102 Discovery in the Electronic Era

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Frank Michael D'Amore is senior managing director of Major, Hagen & Africa in Villanova, Pennsylvania.

Mr. D'Amore was previously vice president of business development and general counsel of InterNetEx, Inc., a Philadelphia-area document management ASP. In addition to his general legal responsibilities, Mr. D'Amore handled the company's partnership relations, sales function, and investor presentations. Mr. D'Amore also served as vice president and general counsel of KV Pharmaceutical Company, a St. Louis based, publicly traded pharmaceutical company. Mr. D'Amore also was vice president and general counsel of Graphic Controls Corporation, a Buffalo, New York medical devices company that was acquired by Tyco International. Mr. D'Amore's in-house career started as assistant general counsel of Alcon Laboratories, Inc., a Fort Worth, Texas pharmaceuticals and medical device company that is a wholly-owned subsidiary of Nestle, S.A. Mr. D'Amore had been a partner with Philadelphia-based Saul, Ewing during the private practice portion of his career.

Mr. D'Amore has served as cochair or vice chair of ACCA's Law Department Management Committee for the past four years. He also was president of the Montgomery County, Pennsylvania Big Brothers/Big Sisters Association.

Mr. D'Amore is a Phi Beta Kappa graduate of Boston College. He attained his JD from the George Washington University National Law Center.

Bernice A. Heilbrunn

Bernice A. Heilbrunn managed the litigation docket for the LYONDELL-CITGO Refinery, the 8th largest U.S. refinery with annual revenues of $2.3 billion and 1250 employees. Her docket included toxic tort litigation, environmental litigation, employment mediations and litigation, commercial lawsuits, and personal injury claims. She worked closely with the documents manager to formulate a company-wide document retention policy.

In her previous role as corporate counsel for U.S. Zinc, Ms. Heilbrunn also managed the litigation docket and was responsible for responding to discovery requests for electronic documents. Ms. Heilbrunn's environmental, health, and safety experience includes all facets of federal and Texas compliance and enforcement. She has counseled clients on hazardous waste, wastewater, air permitting, administrative and civil enforcement, handling agency inspections, TSCA, CERCLA, OSHA, and environmental auditing issues. She has handled a significant number of internal investigations and due diligence reviews. She also has a strong real estate practice background, including representation of lenders

in secured transactions. Ms. Heilbrunn was a partner in New Jersey's Friedman Siegelbaum, now Goodwin Procter LLP.

She is currently chair of ACCA's Environmental Law Committee and is past president of ACCA's Houston Chapter.

Ms. Heilbrunn graduated from Harvard Law School.

Richard S. Mannella

Richard Mannella currently works in major claims management for ACE USA in Philadelphia. His responsibilities include managing and resolving complex commercial and personal injury litigation ranging from drug products, construction defects, and environmental liabilities to toxic torts, tobacco, and insurance coverage involving the company and corporate stakeholders.

Mr. Mannella is an experienced attorney with more than 10 years of comprehensive legal and managerial experience in diverse environments, including several law firms and a major pharmaceutical company.

In addition to representing ACE in mediations and other alternative dispute resolution forums, Mr. Mannella serves as an arbitrator for the Philadelphia Court of Common Pleas. He has also acted as pro bono counsel representing exceptional children in due process proceedings under the Individuals with Disabilities in Education Act.

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The Need for Federal Standards Regarding Electronic Discovery

There are vast differences between discovery of hard-copy documents and those stored electronically, and the difference should be recognized

By Thomas Y. Allman

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THE USE of electronic methods to create, transmit and store information has changed dramatically the way in which document retrieval and production in discovery should be viewed. Last October, the U.S. Judicial Conference's Federal Civil Rules Advisory Committee, through its Discovery Subcommittee, met to hear testimony for and against the proposition that the current problems with electronic discovery warrant changes in the Federal Rules of Civil Procedure.[1] Although a few of the testifying witnesses supported change, several representatives of bar groups and the judiciary did not see any need for immediate action. But there is an urgent need to treat the discovery of electronic records differently from traditional documents, and amendments to the Federal Rules are necessary to help impose order in an area of the law that is both unpredictable and increasingly subject to abuse.

ELECTRONIC RECORDS ARE DIFFERENT

The subcommittee has asked for comments on whether the use of electronic records represents a mere evolution in the discovery regime or whether it has fundamentally changed the landscape of discovery such that amendments to the rules are warranted. Two major differences create a need for the subcommittee to act and propose a different set of discovery rules.

First, the sheer volume of information available in the electronic context is materially different. Take, for example, the matter of routine inter-office communications. The use of electronic mail has increased geometrically the number of places where "copies" of those types of documents may be located. Instead of merely residing in filing cabinets filled with hard copies, electronic documents may exist both in systems designed to retain and manage such records, as well as in systems not intended for that purpose.

"Copies" of electronic records may be heroically retrieved from locations not ordinarily available to the persons engaged in such communications. For instance, part or all of "deleted" documents may be reconstructed from the hard drives of originating personal computers or from network servers relating to the computers. Such documents or document fragments also may be reconstructed from the personal computers or servers of recipients. Additionally, copies might be retrieved from "back-up" tapes that are created daily, weekly or monthly for disaster re-

1. The conference, held at Brooklyn Law School, was the second held under the auspices of the Civil Rules Advisory Committee. The first was held at Hastings College of the Law in San Francisco in March 2000. Presiding at the Brooklyn conference was Chief Magistrate Judge John L. Carroll of the U.S. District Court for the Middle District of Alabama, who is chair of the Discovery Subcommittee of the Rules Advisory Committee. Also present and participating was U.S. District Judge David Levi of the Eastern District of California.

covery purposes. The costs, including the burden and inconvenience to the ordinary operation of a business enterprise, could be enormous if all possible locations must be searched. If multiple litigation occurs in overlapping time frames, the costs would increase geometrically. These and other practical problems are not readily apparent to some courts, which have failed to perceive that different burdens exist with respect to electronic records.[2]

A second major difference is the entirely new class of "embedded" information that may be available in the electronic discovery world. Obtaining this information, which may include such data as editing histories or creation and access dates, usually requires the application of forensic technologies and can increase discovery costs substantially. It is yet to be seen whether this type of electronic information is within the scope of discovery, and it may be necessary to clarify definitions in the rules relevant to this information.[3]

In short, whether acknowledged or not, the retrieval of electronic information for purposes of discovery is different in kind and burden from the efforts associated with hard-copy discovery.

FAILURE TO DIFFERENTIATE

To protect against discovery abuse, Rule 26(c) allows issuance of "protective" orders, and courts are directed by Rule 26(b)(2) to balance the likely benefit against the burden or expense to the producing party on a case-by-case basis. In the early phases of the discovery of electronic data, this generic approach was sufficient since technology was less complicated and in addressing electronic data, the 1970 amendment to Rule 34 intended only "ordinary business records" kept by electronic means to be subject to production.[4] In this regard, courts routinely required that requesting parties pay some or all of the extraordinary costs associated with discovery demands.[5]

However, as technical consultants have acquired greater influence and publicity has attached to extreme cases, requesting parties increasingly have argued that all electronic records—no matter how remote or difficult to locate—must be retrieved at the cost of the producing party. One oft-cited opinion in this regard occurred in the long-running *Brand Name Prescription Drug Antitrust Litigation*, and it does not acknowledge the distinction among types of records and asserts that placing the retrieval obligation on the producing party is entirely appropriate.[6] This approach is apparently based on a misplaced conviction that, regardless of the burdens or complexities, the litigation process contemplates discovery to the full extent of any available technology.[7]

Adding to the problem is the misconception that the production of electronic

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2. *See, e.g.*, Linnen v. A.H. Robins Co., 1999 Mass.Super. Lexis 240, *16 (June 16, 1999) (entering sanctions for failure to preserve backup tapes and holding that "discovery request aimed at the production of records retained in some electronic form is no different, in principle, from a request for documents contained in an office file cabinet").

3. Judge Shira A. Scheindlin of the U.S. District Court for the Southern District of New York and a member of the Civil Rules Advisory Committee, has co-authored an article noting that electronic records often contain a "new breed" of "embedded" information that may not even be covered by Rule 34 as it currently exists. *See* Scheindlin and Rabkin, *Electronic Discovery in Federal Civil Litigation: Is Rule 34 Up to the Task?* 41 B.C. L. REV. 1 (2000) (advocating amendments to Rule 34 to rectify issues identified).

4. *See* Pearl Brewing Co. v. Jos. Schlitz Brewing Co., 415 F.Supp. 1122, 1136 (S.D. Tex. 1976); MANUAL FOR COMPLEX LITIGATION (THIRD) at § 21.446 ("information generated and maintained in the ordinary course of business").

5. *See* Zonaras v. Gen. Motors Corp., 1996 U.S. Lexis 22535, 1996 WL 1671236 (S.D. Ohio).

6. 1995 WL 360526 at *2 (N.D. Ill.) (characterizing need to implement retrieval program as "ordinary and foreseeable risk" of maintaining electronic systems).

7. *See* Bills v. Kennecott Corp., 108 F.R.D. 459, 463-64 (D.C. Utah 1985) (refusing to allocate costs of producing computer data to requesting party and holding that "information stored in computers should be as freely discoverable as information not stored in computers").

records is easy to accomplish—the "press the button" syndrome—which is not the case at all. Computer systems are far more complicated, and are designed and operated for business needs that have nothing to do with litigation. A one-sided concentration on production of all electronic copies without acknowledging the differences between electronic and paper copies risks undermining the practical interpretation of Rule 34 adopted in paper copy discovery. Parties in that context routinely seek to produce in the first instance documents that are readily accessible to identifiable personnel who may retain or have access to them in the ordinary course of business. Similarly, parties seeking to comply with the duty to preserve relevant records after notice of a claim or litigation appropriately notify only the same discrete and predictable class.

