

# *Victor Stanley*: A Valuable Reference Tool Involving Harsh Sanctions for Intentional Spoliation

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## *Introduction*

A recent must-read opinion in the case of *Victor Stanley, Inc. v. Creative Pipe, Inc.*, authored by Chief U.S. Magistrate Judge Paul Grimm, provides an unprecedented analysis of spoliation sanctions nationwide.<sup>1</sup> In *Victor Stanley*, the plaintiff alleged copyright infringement, unfair competition, and other causes of action arising from the defendants' alleged theft of plaintiff's product drawings used to produce a competing product. Against a background of extraordinarily egregious—and nearly criminal—discovery misconduct, Judge Grimm catalogues how each nefarious action by the defendants constitutes spoliation. Judge Grimm's opinion, however, is extremely important for lawyers and e-discovery professionals not for its recitation of the extreme fact pattern that (hopefully) is unlikely to be oft-repeated, but for the deeply analytical manner in which Judge Grimm reached his decision. The opinion includes a detailed analysis of the various standards which have been applied by nearly all federal courts. It will serve, therefore, as a vital reference tool for the current view of the federal bench regarding analysis of e-discovery spoliation.

In an appendix to his already extensive opinion, Judge Grimm details by federal circuit the standards applied to the scope of the preservation duty, culpability and prejudice requirements, and corresponding culpability jury instructions. The

thorough guidance presented by Judge Grimm is applied to a set of almost unbelievable acts by the defendants to destroy evidence, lie to the Court and opposing party about that destruction, and refuse to abide by the Court's numerous discovery orders.

## *The Defendants' Egregious Acts of Spoliation*

Determining the extent of damage in a spoliation case is usually a difficult, expensive, and time-consuming task. Courts are, moreover, often unable to determine the real prejudice caused by a spoliator's efforts. *Victor Stanley* is an exception. Due to the persistence of *Victor Stanley* (VSI), Judge Grimm was able to document an amazing number of instances where the defendant, Mark Pappas, president of defendant Creative Pipe, Inc., (CPI), attempted, in some instances successfully, to permanently destroy electronically stored information (ESI). Indeed, Judge Grimm noted that this was not the first time Mr. Pappas had deleted evidence in a lawsuit.<sup>2</sup> In his divorce proceeding, another court found that Mr. Pappas deleted relevant electronic evidence and thus issued a restraining order prohibiting him from making further deletions.<sup>3</sup> Judge Grimm found that this prior incident was further relevant to Mr. Pappas's state of mind in *Victor Stanley*.<sup>4</sup>

Although lengthy, Judge Grimm's recitation of the impressive number of mind-boggling acts the defendants took to destroy evidence is worthwhile

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reading. In an attempt to organize the numerous bad acts, Judge Grimm placed each of them in the following eight categories:

1. Failure to implement a litigation hold order;
2. Deletions of ESI soon after VSI filed suit;
3. Failure to preserve an external hard drive after the plaintiff demanded preservation of ESI;
4. Failure to preserve files and e-mails after the plaintiff demanded their preservation;
5. Deletion of ESI after the Court issued its first preservation order;
6. Continued deletion of ESI and use of programs to permanently remove files after the Court issued its second preservation order;
7. Failure to preserve ESI when Mr. Pappas replaced the CPI server; and
8. Further use of programs to permanently delete ESI after the Court issued numerous production orders.

Among the most incredible acts of spoliation were:

- Mr. Pappas's repeated intentional deletions of at least 13,500 files immediately following Judge Grimm's orders to preserve evidence;
- Running at least three different hard disk "cleaner" programs to "scrub" his computers after Judge Grimm issued multiple orders to preserve and produce evidence;
- Instructions to third parties involved in the theft of VSI's drawings to destroy their files; and
- Failure to preserve more than 62,000 files on an external hard drive that he simply returned to Office Max after using it.

