act of 2002 into law. The new law reflects the highly publicized concern of Congress that existing criminal statutes do not provide a sufficient deterrent to corporate misconduct of the type that has come to light in the Enron, Andersen, and other recent cases. One provision of Sarbanes-Oxley, Section 802 of Title VII, is entitled "Criminal Penalties for Altering Documents," and adds 18 U.S.C. § 1519 to the U.S. Code:

> Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.

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[2]Carrie Johnson and Peter Behr, *Andersen Guilty of Obstruction: Accounting Firm Will End Audit Work*, WASH. POST, June 16, 2002, at A1. The jury's unanimous agreement on the identity of the corrupt persuader deprived the defense of a basis for appeal, which was widely anticipated when during deliberations the jurors asked for the court's guidance on whether they had to all agree on the identity of a single corrupt persuader. The court replied that the jury must find that at least one agent of Andersen acted with the required knowledge and intent, but that they need not agree unanimously that it was the same person.

  ISBN 1056 3059

Section 1519 provides a more comprehensive basis for liability than either Section 1512(b) or Section 1505, discussed above. Section 1512 (b), the offense with which Andersen was charged, reaches destruction of evidence with intent to obstruct an official proceeding that may not yet have been commenced. However, Section 1512(b) does not reach the "individual shredder." While prosecution of obstruction under 18 U.S.C. § 1505 does not require "corrupt persuasion," it requires the existence of a pending proceeding. Under new Section 1519, the law explicitly reaches activities by an individual "in relation to or contemplation of" any matters. No corrupt persuasion is required.

Avoid a Spoliation Problem with a Document Retention/Destruction Policy. The most effective tool for minimizing charges of spoliation — real or perceived — is a well-constructed, reasonable document retention/destruction policy, adhered to with consistency and not just when storm clouds gather. While no one policy will be appropriate for every company or every situation, what follows are some general guidelines for creating and maintaining a reasonable policy.

1. **Policies should take into account administrative or regulatory record-keeping requirements**. Good management practice requires that files be purged on a regularly scheduled basis, unless the law dictates otherwise. Numerous record-keeping requirements imposed by law dictate that certain records be retained for specified periods of time. For example, Rule 17a-4(b)(4) of the Securities Exchange Act of 1934 requires that originals of all communications (including e-mails) sent by a broker-dealer be preserved for three years. 17 C.F.R. § 240.17a-4(b)(4). Certain tax records and employment records are also required to be maintained for a certain period of time.

2. **Policies should be adhered to uniformly**. Even the most thoughtfully constructed policy may not protect a company if its application is haphazard and uncoordinated. Management must communicate the policy to the appropriate employees, employees must understand the implications of the policy and comply with it consistently, and the policy should be monitored and enforced.

3. **Policies should cover more than just paper documents**. Make sure all storage media and communication resources are covered, *e.g.*, e-mail, facsimile, video-conferencing, etc. Companies should consider requiring e-mail and other non-vital electronic data to be destroyed every 30 to 120 days, not only to free up electronic storage space but to eliminate potentially embarrassing but long-forgotten communications.

4. **Policies should be reasonably tailored**. Management should be able to identify the reasonable business needs underlying the policy and justify the way in which documents are scheduled for destruction.

5. **Procedures should be in place to quickly effect suspension of the policy**. Document destruction should be suspended immediately if litigation or government investigation is foreseeable or pending. Adequate safeguards must be in place to ensure that an executive or general counsel can quickly notify the appropriate personnel that certain documents need to be preserved.

Conclusion. As Arthur Andersen and other companies are learning, the only thing more dangerous than not having a comprehensive document retention and destruction policy is to apply that policy in the breach, or with inconsistency, or with great fidelity only after the company is on notice of an investigation or claim or is embroiled in actual litigation.

ISBN 1056 3059