Without clear guidance from the rules that recognizes the differences between electronic data and traditional documents, however, there is a serious risk that parties planning their compliance will be confused as to the continued acceptability of these practices. Indeed, parties that proceed in good faith to produce electronic records reasonably identifiable and reasonably available in the ordinary course of business are at risk that perfectly appropriate business actions taken in accordance with past practice will be deemed later to be inappropriate.

At any given time, large commercial and governmental users may be defending hundreds of cases, all started at different times and all alleging different claims. When each successive litigation requires restriction on the reuse of backup tapes because of the mere possibility that some needle might be found in a massive electronic haystack, the entity finds itself in the unenviable position of converting its backup systems into de facto litigation storage barns, a burden never intended by the Federal Rules.[8] Indeed, the inadvertent failure to produce backup tapes held for one pending case in a successive case has led to sanctions—including spoliation inferences—when judged in retrospect.[9] This is an unworkable standard that forces large users to choose between maintaining their normal business operations and surrendering valid claims or defenses.

CHANGES TO RULE 34

The basic duty of production of electronic records should, like hard copy discovery, extend in the first instance only to those records that are reasonably available in the ordinary course of business. While there is no real disagreement with this position, several testifying witnesses at the Advisory Committee's session disagreed that this principle should be embodied in the Federal Rules. Some who took this position asserted that most disputes were resolved by reaching a practical compromise, and thus there was no need to amend the rules. Others pointed to the tools available in the rules that permit judges to fashion relief from onerous production requests, especially the balancing provisions of Rule 26(b)(2), and they stressed the merits of a case-by-case approach.

Rather than leaving parties to guess at their responsibilities, however, it would be much fairer for everyone to have an understanding of where the line exists without having to litigate that point in each case. For example, the Texas Rules of Civil Procedure contain useful guidance in this regard. Texas Rule of Civil Procedure 196.4, denominated "Electronic or Magnetic Data," requires a responding party to produce electronic or magnetic data that "is

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8. *See, e.g.*, Applied Telematics Inc. v. Sprint, 1996 U.S. Dist. Lexis 14053 at *11, 1996 WL 539595 (E.D. Pa. Sept. 18, 1996) (holding defendant "at fault for not taking steps to prevent the routine deletion of the backup files"); In re Tyco Sec. Litig., 2000 U.S. Dist. Lexis 11659 at *9 (D. N.H. July 27, 2000) (finding that "large corporations typically overwrite and thereby destroy electronic data in the course of performing routine backup procedures").

9. Linnen, *supra* note 2, at *31 ("failure to preserve documents requested by a party is inexcusable conduct").

reasonably available to the responding party in its ordinary course of business" and provides that the party may object to production if "reasonable efforts" do not allow for retrieval of the data or information requested.

A similar provision could be incorporated into Federal Rule 34(a) by adding this requirement:

> The responding party must produce the electronic or magnetic data that is responsive to the request and is reasonably available to the responding party in the ordinary course of business. If the responding party cannot—through reasonable efforts—retrieve the data or information requested or produce it in the form requested, the responding party must state an objection complying with these rules.

Such a rule would help both requesting and producing parties; it also would guide and inform the magistrate and district court judges called on to resolve disagreements. Requiring a producing party to search its electronic records beyond those maintained and readily available in the ordinary course of business flies in the face of the fundamental principle that each party must bear the "ordinary burden of financing his own suit."[10]

Of course, there are instances in which the special requirements of individual cases would require production of electronic records not maintained in the ordinary course of business. In those circumstances and when the case is made for an extraordinary production effort beyond that required as a matter of course, Rule 34 could explicitly incorporate a cost allocation that reflects that fact.

Analogous to Texas Rule 196.4, Rule 34 could require:

> If the court orders production by the party upon whom the request is served, the court must also order that the requesting party pay the reasonable expenses of any extraordinary steps required to retrieve and produce the information.

Anecdotal information from the Texas experience indicates that predictable allocation of costs has helped reduce the overbroad nature of many requests.

SPOLIATION AND PRESERVATION

Large users of electronic records have legitimate business reasons to eliminate redundant or stale electronic records not intended for retention as business records. Some people have argued, however, that in view of the compact size and relative ease of retention of electronic records, producing parties have "no excuse" not to retain all such material forever. This argument is totally inconsistent with implementation of retention policies,[11] and it has had a paralyzing effect on development of those policies. It would be useful to have an explicit amendment to Rule 34 stating that parties should not be required to suspend the normal operation of reasonable document destruction without prior court orders.

The amendment also should limit spoliation sanctions to willful violations of such orders. For example, Rule 34(d) could provide:

> No sanctions or other relief predicated upon a failure to maintain or preserve documents or data, including electronically stored information, shall be entered in the absence of a discovery request that describes with particularity the specific documents or data requested and evidence that (1) the documents or data requested were relevant to the claim or defense of a party and (2) the party upon whom the request was served willfully failed to preserve such documents or data. Evidence that reasonable steps were undertaken to notify relevant custodians of preservation obligations shall be prima facie evidence of compliance. Nothing in these rules shall require the responding party to suspend or alter the operation in good faith of disaster recovery or other electronic or computer systems absent court order issued upon good cause shown.

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10. Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 179 (1974).
11. *See* Lewy v. Remington, 836 F.2d 1104 (8th Cir. 1988).

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This approach is consistent with American Bar Association Civil Discovery Standard 29(a)(iii), which provides for the restoration of material deleted in the regular course of business only on a showing of substantial need.

CONCLUSION

There are significant and important differences between hard copy and electronic discovery, and these differences have consequences in both the litigation process and business world. The unfair and disruptive effects of electronic discovery, if pressed to the limits of Rule 34, are simply not obvious to those who do not routinely deal in the multiple litigation environments found in the modern world of litigation. The authors of the Federal Rules of Civil Procedure should take into account how those differences are impacting both worlds.

Program 102

"Discovery in the Electronic Era"

The Nature of Electronic Information

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InterNetEx, Inc.[1]

The information age is no longer a sobriquet of a time that may be approaching. It is upon us, and has been for quite some time.

The impact of this transformation on litigation has been profound. One important aspect that has dramatically changed is the nature of document discovery. No longer does one only sit in an opponent's conference room and page through dusty records which are flagged for copying. Rather, information can be found in a plethora of locations, many of which can be accessed from your desktop.

In the litigation arena, "it is black letter law that computerized data is discoverable if relevant."[2] This is consistent with Federal Rule of Civil Procedure 26 (and many state counterparts), which obligates parties to provide opponents with copies or descriptions of documents, *data compilations*, and tangible things in the party's possession, custody, or control.

A typical discovery request may ask for documents which include: data stored in a computer, data stored on removable magnetic or optical media (such as recordable optical disks, floppy disks, and magnetic tape), data used for electronic data interchange, e-mail, audit trails, digitized pictures and video (such as those stored in AVI or JPEG formats), digitized audio, and voice mail.

The purpose of this article is to provide background on *electronic documents*. Specifically, the intent is to provide an overview of the *types* of electronic documents and where they can be *found*.

I. Types of Electronic Documents

The breadth of a typical discovery request will encompass virtually any type of electronic document that can be imagined. Nevertheless, it is important to know the many different forms that exist.

The following is a checklist of the key types of electronic documents. Some brief comments, where necessary, are included.

[1] Mr. D'Amore subsequently has become a Senior Managing Director in the Philadelphia, Pennsylvania office of Major, Hagen & Africa.
[2] *Anti-Monopoly, Inc. v. Hasbro, Inc., 94 Civ. 212, 1995 U.S. Dist. LEXIS 16355 (SDNY 1995).*

A) Word Processing Programs

Microsoft Word® and WordPerfect® are the most prevalent. It is important, if your company does not have both programs, to be careful in converting documents. Critical information can be lost, or miscast, in the conversion process.

One also should be aware of hidden data that is often lurking in word processing documents. In Word, for example, the File/Properties pull-down menu can provide key information, including who originally prepared a document, the number of times it was revised, and the dates on which the revisions were made. Additionally, depending on how the document was saved, one may also be able to track previous changes that were made to the document that were not intended to be made known to outsiders. The "Comments" utility also can contain background information that could be significant.

B) Spreadsheets

Microsoft Excel® is the most common program, while Lotus 1-2-3® still has its adherents. These documents also have hidden information, most of which can be found in formulae that are used for data calculation.

C) Database Programs

There are innumerable database programs. A common program that many persons use is Microsoft Access®. These programs are also rife with hidden data, which include: field name explanations, tables, queries, forms, reports, modules, hidden fields, and macros. Many companies use databases that have are central to their operations, the programs of which were customized for them.

D) HTML Documents

Electronic documents are not only captured in .doc or .txt files. HTML is used on many websites and is an increasingly popular format to use in creating documents.

E) Operating Systems

The operating system on a desktop computer or server also contains a variety of data . This includes temporary files, registration information, and programs such as Notepad.

F) E-mail

This is the hot discovery area du jour. Despite its march toward ubiquity, many authors still use this communication tool quite carelessly. As a result, many a smoking gun has been found among stacks of e-mail messages.

E-mail data include the text of the actual message, attachments that are appended to the message, and header information (which reveals the name of a recipient and transmittal/receipt times).

Searchers should look beyond the local or network hard drive of a specific user. Many persons, even in corporate settings, keep company-related data in private e-mail accounts (such as Hotmail, Yahoo!, Excite, and others).

G) EDI

Electronic Data Interchange ("EDI") is a common vehicle used for business ordering and purchasing. EDI documents provide wonderful audit trails of business activity.

H) Faxes

A category that e-mail has almost rendered antiquated. Nonetheless, faxes are still prevalent and contain good audit trails (such as whether a transmission was received, date, time, etc.).

I) Voice Mail

This may not leap to mind, in thinking about documents, but voice mail contains critical business information. Many companies keep logs of voice mail, which can contain detailed tracking information.