Based on the circumstances of the deletions, including piecing together evidence of Mr. Pappas's

computer usage and expert testimony, Judge Grimm found each of these acts were intended to delete relevant evidence and caused prejudice to the plaintiff.

#### *The Court's Legal Analysis*

#### **When do acts of spoliation warrant sanctions?**

In his opinion, Judge Grimm embarks on a comprehensive discussion of the legal standards applicable in the U.S. Court of Appeals for the Fourth Circuit to sanctions for spoliation of evidence, as well as a comparison to other circuits which is summarized in the opinion's appendix. Judge Grimm also liberally cites Judge Shira Scheindlin's recent opinion in *Pension Committee of University of Montreal Pension Plan v. Banc of America Securities, LLC*.<sup>5</sup> Judge Grimm noted that recent decisions on sanctions concerning spoliation of ESI

have generated concern throughout the country among lawyers and institutional clients regarding the lack of a uniform national standard governing when the duty to preserve potentially relevant evidence commences, the level of culpability required to justify sanction, the nature and severity of appropriate sanctions, and the scope of the duty to preserve evidence and whether it is tempered by the same principles of proportionality that Fed. R. Civ. P. 26(b)(2)(C) applies to all discovery in civil cases.<sup>6</sup>

Judge Grimm stated that he hoped this analysis would "provide counsel with an analytical framework that may enable them to resolve preservation/spoliation issues with a greater level of comfort that their actions will not expose them to disproportionate costs or unpredictable outcomes of spoliation motions."<sup>7</sup>

Judge Grimm further noted that a federal court has two main sources of authority to impose spoliation

sanctions—the inherent power to control the judicial process and litigation, and the authority granted pursuant to Rule 37(b)(2) of the Federal Rules of Civil Procedure.<sup>8</sup> Judge Grimm determined that he had authority under Rule 37(b)(2) to impose sanctions for the violation of both his four orders to produce discovery and his three orders to preserve evidence even though those preservation orders did not order the production of the preserved evidence.<sup>9</sup>

To prove that spoliation warrants a sanction in the Fourth Circuit, Judge Grimm stated that a party must show that

(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, to the extent that a reasonable fact finder could conclude that the lost evidence would have supported the claims or defenses of the party that sought it.<sup>10</sup>

With respect to the first requirement of preservation, Judge Grimm focused on proportionality issues, stating that

[a]lthough, with few exceptions, such as the recent and highly instructive *Rimkus* decision, courts have tended to overlook the importance of proportionality in determining whether a party has complied with its duty to preserve evidence in a particular case, this should not be the case because Fed. R. Civ. P. 26(b)(2)(C) cautions that all permissible discovery must be measured against the yardstick of proportionality.<sup>11</sup>

Judge Grimm also highlighted that the different preservation guidelines adopted by district courts across the country frustrate a national corporation's ability to develop and implement defensible preservation policies. Judge Grimm opined that

[t]he only "safe" way to [comply with the preservation duty] is to design one that complies with the most demanding requirements of the toughest court to have spoken on the issue, despite the fact that the highest standard may impose burdens and expenses that are far greater than what is required in most other jurisdictions in which they do business or conduct activities.<sup>12</sup>

Moreover, Judge Grimm stated that the duty to preserve relevant evidence is owed to the court, not to the opposing party.<sup>13</sup> Thus, the court does have the power to impose fines for the spoliation of evidence for that injury to the judicial system, but the court may be required to comply with the due process procedures for criminal contempt proceedings before imposing a fine payable to the court.<sup>14</sup> In addition, in some jurisdictions, the spoliation of evidence may also be an actionable tort.<sup>15</sup>

Judge Grimm also discussed the "culpable state of mind" standard. After noting the differences among the federal district courts as to the level of intent required before sanctions are warranted, Judge Grimm applied the standard in the Fourth Circuit, which provides that "for a court to impose some form of sanctions for spoliation, any fault—be it bad faith, willfulness, gross negligence, or ordinary negligence—is a sufficiently culpable mindset."<sup>16</sup>