J) Electronic Calendars/Contact Management Programs

Microsoft Outlook®, ACT®, and other similar programs are loaded with data. As many persons keep and synchronize their calendars on the Internet, one should remember to check the "Favorites" tab or other browser settings that would lead to such sites. ECal and AnyDay are two popular on-line calendar sites.

K) Adobe Acrobat® PDF Documents

Adobe Corporation provides software that enables users to open documents that have been captured as PDFs (which is analogous to taking a picture of a document). Users can also save documents in this format; as such, the Adobe program on a hard drive can also contain key information.

L) ZIP® files

ZIP files are compressed versions of documents. ZIP programs are frequently used to minimize the size of files that are being sent on the Internet. Once such files are opened, they can be kept on a person's hard drive (or, actually, in any other place that data is stored). A simple search for text documents will not produce ZIP files—one must search for all file types to gain access to such files.

M) Utility Programs

There are countless utility programs that are used to simplify or expand computer usage. Many of these programs store or generate documents and other data. Antivirus, encryption, and backup programs are but three examples of such program types.

N) Cookies

Cookies, which are placed on hard drives by a web site, can provide a detailed history of areas visited on the Internet, which could be of relevance in discovery. Such information typically can be found on an individual's hard drive.

O) Browser History Files/Bookmarks

Much like cookies, the history file contained in a browser, also reveals, in much more complete detail, where a person has been on the Internet. Bookmarks flag the sites that a person finds of particular interest, which typically are visited much more often than others.

P) Temp Files

Files that are downloaded or otherwise opened after receipt are sometimes kept in a "Temp" file on a person's hard drive. In many cases, the recipient is completely unaware that such files exist. As a result, a person asked to produce documents from his file may honestly, but mistakenly, think that he generated everything, even though the Temp file was not checked.

Q) Specialized Software

There are untold numbers of programs that are tailored to specific industries or to select groups of users. Many accountants, for example, use programs such as MAS 90® or Timberline® to generate trial balances. One must become familiar with all such programs that are typically used in a company.

R) Corporate Intranet Documents

Corporate intranets contain many different types of documents (such as HR manuals, how-to guides, notices, newsletters, etc.) that may not be found elsewhere. It is an important point for a search.

S) Newsgroup postings/Website submissions

Many employees post messages in newsgroups or in other on-line fora. Additionally, on-screen documents are completed and submitted at many websites. While retrieval of such information can be maddening, cookies, bookmarks, and history files produce clues as to where such data could be found.

II. Storage Locations

The documents and other data discussed above can be found in many different media. The following are the most common locations:

A) Desktop Hard Drive

The most obvious, and logical starting point for any electronic document search, is the hard drive of an employee's desktop computer. Typically, this is where one will find the most documents. In conducting a search on a hard drive, it is critical that one not restrict the hunt to "active" or visible documents.

In many instances, an employee may have marked a document to be "deleted" or "erased." Such a designation does not instantly get rid of a document; rather, the data remains on the hard drive until its sector is overwritten. If the computer were never used again after a document were deleted, the data would survive forever.

As many persons also do company-related work on home computers, the hard drive of such home machines may also be a data source.

B) Laptop Hard Drive

The hard drive of an employee's laptop similarly is replete with data. As some companies use laptops in pools, it is possible that a single employee's data could be found on multiple laptops.

C) Network Servers

Company networks typically are an excellent data repository. In fact, many companies discourage copying of files to hard drives, as they prefer having files available to all persons on the network.

Servers can be found within the environs of a company, in off-site locations owned by the company, or in third-party sites that either co-locate company servers or use servers that are owned by the third-party.

D) Data Tapes

Tapes are typically used for back up purposes. As with servers, such tapes can be found in on or off-site locations.

E) Zip® or Jaz® Disks

Iomega Corporation manufactures removable media, such as its popular Zip and Jaz Disks. Many persons back up data on these disks.

F) DVDs

Digital Video Disks ("DVDs") can be used to store significant amounts of data. DVD drives are becoming standard items on many desktop and laptop computers.

G) CDs

A number of CD media are currently in use. Computer Disk Read Only Memory ("CD-ROMs") are produced with data that can be reviewed, but not edited. Such CDs have become quite common.

Computer Disk Recordable ("CD-R) media can be written to one time to store data (including sound files).

Computer Disk Recordable or Write ("CD-RW") media can be written to multiple times. CD-RWs, however, at this time, cannot store many sound file formats.

H) Floppy Disks

A media that is well on its way to extinction. 5.25 floppies can hardly be found anymore, while the use of 3.5 disks is also in decline. The advent of CD-RW drives, network storage, and online backup and storage, has significantly impacted the use of such disks.

I) Online Storage Sites

Many persons are becoming much more comfortable with using Internet-based storage sites, such as X-Drive, for the storage of files. Other sites, such as those that offer e-mail accounts (such as Hotmail), can also be used to store documents.

J) Optical Disks

This media uses low-powered lasers to record and retrieve digital (binary) data. Optical storage provides greater memory capacity than magnetic media because laser beams can be controlled and focused much more precisely than tiny magnetic heads.

K) Holographic Storage

Three-dimensional optical storage of digital images has been keeping scientists and engineers fascinated for many decades. This has the potential to be the next quantum leap in the storage arena. Very fast information storage and projected storage densities in the order of 10 to 100 gigabytes per cubic centimeter are projected.

L) Video

Information can also be found on video cameras and vide tapes. Companies, for example, use this media for training purposes, which may be of relevance in certain cases.

M) Buffer Memory

The memory installed on certain printers, scanners, and digital copiers can store data, typically in the range of one to five megabytes. This amount of memory can store several hundred pages of text.

N) Back-Up Tapes

Most IT staff back up network data on a daily, or at least weekly, basis. Back-up tapes can also be found at off-site locations, such as ISPs, ASPs, and companies that run VPNs.

O) LAN-Connected PCs

Some Local Area Networks ("LANs") that are set up inside of companies have attached computers that are only used for independent storage purposes. Such computers must be examined in any search.

P) Voice Mail Systems

Company voice mail systems contain communications that can be of relevance to a discovery investigation. Voice mails can be found on back-up tapes or in the active system.

Q) PDAs, Cell Phones, Pagers, Organizers

Personal Digital Assistants ("PDAs"), such as Palm Pilots® or Compaq iPaQs®, cell phones, pagers, and organizers can contain valuable information. Such information can include contact data, documents, audio, and messages. In light of

the ease of synching with one's work computer, much business-related information can be found on these devices.

R) ISPs

Internet Service Providers ("ISPs") may be used to store data that is kept on the ISP's own servers or on servers that are owned by a company, but co-located at the ISP.

S) ASPs

Application Service Providers ("ASPs"), such as InterNetEx or NetDocuments, store documents that have been uploaded to the Internet. These documents could reside on servers that are maintained by the ASP or at third-party locations, such as ISPs.

T) Peer to Peer

Peer to Peer technology (such as Gnutella) uses no central or independent file storage. Rather, users have remote access to each other's hard drive. Consequently, documents generated by Person A could be pulled off his hard drive by Person B and could therefore be found on Person B's hard drive. The scope of a discovery search could necessarily widen as a result.

U) Computer Logs, Audit Trails, Access Lists

Computer logs, audit trails, and access lists can be a treasure trove of data. This information is typically generated by network software. These sources record information about when, where, and who accesses a network. The level of detail can include the exact computer at which an employee was working at a specific date and time. Logs and audit trails may also contain information about who modified a file and when the change was made.

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Only the Westlaw citation is currently available.

United States District Court, N.D. Illinois, Eastern Division.

David DANIS, on behalf of himself and all others similarly situated,
Plaintiffs,
v.
USN COMMUNICATIONS, INC., et al.,
Defendants.

No. 98 C 7482.

Oct. 23, 2000.

REPORT AND RECOMMENDATION

SCHENKIER, Magistrate J.

***1** Day in and day out, in countless courts throughout this country, courts resolve disputes of every kind imaginable. Even when disappointed (or outraged) by the outcome, the parties to these disputes do not engage in lawlessness or self-help. Having had their day in court, the parties accept judgment and move on with their lives. They would not do so unless they had faith in the integrity of our judicial system. Not a faith that the system is perfect and will never err, but rather a faith that the system will give the parties a fair opportunity to be heard.

This fair opportunity to be heard is achieved through lawyers for each side, having obtained and marshaled the relevant evidence, presenting their clients' respective positions vigorously. Our system is premised on the view that through this clash of competing stories, judges and juries will have the information they need to make a fair decision. In our system of civil litigation, the discovery process is the principal means by which lawyers and parties assemble the facts, and decide what information to present at trial.

Federal Rule of Civil Procedure 26 requires a party to produce non- privileged documents which are "relevant to the subject matter involved in the pending action." That requirement embraces not only documents admissible at trial but also documents and information that are "reasonably calculated to lead to the discovery of admissible evidence." This broad duty of disclosure extends to all documents that fit the definition of relevance for the purposes of discovery--whether the documents are good, bad, or indifferent. While it may seem contrary to the adversarial process to require such "self-reporting," it is in fact a central tenet of our discovery process. The duty of disclosure finds expression not only in the rules of discovery, but also in this Court's Rules of Professional Conduct, which prohibit an attorney from "suppress[ing] any evidence that the lawyer or client has a legal obligation to reveal or produce," Rules for the Northern District of Illinois, LR 83.53.3(a)(13), or from "unlawfully obstructing another party's access to evidence.... *Id.* LR 83.53.4(1).

This duty of disclosure would be a dead letter if a party could avoid the duty by the simple expedient of failing to preserve documents that it does not wish to produce. Therefore, fundamental to the duty of production of information is the threshold duty to preserve documents and other information that may be relevant in a case. That duty, too, finds expression in this Court's Rules of Professional Conduct. *See* Rules for the Northern District of Illinois, LR 83.53.4(1) (a lawyer shall not "unlawfully alter, destroy, or conceal a document or other material having potential evidentiary value").

Suffice it to say, there is no "bad document" exception to these duties of preservation and production. These twin obligations are so ingrained in our system, and in the lawyers and parties who operate within it, that the obligations routinely are discharged without question. Parties and attorneys frequently are called upon to preserve and produce documents that are against their interest in a particular case. And when they do so, the parties and the attorneys uphold the integrity of our litigation system and inspire confidence in it.

***2** Conversely, when a charge is made that relevant information has been destroyed, and especially when a charge is made of intentional destruction, it is a charge that strikes at the core of our civil litigation system. The motion presently before this Court presents just such a charge.

This lawsuit involves a class action brought by two groups of purchasers of common stock issued by USN Communications, Inc. ("USN"), which is now in bankruptcy. The suit alleges a variety of federal securities law violations against three groups of

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defendants: (1) eleven officers or directors of USN; (2) three companies who managed the underwriting of USN's initial public offering in February 1998; and (3) the accounting firm that audited USN's financial statements and provided various consulting services to USN. In earlier rulings in this case, the District Judge denied a motion to dismiss (except as to one claim against certain individual defendants), and certified the case as a class action, with the class period running from February 4, 1998 to November 20, 1998. The trial in this case is set to commence on December 4, 2000.

On December 13, 1999, plaintiffs filed a motion for sanctions against six of the eleven individual officer and director defendants: Richard Brekka, J. Thomas Elliott, James Hynes, William Johnston, David Mitchell, and Eugene Sekulow. Mr. Elliott is the only one of those defendants who held the position of inside director to USN during the class period; the remaining defendants named in the motion were outside directors to USN during the class period. Plaintiffs premised their motion on the assertion that "USN employees, acting at the direction or under the supervision of the individual defendants and USN's senior officers, destroyed virtually all evidence of the massive fraud alleged in plaintiff's complaint" (Pls.' 12/13/99 Mot., at 1). As a sanction for this alleged misconduct, plaintiffs sought the most draconian remedy available under the rules against the individual defendants named in the motion: a default judgment.

On January 13, 2000, the District Judge referred the motion to this Court for a report and recommendation (doc. # 117) (subsequently, the referral was expanded to all discovery motions) (doc. # 131)). This Court held a status hearing on the sanctions motion on January 21, 2000. At that time, it was obvious that little discovery had yet been done in the case: no documents had yet been produced from USN, and no depositions had yet been taken. Accordingly, the Court entered and continued plaintiffs' motion for sanctions pending completion of discovery, which would allow plaintiffs (and, if necessary, the Court) to determine more precisely what, if anything, had been destroyed; what information remained available notwithstanding any alleged destruction; and what prejudice, if any, the plaintiffs had suffered. At that time, non-expert fact discovery was set to close on April 30, 2000; by an order of the District Judge dated March 14, 2000, the period for non-expert fact discovery was extended to July 7, 2000 (doc. # 151).

***3** The parties indeed have engaged in discovery--with a vengeance. In the nearly six months between January 21 and July 7, 2000, the parties exchanged in excess of one million pages of documents, and took and defended some ninety non-expert fact depositions. The discovery was not only extensive, but was extraordinarily contentious--not including the sanctions motion, this Court has been required to rule on 27 contested discovery motions brought by the various parties, both plaintiffs and defendants alike (*see* doc. 135, 137, 145, 157, 162, 165, 170, 183, 188, 191, 212, 214, 216, 225, 226, 276).

On July 12, 2000, after the completion of non-expert fact discovery, the Court discussed the status of plaintiffs' motion for sanctions. The plaintiffs indicated that they still wished to pursue the sanctions motion, and sought leave to file an addendum to advise the Court of further information developed in discovery. For their part, counsel for the individual defendants threatened to file a motion pursuant to Rule 11 of the Federal Rules of Civil Procedure if plaintiffs persisted with the sanctions motion. Because of the substantial additional information developed since the filing of the original sanctions motion, the Court suggested--and plaintiffs agreed--to withdraw their original motion for sanctions. The Court granted plaintiffs leave to file an amended motion for sanctions, if they chose to do so, by July 25, and set a briefing schedule that would apply if the motion were filed (doc. # 191).

On July 25, 2000, plaintiffs filed an amended motion for sanctions (doc. # 208), directed at the same six individual defendants as the original sanctions motion (the amended motion and memorandum will be referred to as "Pls.' 07/25/00 Am. Mem."). [FN1] The amended motion alleges, among other things, that these individual defendants are "corporately" responsible for "having supervised, sanctioned, or permitted the destruction of crucial USN ... Finance, Accounting and Sales Department hard copy and electronically stored documents and data critical to plaintiffs' proof," in violation of the Private Securities Litigation Reform Act of 1995 ("PSLRA"), 15 U.S.C. § 78u- 4(b)(3)(C)(i), a preservation order entered by the District Judge on February 2, 1999, and the Federal Rule of Civil Procedure 37 (Pls.' 7/25/00 Am. Mem. at 1-2). In the amended sanctions motion, plaintiffs continue to seek the ultimate sanction against those defendants of a default judgment. Pursuant to the schedule set by the Court, the amended sanctions motion was fully briefed as of August 15, 2000: Mr. Elliott submitted an opposing

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memorandum ("Defs.' Mem."); the outside directors joined in that memorandum, and filed an additional memorandum of their own ("Outside Dirs.' Mem."); and plaintiffs filed a reply ("Pls.' Reply Mem.").

FN1. Plaintiffs' statement that this Court ordered a sanctions motion to be filed (Pls.' 7/25/00 Am. Mem. at 1 n. 1) is incorrect. The Court did not order plaintiffs to file an amended sanctions motion; they were free to file or not to file a motion. What the Court ordered was that if such a motion were to be filed, the plaintiffs must do so by July 25.

Upon reviewing the briefs, on August 24, 2000, the Court ordered the individual defendants to present a supplemental submission setting forth, by Bates number and other identifying information, a list of certain documents that the individual defendants claimed to have produced but that plaintiffs claim they did not possess (doc. # 245). The individual defendants provided that submission on September 5, 2000 ("Defs.' 09/05/00 Submission"). On September 6, 2000, the Court ordered that the individual defendants supplement that submission, and that the plaintiffs provide copies of their Rule 26 expert reports (doc. # 275). On September 7, 2000, all parties complied with that order (*see* Defs.' 09/07/00 Submission; Pls.' 09/07/00 Notice).

***4** Because the briefs and the supporting papers raised certain issues as to credibility of statements made by various witnesses, the Court planned to hold a hearing during the week of August 21 to take in-court testimony. At the request of plaintiffs, and with the agreement of the individual defendants, the hearing was postponed to August 28-29, 2000 (doc. # 241). Thereafter, at the request of counsel for certain individual defendants, the matter was further rescheduled--over the plaintiffs' objections--to September 11-12, 2000 (doc. # 245). The evidentiary hearing took place at that time, with the parties calling a total of twelve witnesses, including two of the individual defendants on this motion--Messrs. Elliott and Hynes. [FN2] At the close of that evidentiary hearing, the Court requested (doc. # 292), and has since received, further submissions by the parties stating the fees and costs they claim to have incurred in connection with the sanctions motions and related matters (*see* Pls.' 09/29/00 Submission; Certain Outside Dirs.' 09/29/00 Submission; Elliott's 09/29/00 Submission; Hynes' 09/29/00 Submission).

FN2. The witnesses at the hearing also included an individual (George Doyle) whom plaintiffs sought leave to add to their witness list on September 7, 2000, on the ground that he would testify about "newly discovered evidence." The Court granted that motion (doc. # 283), over the written objection of the individual defendants (doc. # 282).

Before turning to the Court's findings and recommendations, the Court makes several observations about how this sanctions motion--and the case in general-- has been litigated by the parties.

Sorting out what happened here has been a challenging task not only due the complexity of some of the issues presented, but--regrettably--due to assertions of counsel that often have confused than clarified the issues. On a number of occasions, plaintiffs have asserted that certain documents were not produced, when in fact it later turned out that the documents long ago had been produced. Conversely, defendants have on occasion informed the Court that they have produced certain documents, when in fact it turned out that they had not. Moreover, throughout these proceedings, the submissions by the lawyers too often have offered overblown rhetoric rather than accurate information and careful reasoning. In the Court's judgment, there are several reasons why--despite the high level of experience and quality of the attorneys--this has occurred.

First, even to this day, neither side to this motion has demonstrated to this Court a complete mastery of what types of documents were generated by USN in the ordinary course of business, how they were used, or their significance. In part, this may be a function of the fact that USN went into bankruptcy, and that the lawyers representing the individual defendants do not have a functioning client to which they can go for ready answers to such questions. In part, this may be attributable to plaintiffs' decision to take a case in which they had six months to conduct fact discovery and, instead of focusing and tailoring their discovery efforts accordingly, attempting to compress into a six-month time frame the amount of discovery that they might have sought to take if discovery had extended for a much longer period. The result was inevitable: discovery proceeded at a breakneck pace, and information was received faster than the

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attorneys could absorb it.

***5** *Second*, the heated rhetoric is, in the Court's view, a direct result of the serious charges that plaintiffs leveled against these defendants in the sanctions motion. Accusations of intentional misconduct are not generally conducive to an atmosphere of civility and cooperation among the attorneys, and this case was no exception. The plaintiffs, of course, cannot and should not be criticized for challenging USN's program for preserving of documents: not only did they have a reasonable basis to believe that adequate preservation steps were not taken, but (as is described below), they also were right. For their part, the individual defendants only further threw fuel on the fire by steadfastly defending a preservation program that was plainly inadequate. However, in attempting to parlay that failing into a claim that their case had been undermined and that a default was appropriate, plaintiffs vastly overstated the missing evidence and its significance, and thus unreasonably upped the stakes of their sanctions motion. Again, the individual defendants did little to defuse matters. Indeed, even in their briefing in opposition to this sanctions motion, the defendants did not provide a straight-forward list of the key documents that the plaintiffs said they were missing but that they had in fact produced--until the Court ordered them to do so.