In discussing the relevance of the lost evidence, Judge Grimm confirmed that "[i]n the context of spoliation, lost or destroyed evidence is 'relevant' if 'a reasonable trier of fact could conclude that the lost evidence would have supported the claims or defenses of the party that sought it.'"<sup>17</sup> With respect to finding prejudice resulting from

spoliation, Judge Grimm noted that prejudice occurs "when, as a result of the spoliation, the party claiming spoliation cannot present 'evidence essential to its underlying claim.'"<sup>18</sup> Judge Grimm also noted that at least one court has found that delayed production of evidence alone can cause prejudice.<sup>19</sup> In the Fourth Circuit, the relevance of the evidence is presumed when the party shows the spoliating party acted willfully in failing to preserve evidence.<sup>20</sup> In addition, in this case, "the evidence of prejudice to Plaintiff is manifest."<sup>21</sup> Thus, Judge Grimm found in this case that defendants' willful, bad faith conduct permits the Court to presume relevance and prejudice.<sup>22</sup>

### What sanctions are appropriate?

Judge Grimm acknowledged the variety of approaches used by the different circuits when assessing which spoliation sanction is appropriate. Spoliation sanctions run the gamut and include assessing attorneys' fees and costs, giving the jury an adverse inference instruction, precluding evidence, or granting dismissal or judgment by default. This variety makes predicting the outcome of a spoliation dispute difficult, if not nearly impossible. When ordering sanctions, a court must consider the extent of the prejudice and the degree of culpability to ensure that the sanction is proportionate to the prejudice—as Judge Grimm put it, a sanction should "generate light, rather than heat."<sup>23</sup>

Unlike other circuits—including the Seventh, Eight, Tenth, and Eleventh Circuits, where dispositive sanctions require bad faith, or the Fifth Circuit which requires bad faith and severe prejudice—the Fourth Circuit has adopted an either/or test.<sup>24</sup> While the test claims that dispositive sanctions can be granted when the offending party's behavior is either egregious or when the effect is so prejudicial that the innocent party cannot defend his claim, Judge Grimm noted that the Fourth Circuit has never terminated a case involving bad faith in the absence of substantial prejudice.<sup>25</sup> When determining whether there is substantial prejudice,

"the Court must examine the record that remains to determine whether it contain[ed] enough data for the aggrieved party to build its case or defense, and the Court must decide whether a lesser sanction than dismissal [or default judgment] would level the playing field."<sup>26</sup> Relying on this standard, Judge Grimm determined that VSI's ability to prove its claim of copyright infringement was so prejudiced that it could not defend its claim and that the record clearly demonstrated defendant's bad faith. Indeed, the defendants consented to a default judgment on the copyright infringement claim as an appropriate sanction.<sup>27</sup> Thus, Judge Grimm recommended that the court grant the plaintiff default judgment and a permanent injunction on the copyright infringement claim, but not the remaining claims.<sup>28</sup>

Attorneys' fees and costs are considered less severe sanctions, and the relevant inquiry focuses less on the offending party's culpability and more on the prejudice suffered by the innocent party.<sup>29</sup> Typically, the offending party pays the costs associated with the spoliation proceedings to the innocent party. Judge Grimm found there was no justification for the defendants' actions and ordered that they pay all of the plaintiff's costs associated with discovery and litigating the spoliation issues.<sup>30</sup>

Finally, Judge Grimm considered whether and when contempt of court was an appropriate sanction. The Federal Rules of Civil Procedure permit a court to consider a party's failure to provide or permit discovery of ESI evidence as a failure to obey a court order. These sanctions may be criminal or civil. Due to the additional costs associated with a criminal proceeding and the limited resources of the U.S. Attorneys' Office, Judge Grimm noted that criminal contempt would not be worthwhile.<sup>31</sup> He did recommend, however, that Mr. Pappas be held in civil contempt and recommended that he be imprisoned, for not longer than two years, unless and until he pays the plaintiff's attorneys' fees and costs.<sup>32</sup>