As a result, both sides were the losers. They lavished huge sums of time and money on an issue that did not remotely justify the expenditure, and which would have been more profitably spent focusing on the merits of this case.

The Court makes the following findings:

1. As of November 12, 1998, the date that this litigation commenced, USN had a duty to preserve documents and other information that might be discoverable in the litigation.

2. Plaintiffs have failed to establish that USN (or any of the individual defendants) intentionally destroyed, or directed others to destroy, documents to deprive plaintiffs of discoverable information in this case. However, plaintiffs have established that USN failed to implement adequate steps to discharge its duty to preserve documents and information that might be discoverable in this case.

3. Plaintiffs further have established that Mr. Elliott, both as a defendant himself and as Chief Executive Officer of USN, had the authority and responsibility to implement a suitable document preservation program; that Mr. Elliott was at fault for delegating that function to a person who lacked the experience to perform that job properly; and that Mr. Elliott further was at fault for failing to exercise any ongoing oversight to ensure that the job was done properly.

4. Plaintiffs have failed to establish that the other individual defendants on the motion, who were outside directors without a physical presence at or supervisory role in the day-to-day operations at USN, are at fault for the failure to implement an adequate document preservation program--although, as will be described below, their conduct is not particularly worthy of praise.

***6** 5. The plaintiffs have established that as a result of the failure to implement an adequate preservation program, certain potentially discoverable documents and information may have been lost. Moreover, the evidence shows that each side has engaged in discovery conduct that unnecessarily increased the cost of this case for the other side.

6. Plaintiffs have substantially overstated the impact of the failure of USN to implement an adequate document preservation program. The documents and information that plaintiffs claim were destroyed have, in the main, been produced--although, in some instances, that production has been by third parties rather than the individual defendants. Moreover, to the extent that there are some gaps in the production of certain categories of documents that plaintiffs have described as critical, plaintiffs have failed to establish prejudice to their ability to litigate their claims.

In short, the Court finds that while plaintiffs have shown that the document preservation requirement was not fully met, plaintiffs have fallen far short of substantiating their assertions that the individual defendants engaged in intentional destruction, or that the documents and information missing are "critical to plaintiffs' proof" (Pls.' 7/25/00 Am. Mem. at 1). In light of these findings, the Court respectfully recommends that plaintiffs' amended motion for sanctions be granted in part and denied in part as follows:

1. The Court recommends that the request for a default judgment be denied. The Court believes that this ultimate sanction is completely inappropriate in this case, where the Court finds no evidence of intentional destruction by the defendants and where

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plaintiffs have failed to establish prejudice.

2. In order that the jury not draw any inference adverse to plaintiffs from any gaps in the production of documents, the Court recommends that pursuant to Fed.R.Civ.P. 37(b), the District Court inform the jury that any such gaps are the result of USN failing to produce those documents, even though plaintiffs requested them.

3. The Court recommends that, as a result of his failure to adequately discharge his responsibility to institute a program to preserve documents, Mr. Elliott be required to pay a fine payable to the registry of the Court of $10,000.00. Even though the Court finds that the failure to institute a preservation program has not resulted in prejudice to the plaintiffs, the Court believes that this fine is appropriate as a sanction to impress upon Mr. Elliott the seriousness of the duty of preservation, and to deter others from failing to properly discharge that duty.

4. The Court recommends that no monetary sanctions be imposed on either party for their discovery missteps: the additional costs each has imposed on the other are roughly comparable, and it would be counter productive at this point to engage in further litigation on this issue.

5. The Court recommends that no attorneys' fees and costs be assessed in connection with the prosecution or defense of this motion. Plaintiffs claim that their fees and costs on the sanctions issue total $757,559.61, and (not to be outdone) the individual defendants assess their fees and costs at $767,202.42. Viewed separately, not to mention collectively, these statements of fees and costs are nothing short of shocking: they are wholly disproportionate to what the evidence has disclosed. Because the conduct of each side has contributed to an excessive expenditure of fees and costs, the Court considers the fees and costs incurred to be a self-inflicted wound by each side, and that neither side should be forced to pay the costs and fees of the other side.

I.

***7** We begin with the factual findings, which are drawn from the pleadings, the discovery record and prior proceedings in this Court, the written submissions on the amended motion for sanctions, and the testimony at the evidentiary hearing on September 11-12, 2000.

A. The Parties.

This case proceeds as a class action, upon consolidation of 14 federal securities suits filed in this jurisdiction in late 1998 and early 1999 (*see* doc. # 12 (Pretrial Order No. 1)). [FN3] On June 17, 1999, the plaintiffs filed an amended complaint in these consolidated cases ("the Consolidated Complaint"). On October 29, 1999, the District Court certified a plaintiff class consisting of persons who purchased stock pursuant to USN's registration and prospectus statements of February 2 and 4, 1998, and those who purchased USN stock between February 4, 1998 (the date of USN's initial public offering) and November 20, 1998.

FN3. The other seven suits were filed in the Southern District of New York in late 1998, and by a stipulation of January 27, 1999 were transferred to this District: *Glotzer v. USN Communications, Inc., et al.*, 98 C 8088, *Kassover v. USN Communications, Inc., et al.*, 98 C 8250, *Murphy v. USN Communications, Inc., et al.*, 98 C 8369, *Crowley v. USN Communications, Inc., et al.*, 98 C 8529, *Cummings v. USN Communications, Inc., et al.*, 98 C 8616, *Dawson v. USN Communications, Inc. et al.* 98 C 8781, and *Raino v. USN Communications, Inc., et al.*, 98 C 9189. Seven of the consolidated cases were originally filed in this District: *Danis v. USN Communications, Inc., et al.*, 98 C 7482, *Donoghue v. USN Communications, Inc., et al.*, 98 C 7610, *Rosenbaum v. USN Communications, Inc., et al.*, 98 C 7674, *Egan v. USN Communications, Inc., et al.*, 98 C 8044, *Chanik v. USN Communications, Inc., et al.*, 98 C 8082, *Roop v. USN Communications, Inc., et al.*, 99 C 0067, and *Brent v. USN Communications,Inc., et al.*, 99 C 119.

The individual defendants in this case (many of whom are not the subject of the sanctions motion) are J. Thomas Elliott, a director and USN's President and CEO since April 1996; Gerald Sweas, USN's Executive Vice President and Chief Financial Officer until approximately July 1998; and Richard Brekka, Dean Greenwood, Donald Hoffmann, James Hynes, William Johnston, Ian Kidson, Paul Lattanzio, David Mitchell, and Eugene Sekulow, all of whom were

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directors of USN. The underwriter defendants, Merrill Lynch & Co., Inc., Cowan & Company, and Donaldson, Lufkin & Jenrette Securities Corporation, allegedly were all involved in the management of the underwriting of USN's initial public offering. The remaining defendant, Deloitte and Touche, L.L.P., audited USN's financial statements for the fiscal years preceding the public offering, and provided consulting services to USN both prior to and during the class period.

Notable by its omission from this roster of defendants is USN itself. USN was named as a defendant in each of the lawsuits originally filed. However, on or about February 19, 1999, USN filed for bankruptcy protection. Thereafter, when the Consolidated Complaint was filed on June 17, 1999, USN was not named as a defendant--presumably, to avoid potential complications that might be created by the automatic stay that protects those who have filed for bankruptcy protection. *See* 11 U.S.C. § 362.

B. The Allegations of the Consolidated Complaint.

USN was a "local telecommunications reseller" which sought to purchase various local and long distance telecommunication services from Regional Bell Operating Companies ("RBOCs"), bundle them into a single package of services, and sell that package of services to the public. USN sought to persuade the existing customers of RBOCs to switch to USN by offering them lower rates for the packaged services. When USN succeeded in gaining a customer, USN would "provision," or switch, the new customer from the existing telephone company over to USN.

The gravamen of the Consolidated Complaint is that USN allegedly embarked on a scheme to build a seemingly large, but in reality fictitious, book of business in order to induce a larger telecommunications company to purchase USN. The Consolidated Complaint alleges that in aid of this scheme, USN issued false public reports and statements to portray USN as successful, when in fact it was not. Plaintiffs allege that when the truth became known, the value of its shares plummeted, causing injury to investors.

***8** The Consolidated Complaint is plead in four counts: Count I alleges that all defendants have violated Section 11 of the Securities Exchange Act of 1933 ("the Securities Act"), and that the individual defendants additionally have violated Section 15 of that Act; Count II alleges that the underwriter defendants have violated Section 12 of the Securities Act (the District Judge has dismissed the Section 12 claim alleged against the individual defendants); Count III alleges that all defendants have violated Section 10(b) of the Securities Exchange Act of 1934 ("the Exchange Act"), and Rule 10b-5 promulgated thereunder; and Count IV alleges that the individual defendants have violated Section 20(a) of the Exchange Act.

The fundamental premise of plaintiffs' amended sanctions motion is that once the litigation commenced, USN destroyed key sales, financial and accounting documents that are "critical to plaintiffs' proof" that USN's public financial statements were false and misleading. In particular, plaintiffs' amended sanctions motion focuses on several categories of documents: (1) Monthly Sales Roll Up Reports; (2) Final Sum and Final Sum Summary Reports; (3) Aged Accounts Receivable Reports; and (4) Monthly Close Packages (*see*, *e.g.*, Pls.' Reply Mem. at 1-2). Thus, we begin with an explanation of those documents, and the evidence concerning how they were used at USN inthe ordinary course of business.

C. Business Documents Generated by USN.

During the course of soliciting and signing up a new customer, USN generated various sales and marketing-related documents. One type of sales-related document tabulated and totaled the new sales, as reported by the USN various sales offices. This document, referred to variously by different witnesses as a "Monthly Sales Roll Up Report" or "State Directors Report," tabulated sales on a weekly basis, and then totaled (or, "rolled up") those sales over a four- week period for a cumulative total covering approximately a one-month period. The reports also provided projections by the sales force as to the number of lines sold and the amount of revenue that the sales would generate, as well as a comparison of the dollar value of the projected sales revenue to the sales quota provided for that particular office or region (a sample of a document labeled "State Directors Report" was offered at the evidentiary hearing as Defendants' Exhibit 2).

These "Monthly Sales Roll Up Reports" or "State Directors Reports" were generated at least through November 1997. Thereafter, beginning in mid-December 1997, this type of sales information was contained in a computer-generated Sales Summary

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report. One reason for using this computer system was an attempt to increase the reliability of the sales information reported from the field (Hrg. Tr. 422 (Dundon)). Because sales people earned commission based on sales volume, there was a concern at USN that sales numbers could be changed after they were initially submitted in order to increase commissions; according to the testimony, the switch to a computer system to generate sales reports was intended to provide sales information "on a more structured and more, I guess, rigorously auditable basis" (Hrg. Tr. 422 (Dundon)). [FN4]

FN4. The parties disagree about whether a State Directors Report is the same thing as a Monthly Sales Roll Up, and whether either of those reports continued to be generated after November 1997. We address this dispute below (*see* 35-40, *infra*).

***9** After receiving sales reports from the field, USN did not immediately switch the putative new customer to USN service. Rather, USN engaged in a process of "scrubbing," (that is, verifying) the sale, to make sure that the new customer actually desired to switch to USN, what level of service was requested, and whether the customer had provided all information necessary to effectuate the switch. This function originally was performed by the provisioning group in USN; as of approximately late 1997, this function was performed by a separate group, known as "Business Administration" ("BA"), which performed this check on the sales before providing the information to the provisioning group to actually effectuate the switch of the customer (Pls.' 07/25/00 Am. Mem., App. 13 (Jeavons Dec. § 9)).

Once the switch was completed, and the customer was converted to USN, the customer would have to be billed for the services delivered. That billing function initially was outsourced to two companies: Spectrum and Profitec. As of the billing for the month ending October 1997, USN contracted with Spectrum to be the exclusive provider of issued bills for all USN accounts involving "competitive local exchange billing," including the Midwest and Northeast regions from November 10, 1997 onward (Hrg. Tr. 131-32 (Doyle)). In order to perform this billing function, Spectrum received various reports and information from USN, and sent various reports and information to USN. These exchanges of information were accomplished by e-mail and through a dedicated T- 1 line. Information transmitted on this T-1 line did not run directly between Spectrum and USN's UNIX computer system. Rather, information was transmitted through a file transfer protocol ("FTP") server that linked Spectrum and USN (Hrg. Tr. 141 (Doyle)). The sole purpose of this FTP server use was to pass large amounts of data back and forth between Spectrum and USN (Hrg. Tr. 348 (Struble)).

According to the testimony of George Doyle, the founder and Executive Vice President of Spectrum, each month USN sent to Spectrum via the FTP server twelve to eighteen files (extracted from billing and financial databases) to use for billing (Hrg. Tr. 152, 158, 162 (Doyle); Hrg. Tr. 346-47, 381 (Struble)). Included among these files were credit files, which would show, on an account by account basis, the amount of credit to be applied to a particular customer and the reason the credit was given (*Id.*, at 147); Plaintiffs' Exhibit 3 is an example of such a credit file (*Id.*, at 149). Spectrum used the information from USN, as well as information obtained from the local or long distance carriers concerning usage (Hrg. Tr. 195-96 (Doyle)), to generate detailed billing information for each USN customer account.

This detailed billing information was transmitted over the T-1 line to USN (Hrg. Tr. 132, 145, 147 (Doyle)), where it was stored in a database called "REPGEN"--which is an acronym for "report generator" (Hrg. Tr. 349-50 (Struble)). Charles Struble, USN's Vice President for Information Systems, described REPGEN as a physical data base, containing detailed records from Spectrum in the form of tables, as well as other financial information (*Id.*, at 349). According to Thad Pellino, USN's Vice President of Revenue Assurance, who was responsible for calculating revenue and ensuring the accuracy of those calculations, this information was electronically accessible to USN, but was not conveyed by Spectrum to USN (or printed out by USN) in a hard copy report format (Hrg. Tr. 299-300). Once the REPGEN information was received by USN, the finance group would internally generate selected reports to use for balancing and reconciliation (Hrg. Tr. 367 (Struble)).

***10** In addition to this detailed source information, two reports relevant to billing were generated by Spectrum and delivered to USN. One such report was entitled Final Sum Summary, which Spectrum sent to USN by e-mail in an Excel spread sheet format. This

report "aggregate[d] all billing categories or aggregate[d] each billing category for all accounts" and eliminated the account-byaccount detail, showing only totals by billing category (Hrg. Tr. 164 (Doyle)). The other report, entitled Final Sum, also was sent by e-mail in an Excel format, prior to 1998; according to Mr. Doyle, because of the volume of information communicated in the Final Sum Report, thereafter the report was converted to a Paradox format (which had greater capacity than Excel) and transmitted on the T-1 line (Hrg. Tr. 144 (Doyle)). [FN5]

> FN5. As with the "Monthly Sales Roll Up" reports, there is conflict in the testimony as to what constitutes a "Final Sum" Report. Mr. Doyle identified the detailed, voluminous report marked as Plaintiffs' Exhibit 2 as a Final Sum Report (Hrg. Tr. 134, 135), which he said was sent to USN for every billing period in 1998 (*Id* ., at 140-41, 143-44). However, Mr. Pellino identified that document as a print-out from the REPGEN file, and testified that Defendants' Exhibit 7 (a much thinner document) was an example of the Final Sum Report (Hrg. Tr. 293-94). Likewise, Mr. Struble distinguished Final Sum Reports from the REPGEN file, which he said contained the physical data behind the Final Sum Reports (Hrg. Tr. 373). And, indeed, even Mr. Doyle at one point referred to Plaintiffs' Exhibit 2 not as a Final Sum Report, but as Final Sum "detail files" (Hrg. Tr. 164)-- which is consistent with the explanations by Messrs. Doyle and Struble. While the Court is inclined to credit Mr. Pellino on this point, for the reasons described below, this dispute is not material to the outcome of the motion.

USN's Revenue Assurance Group, headed by Mr. Pellino, used the monthly billing information from Spectrum as the starting point for the revenue figures to be used in USN's financial statements (Hrg. Tr. 293 Pellino)). Adjustments then would be made to revenue and costs would be calculated, including the cost of the service purchased for the customer by USN from the RBOCs. In this regard, USN issued reports concerning not only the amounts of accounts receivable, but also their age: that is, the length of time a particular amount had been outstanding but unpaid. The various revenue and cost information would be assembled in what USN referred to as a "Monthly Close Package" or "Revenue Close Package," which would then form the basis of the cost and revenue information set forth in USN's financial statements.

D. USN's Computer Systems.

Because much of the information at issue was stored electronically (in addition to or in lieu of hard copy printouts), we turn to a discussion of the USN computer system. As of November 1998, when the first lawsuits were filed, USN's computer systems were divided into two overarching categories (*see* Defs.' Demonstrative Ex. 1).

First, there was a UNIX server that contained a number of databases which could be accessed through different software application. The databases included (1) the FPS database, which was a repository of the billing information for customers, product and pricing information, and customer account data that was used to send the various reports to Spectrum (Hrg. Tr. 346 (Struble)); (2) the "Vantive" system, which was used by the sales organization and contained marketing and sales information (and from which the Sales Summary reports were generated beginning in mid-December 1997) (*Id* ., at 348); (3) Mas 90 (and later Oracle), which contained the financial information of the company (*Id.*, 348-49); and (4) "REPGEN," which was the repository for information received from Spectrum concerning customer billing (*Id.*, at 349). The Vantive system, which contained sales information, was maintained on a UNIX developmental server; the other databases mentioned, which contained financial and billing information, were on a UNIX production server.

***11** *Second*, USN maintained NT servers. These servers were used by USN for e-mail, desk top computers, and local area networks (Hrg. Tr. 345-46 (Struble)). Through these systems, USN employees could generate correspondence and other original documents. In addition, information contained in the databases on the UNIX system could be accessed through the desk top computers on the NT servers, but when accessed and/or copied electronically, the information also would remain stored in the UNIX database (Hrg. Tr. 346 (Struble)).

Charles Struble was the person with overall responsibility for all computer systems at USN. Mr. Struble delegated direct responsibility for the two sides of the USN computer systems to two different

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people: Christopher Urban was responsible for the NT servers and desk tops and David Rohrman was responsible for the UNIX servers (Hrg. Tr. 350-51 (Struble)).

E. USN's Pre-Litigation Retention Practices.

Prior to the commencement of this litigation in November 1998, USN did not have in place any formal retention policy covering the many categories of documents and electronic information USN regularly created and received (Hrg. Tr. 215 (Monson), Hrg. Tr. 249 (Elliott)). Thus, not surprisingly, as of November 1998 it appears that USN did not have a set of complete and organized files of important business documents that were readily accessible. In September 1998, an Arthur Andersen report commented on the inability to locate certain types of business documents at USN (Pls.' Reply Mem., App. A). However, as of the time this litigation commenced, USN did maintain several practices documents that are of relevance here with respect to preservation (or elimination) of hard copy and electric.

First, with respect to e-mails, USN routinely created backup tapes that were stored on computers. USN maintained copies of these back-up tapes only for a period of about thirty days, in order to facilitate disaster recovery; the tapes used to make these copies were then reused. Thus, these back-up tapes were not intended to, and did not, create an archival record of the e-mail system (Hrg. Tr. 393 (Struble)).