### *Defendants' Objections and Final Order*

On September 23, 2010, the defendants filed objections to Judge Grimm's order on two grounds. First, the defendants argued that Judge Grimm's order of imprisonment pending payment of attorneys' fees and costs did not employ the least possible coercive power adequate to the payment of fees. The defendants argued that Mr. Pappas should be permitted to demonstrate his inability to comply with the fee payment prior to being imprisoned and that he be imprisoned only if he refuses to pay or ceases making payments toward the fee award. Second, the defendants objected to Judge Grimm's recommendation of granting permanent injunctive relief as to the copyright infringement count, arguing that the injunction was overbroad and should be modified.

On September 30, 2010, U.S. District Judge Marvin J. Garbis adopted in full Judge Grimm's Order and Recommendation. Judge Garbis left in place the recommended term of imprisonment for two years "unless and until [Mr. Pappas] pays to Plaintiff the attorney's fees and costs that will be awarded." Judge Garbis did specify with respect to the injunctive relief that the Court would determine the provisions of the injunction after considering the parties' respective positions. The plaintiff's bill of costs was due to be filed with the Court on October 12, 2010, with the defendants' response due on November 12, 2010.

#### *Practice Tips*

*Victor Stanley* is an extraordinary case because Judge Grimm used this opinion to provide a survey of spoliation case law throughout the federal courts. Moreover, the plaintiff was able to thoroughly document most of the defendants' wrongdoing, thus painting an amazing picture of intentional e-discovery misconduct that even the defendants could not wholly deny. For these reasons, many valuable practice tips can be extrapolated from this opinion, including:

**While your corporation may not have to adhere to the strictest ESI preservation standard, it is**

**important to avoid negligent behavior by taking all necessary actions to preserve and produce relevant data.** Each circuit relies on different standards when considering whether to grant spoliation sanctions. Depending on the circuit, severe sanctions may be appropriate even for unintentional behavior if the prejudice is great enough. It is important to avoid negligence by educating in-house counsel and relevant employees on the standards applicable in your jurisdictions. When in doubt, consider adopting the strictest preservation standard among the jurisdictions where the company is involved in pending litigation.

**If your company becomes embroiled in a discovery dispute, make sure that the computer consultant or ESI expert that you hire is both capable and personally uninterested in the litigation.** You should expect that the opposing party will hire the best available expert and your expert will be testifying against the opposing expert. Therefore, you want your expert to be educated and experienced in the most up-to-date technology and forensic methods as well as personally credible. In *Victor Stanley*, the court discredited the defendants' expert for his lack of experience and because he was married to one of the defendants' employees. Further, when using an expert to examine the opposing party's data, ensure that your expert is knowledgeable enough to assist counsel in piecing together all of the forensic facts to present a completed puzzle of the opposing party's acts to the judge. As can be seen in *Victor Stanley*, when the court can determine the relevance of lost data through all types of nefarious user activities on a computer during a given time period, the case for sanctions will be much stronger.

**Cooperate with your ESI expert.** The more information you share with your ESI expert the better the preservation and collection process will operate. For example, tell the expert how your network is managed, when and how often your network is backed up, what servers likely contain relevant custodian data, and if there are any locations containing relevant data that might be

difficult to identify, such as external hard drives and other removable media.

**Whenever possible, fully image custodians' hard drives and relevant server space, as opposed to conducting only a targeted collection.** While there are situations where targeted collections may be sufficient, such as when a server hosts hundreds of custodians and relevant documents are contained with only three of those custodians, imaging allows both the active and unallocated space to be preserved, which facilitates a more complete preservation and production, including deleted data, if it becomes a matter of contention later in the litigation.