Second, in approximately the summer of 1998, in anticipation of upcoming office closures and layoffs, USN put into place a set of procedures for "preserving company assets [and] retrieving key records" (Pls.' 07/25/00 Am. Mem., App. 12 (Foster Dec., § 6)). Lane Foster, USN's Vice President for Human Resources, was placed in charge of developing these procedures (*Id.*). In putting together these procedures, Mr. Foster met with in-house lawyers at USN (including Dennis Monson, USN's Vice-President, Secretary, and General Counsel), and with Tom Jeavons, a Senior Vice-President for Sales (*Id.* at § 7). As a result of those discussions, the criteria that USN put into place for preserving documents from the closed sales offices focused on preserving two categories of documents: (1) original documents that were important to USN's ability to service existing customers, and (2) other documents that individual sales people wished to maintain for their personal reasons. Documents not falling into one of those categories would be discarded.

***12** *Third*, in the summer of 1998, Mr. Urban was placed in charge of a project to purge the computer drives of terminated USN employees. This program was initiated for several reasons: (1) USN was concerned about security risks that might be created if terminated employees potentially could access the computers, and (2) computer server space was at a premium, and purging the computer files of former employees would free up space of the servers (Hrg. Tr. 43 (Urban)). As part of the procedure implemented by Mr. Urban, when an employee was terminated, Mr. Urban would notify appropriate people at USN that the terminated employee's files (including e-mail files) would be deleted, and that if anyone believed that something should be saved, then Mr. Urban was to be informed so that it would not be deleted (*Id.*, at 43-46). This process had been ongoing for several months prior to the filing of this litigation in November 1998 (*Id.*, at 43-46).

F. The Initiation of Litigation.

On November 12, 1998, the *Glotzer* case was filed in the Southern District of New York. In rapid succession, 13 other lawsuits were filed against USN in the Southern District of New York, the Northern District of Illinois and elsewhere.

The *Glotzer* case did not contain many of the detailed allegations that are presently found in the Consolidated Complaint. However, in *Glotzer*, the plaintiff alleged, among other things, that USN falsely and misleadingly stated that the money collected in the initial public offering was sufficient to meet both capital expenditures and "anticipated negative operating cash flow for the foreseeable future" (§ § 66, 71(c)); that USN falsely and misleadingly stated that it attracted and retained customers well, due to its billing capabilities (§ § 67, 71(e)); and that USN in these and other ways materially misrepresented its financial condition (§ 71).

Immediately upon the filing of the *Glotzer* lawsuit, USN was required to preserve for possible production in the lawsuit documents (whether in hard copy or electronic form) that might be discoverable. That duty flowed both from the Private Securities Litigation Reform Act of 1995 ("PSLRA") 15 U.S.C. § 78u- 4(b)(3)(c)(i), and from a common law duty not to spoil documents that might be discoverable in the litigation. *See, e.g., Barnhill v. United States*, 11

F.3d 1360, 1368 (7 th Cir.1993).

G. The November 12, 1998 Board Meeting.

The need to preserve documents in light of the *Glotzer* lawsuit, was discussed at a USN board meeting held on the evening of November 12, 1998, the day that the *Glotzer* case was filed. In attendance at that meeting were the defendants on this motion (Messrs. Elliott, Brekka, Greenwood, Hynes, Johnston, Mitchell, and Sekulow); USN's Chief Operating Officer, Dennis Dundon; USN's Vice-President/Secretary/General Counsel, Thomas Monson; USN's Executive Vice President (and formerly its general counsel), Ron Gavillet; and outside attorneys from the law firm of Skadden, Arps, Slate, Meagher & Flom ("Skadden"). The affidavits and in court testimony establishes that the participants at the meeting are unanimous on one point: one of the Skadden attorneys, Mr. Kraus, made it clear, in vivid terms, that with filing of the lawsuit document preservation must be a top priority at USN. The witnesses testified that Mr. Kraus warned that he "could deal with bad documents," but "there was nothing worse than destroying documents," thus, he emphasized the "importance of maintaining the documents" (Hrg. Tr. 210, 215 (Monson)); *see also* Defs.' Mem., App. 5 (Monson Supp. Decl. § 3)).

***13** The testimony also has been unanimous that at the meeting, USN's directors took heed of this admonition and directed that USN management--headed by Mr. Elliott, the CEO--promptly take steps to preserve documents. The witnesses differ, slightly, on how they recall the direction being phrased. Several witnesses indicate that the advice by Mr. Kraus and the direction by the board was that "all *relevant* documents be preserved and not destroyed" (*See, e.g.*, Hrg. Tr. 247 (Elliott); Outside Dirs.' Mem., Apps. 4 (Aff. of D. Mitchell, § 5) and 2 (Aff. of J. Hynes, § 3)) (emphasis added). Other witnesses described the directive as requiring that USN preserve documents that "could be" or "may be" relevant to the litigation (*See* Defs.' Mem.' Apps. 22 (Supp. Dec. of T. Elliott, § 3); and 19 (Dec. of R. Gavillet, § 2)). One witness stated that both the advice and the direction were broader: that "the Board and management needed to preserve and not destroy *any* corporate files" (Outside Dirs.' Mem., App.5 (Aff. of E. Sekulow, § 3)) (emphasis added).

H. The Steps Taken to Implement the Board's Directive.

Shortly after the November 12, 1998 Board meeting, the need to preserve documents was discussed at a USN staff meeting attended by USN officers and high level managers representing every business group within USN: operations, sales, marketing, information technology, revenue assurance, and customer service. The attendees included, among others Messrs. Elliott, Gavillet, Monson, and Dundon, all of whom had been at the Board meeting; Messrs. Jeavons and Patrick, from sales; Mr. Pellino; Messrs. Struble and Bethke, from Information Systems; Ellen Craig (another in-house lawyer); and Steve Parrish (Executive Vice-President of Operations) (*see,* Defs.' Mem., App. 18, (Dundon Dep. 252)). Mr. Dundon testified that this meeting had several purposes: to inform the managers of the lawsuit, and to assure them that the company would respond to it appropriately; and for Mr. Monson to relate to managers the need to preserve documents (Hrg. Tr. 408). At the meeting, Mr. Monson relayed Mr. Kraus' admonition concerning the dangers of document destruction, and directed that all documents be preserved (Hrg. Tr. 226-27) (Monson). Mr. Monson further instructed that his direction be communicated by the managers "within their respective departments" ((Defs.' Mem., App. 5, Monson Supp. Dec., § 4); *see also* Hrg. Tr. 358 (Struble)).

Several witnesses who attended the meeting have testified that Mr. Monson indeed communicated a broad directive that all documents were to be preserved. Mr. Jeavons testified that a "substantial warning was given" (Defs.' Mem., App. 4 (Jeavons Dep. 94)), and while no direction was given as to what specific types of documents to retain, *"my interpretation was don't throw out anything"* (*Id.* at 95) (emphasis added). Similarly, Mr. Dundon testified that, while he could not recall any specific instructions being given at the staff meeting, "I think it was just a caution that *most everything that the company had would need to be looked at by the lawyers"* (Defs.' Mem., App. 18 (Dundon Dep. 255)) (emphasis added).

***14** However, the Court finds that after this staff meeting, Mr. Elliott personally took no affirmative steps to ensure that the directive was followed. Mr. Elliott did not direct that USN implement a written, comprehensive document preservation policy, either in general or with specific reference to the lawsuit; he did not instruct that any e-mail or other written communication be sent to staff to ensure that they were aware of the lawsuit and the need to preserve

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documents; and he did not meet with the department heads after this staff meeting to follow up to see what they had done to implement the document preservation directive (Hrg. Tr. 247-48 (Elliott)). Mr. Elliott had a day-to- day presence at USN, and readily could have inquired into what was being done to preserve documents. He did not do so.

Rather, it appears that Mr. Elliott attempted to delegate that responsibility completely to Mr. Monson. In so doing, Mr. Elliott exhibited extraordinarily poor judgment. He had at his disposal the Skadden law firm, with scores of experienced attorneys capable of developing and implementing a suitable document preservation program in a major securities lawsuit. Instead, Mr. Elliott entrusted that task to Mr. Monson, an in-house attorney with no litigation experience whatsoever, and with no experience in putting together a document preservation program (Hrg. Tr. 208 (Monson)). Nor is there any evidence that Mr. Elliott (or Mr. Monson, for that matter) consulted with Skadden about how to implement such a program.

Mr. Monson's approach to the document preservation task reflected his inexperience. Mr. Monson did nothing to ensure that all USN employees who handled documents that might be discoverable were aware of the lawsuit and the need to preserve documents: he held no meetings with employees below the managerial level, and he did not issue any written communications to *anyone* on the subject (Hrg. Tr. 216-17 (Monson); 247-48 (Elliott)). Mr. Monson did nothing to determine whether the managers who attended the staff meeting followed his direction of communicating to their respective departments the need to preserve documents, or if they did so, in a way that sufficiently impressed upon USN's employees the urgency of the task. This resulted in potential inconsistencies in whether or how USN's managers communicated with staff on this important matter. And, indeed, the evidence is that employees responsible for discarding documents from the closed offices were unaware of any document preservation directive (*e.g.*, Hrg. Tr. 17, 19, 20 (Coleman); 103- 04 (Van Dinther)).

Moreover, Mr. Monson did not review the pre-existing practices at USN relating to document preservation for terminated employees and closed offices, to determine whether these practices were still suitable in light of the need to preserve documents as a result of litigation. Had Mr. Monson conducted such a review, it would have been evident that they were not.

***15** The criteria for preserving documents from closed offices created in July 1998 (which called for saving documents necessary to service customers, and those requested by individual sales people) were far less inclusive than the broad directive Mr. Monson gave for documents to be preserved in light of the litigation. There were no specific criteria regarding what should be saved and what should not be saved related to the lawsuit (Hrg. Tr. 247-48 (Elliott)). Moreover, the plan implemented by Mr. Foster did not require attorneys to review documents before discarding them, whereas the message Mr. Monson delivered was that in light of the lawsuit, attorneys would need to review "most everything that the company had" (Defs.' Mem., App. 18 (Dundon Dep. 255)). Similarly, the procedure for purging e-mails from terminated employees was not reviewed in light of this lawsuit. While it may have been Mr. Monson's "expectation" that people who were intending to discard potentially relevant documents "against the backdrop of this litigation" would contact him for "further clarification" (Hrg. Tr. 245 (Monson)), he failed to take steps to determine if that expectation was being met.