### Conclusion

While in-house and outside counsel, along with the federal judiciary, will continue to struggle with interpreting the Federal Rules of Civil Procedure and varying e-discovery standards in the federal circuits, Judge Grimm's opinion certainly goes a long way toward analyzing and explaining the different standards that are currently applicable when addressing e-discovery spoliation across the country. Counsel should take advantage of Judge Grimm's thorough opinion by incorporating its lessons into their client's e-discovery preservation, collection, and production protocols in order to avoid spoliation and the resulting sanctions. A uniform national standard governing e-discovery obligations and sanctions may either be a pipe dream or years in the making, but until that uniform standard evolves, opinions like the one issued by Judge Grimm give litigants some hope and guidance in navigating the complex and ever-changing e-discovery legal landscape.

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<sup>1</sup> No. 06-cv-02662, 2010 BL 209330 (D. Md. Sept. 9, 2010).

<sup>2</sup> *Id.* at 8 n.10.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> 685 F. Supp. 2d 456 (S.D.N.Y. 2010). Judge Scheindlin's opinion in *Pension Committee of the University of Montreal v. Banc of America Securities, LLC*, raises the bar on the standards clients and their counsel will be held to in fulfilling e-discovery obligations and presents new formulations of culpability standards, burdens of proof, and the crafting of adverse inference jury charges.

<sup>6</sup> 2010 BL 209330, at 36-37.

<sup>7</sup> *Id.* at 38.

<sup>8</sup> *Id.* at 39-41.

<sup>9</sup> *Id.* at 42-45.

<sup>10</sup> *Id.* at 46 (citations omitted). The same standard is applicable in the Second, Fifth, Sixth, Seventh, and Ninth Circuits. *Id.* at 46.

<sup>11</sup> *Id.* at 50.

<sup>12</sup> *Id.* at 51.

<sup>13</sup> *Id.* at 55.

<sup>14</sup> *Id.* at 55, 60-61 (citing *SonoMedica, Inc. v. Mohler*, No. 08-cv-00230 (E.D. Va. July 28, 2009)).

<sup>15</sup> *Id.* at 55.

<sup>16</sup> *Id.* at 63.

<sup>17</sup> *Id.* at 68 (quoting *Thompson v. U.S. Dep't of Housing & Urban Dev.*, 219 F.R.D. 93, 101 (D. Md. 2003)).

<sup>18</sup> *Id.* at 69 (quoting *Krumwiede v. Brighton Assocs.*, No. 05-cv-03003, 2006 BL 74446 (N.D. Ill. May 8, 2006)).

<sup>19</sup> *Id.* at 69 (citing *Jones v. Bremen High School Dist.* 228, No. 08-cv-03548, 2010 BL 116305 (N.D. Ill. May 25, 2010) (citations omitted)).

<sup>20</sup> *Id.* at 70.

<sup>21</sup> *Id.* at 71.

<sup>22</sup> *Id.* at 71.

<sup>23</sup> *Id.* at 74.

<sup>24</sup> *Id.* at 76 (citations omitted).

<sup>25</sup> *Id.* at 75-76 (citations omitted).

<sup>26</sup> *Id.* at 75 (citations omitted).

<sup>27</sup> *Id.* at 83.

<sup>28</sup> Judge Grimm did not grant default judgment on the plaintiff's other claims, finding that the plaintiff failed to make a sufficient showing of prejudice. However,

Judge Grimm left open the opportunity for the plaintiff to make such a showing later in the case. *Id.* 82-83.

<sup>29</sup> *Id.* at 79 (citations omitted).

<sup>30</sup> *Id.* at 85. Judge Grimm also discussed the sanction of adverse jury instructions, but did not issue that sanction in this case. *Id.* at 77 (citations omitted).

<sup>31</sup> *Id.* at 85-86.

<sup>32</sup> *Id.* at 86-87.