The Court finds nothing in the record to suggest that, in the face of Mr. Kraus' warning and the Board's directive, Mr. Elliott (either directly or through Mr. Monson) embarked on a scheme to willfully destroy documents, or to knowingly turn a blind eye to destruction of documents relevant to this litigation. [FN6] Nonetheless, it was Mr. Elliott's responsibility, as the head of day-to-day management, to take steps to ensure that a suitable document presentation program was implemented. Through a failure to take action himself or to entrust that responsibility to someone with the experience to carry it out, Mr. Elliott failed to discharge that responsibility. The fact that this failure was the result of poor judgment (perhaps clouded by the chain of events that had sent USN reeling at the time) rather than malicious intent provides an explanation for Mr. Elliott's conduct that helps show it was not willful--but it does not entirely excuse his failing.

FN6. Prior to the evidentiary hearing, Ms. Van Dinther had stated that Virginia Alpers, Mr. Elliott's secretary, had told Ms. Van Dinther that Mr. Elliot had instructed Ms. Alpers to throw away files. Ms. Alpers flatly denied that she had made such a statement to

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> Ms. Van Dinther, or that Mr. Elliott had given her such an instruction (Hrg. Tr. 314 (Alpers)). At the hearing, Ms. Van Dinther clarified that Ms. Alpers had said that Mr. Elliott had told Ms. Alpers to "clean out" his old office after a move; Ms. Van Dinther admitted that she did not know if certain documents already had been set aside to retain (Hrg. Tr. 121-22). Based on the Court's assessment of these witnesses and Mr. Elliott (all of whom testified in person), the Court finds that Mr. Elliott did not direct that relevant documents be discarded.

As for the outside directors, the Court notes that the evidence is undisputed that they preserved and produced their documents, and certainly gave no direction to destroy documents. But, these defendants also did not play any active role in implementing a broader preservation policy at USN, and there is no credible evidence that they followed up with Mr. Elliott or others to determine if their directive had been implemented. None of the affidavits or declarations submitted by the directors detail any such follow-up efforts. The only director to testify at the hearing, Mr. Hynes, suggested that he sought at least one assurance that the directive was being followed. However, Mr. Hynes' affidavit contained no such assertion; and in his in-court testimony, Mr. Hynes could provide no details as to when, where or by whom the assurance was asked for or given (Hrg. Tr. 205-06). We give Mr. Hynes in-court testimony on this point no weight.

***16** For this lack of follow up, the outside directors may fairly be criticized. This lack of follow up reflects the view, as expressed by Mr. Hynes in his testimony, that the outside directors believed that taking an active role in ensuring preservation of documents was not part of their "responsibility as director[s]," but that "[t]he people down in the trenches who gathered the data" would perform that task (Hrg. Tr. 202, 204 (Hynes)). This myopic view begs the question of who was supposed to see to it that the "people down in the trenches" actuallycarried out the task. The Court suspects that if the outside directors had instructed Mr. Elliott to pursue an advantageous corporate opportunity, they would have taken an "active" role to follow up to see what had been done. They should have done the same thing with respect to the less pleasant task of document preservation.

Nonetheless, the Court is mindful that these outside directors were just that: outside the company, without a day-to-day presence at USN. And, this is not a case where they learned of the duty to preserve and did nothing (or, even worse, directed document destruction). To the contrary, they gave an explicit direction to Mr. Elliott to see to it that documents were preserved. The Court finds that in the circumstances, the outside directors could reasonably rely on Mr. Elliott following a Board level directive to implement a preservation program, and thus they are not at fault for Mr. Elliott's failure to do so.

I. The Gaps In USN's Document Preservation.

It is plain that USN made efforts to preserve documents--and, as will be discussed later, has produced a massive volume of hard copy and electronically stored information. However, the inadequacies in the document preservation program at USN created several potential gaps, which resulted in documents being discarded without having been reviewed to determine whether they should have been preserved. Each of these gaps will be discussed below.

1. The Closing of Sales Offices.

As a result of financial distress, USN closed a number of sales offices in November 1998, including a substantial sales office located on the fourth floor of the USN offices at 10 South Riverside in Chicago. By November 1998, only the sales function remained on the fourth floor office; other administrative and executive functions had been moved elsewhere earlier in 1998 (Hrg. Tr. 261 (Elliott); 228-29 (Monson)).

Pursuant to the procedures implemented by Mr. Foster in July 1998, the documents in the closed offices were to be reviewed for the purposes of separating out and preserving those which were needed to support the customer base. The sales department was required to review the documents to determine what was to be preserved; once that process was completed, the rest would be discarded by persons under the direction of Mary Coleman, USN's Facilities Manager, who reported to Mr. Foster. The person from the sales department involved in that screening process was Christine Van Dinther, an Administrative Assistant to Messrs. Jeavons and Patrick.

***17** Ms. Van Dinther and Ms. Coleman both testified

at the evidentiary hearing. Ms. Van Dinther stated that, despite the program implemented by Mr. Foster, she was never told what needed to be saved from the fourth floor; however, she "had an idea in [her] mind" that sales literature and customer files should be saved (Hrg. Tr. 104-05 (Van Dinther)). Ms. Van Dinther indicated that she identified and placed in the boxes those materials to be saved, as well as files from Ryan Mullaney, the former Vice-president of Sales and Marketing who had left USN in July 1998, and Lori Kloonan, his Administrative Assistant (Hrg. Tr. 104 (Van Dinther); *see also* Hrg. Tr. 266 (Elliott)). Ms. Van Dinther testified that when she performed this function of identifying which documents were to be preserved, she was unaware of the lawsuit and of the directive that documents needed to be preserved for litigation (*id.*, at 103-04). The individual defendants did not offer any testimony or other evidence at the hearing to contradict Ms. Van Dinther on this point. In light of USN's failure to implement a program to ensure employees knew of and followed the document preservation requirement, the Court credits this testimony.

Ms. Coleman testified that her staff began discarding documents from the fourth floor office in November 1998, and that this process continued for several months through April 1999. It is undisputed that numerous dumpsters full of documents were discarded from that office during that time period (Hrg, Tr. 104, 107 (Van Dinther)). When Ms. Coleman discarded the documents, she believed that Ms. Van Dinther and the people working with her in the sales group already had gone through the documents and identified what needed to be retained. Ms. Coleman indicated that she, too, performed this function without having been informed of the lawsuit, or any special preservation requirements imposed by it (Hrg. Tr. 17 (Coleman)). In light of the absence of contrary testimony, the absence of Ms. Coleman or anyone from Human Resources at the staff meeting at which Mr. Monson gave the directive to preserve documents, and the absence of any systematic follow up after that meeting, the Court finds this testimony credible.

Through this process, numerous documents were discarded without ever having been reviewed by lawyers to determine their potential discoverability in this lawsuit (Hrg. Tr. 218 (Monson); 248 (Elliott)). That was a substantial flaw in USN's efforts to preserve documents. Nonetheless, the Court finds that, while it is impossible to say that *no* discoverable documents were discarded, it is unlikely that the sole sources of certain discoverable information were located in the closed sales offices.

By November 1998, the executive and financial branches of USN had already been relocated to different floors at the Riverside location. Thus, it is not likely that hard copy financial reports and other related documents had been moved to offices on other floors of the building. By all accounts, the documents in the sales offices largely consisted of sales and marketing forms, which were not likely to possess information relevant to the claims in this case. The sales offices also housed customer files, but under Mr. Foster's pre-suit preservation policy, those were preserved. Indeed, hundreds of customer files were produced; plaintiffs inspected a sample of 41 of those files, but elected not to copy any of them (Defs.' Mem., App. 1 (Walton Dec. § § 10-13)).

***18** The only clearly discoverable category of sales related documents identified by plaintiffs as having been discarded on the fourth floor are the Monthly Sales Roll Up reports. However, the testimony is seriously contested as to whether any such reports were destroyed. The principal evidence of destruction of Monthly Sales Roll Up Reports comes from Ms. Van Dinther. At the evidentiary hearing, Ms. Van Dinther stated that she had boxed up for preservation documents from the fourth floor, including customer files, sales literature, Monthly Sales Roll Up Reports, and certain other files, but subsequently was told by Ms. Coleman that those boxes had been destroyed (Hrg. Tr. 108 (Van Dinther)). The Court does not credit this testimony for two reasons.

First, Ms. Van Dinther's testimony concerning Ms. Coleman's purported statement is hearsay. The Court finds it curious that plaintiffs elicited this testimony from Ms. Van Dinther, whom they called to testify *after* Ms. Coleman had completed her testimony, without first asking Ms. Coleman if she had made such a statement to Ms. Van Dinther--even though plaintiffs also had called Ms. Coleman as a witness.

Second, plaintiffs elicited from Ms. Coleman the testimony that the only documents that Ms. Van Dinther had identified for preservation that had been lost were some preprinted sales forms, which had been discarded accidentally (Hrg. Tr. 28, 29 (Coleman)). Ms. Coleman was never confronted with the accusation that she had discarded boxes containing Monthly Sales Roll Up Reports. In these circumstances, the Court finds credible Ms. Coleman's testimony that the only box earmarked for

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preservation that was destroyed was the box of preprinted sales forms. [FN7]

FN7. Ms. Van Dinther also testified that she had copies of Monthly Sales Roll Up Reportson her computer hard drive, but that these were lost in early 1999. Ms. Van Dinther stated that this occurred not in connection with an office closing, but occurred later when she was changing job positions: she testified that in connection with that change, Mr. Patrick directed her to delete everything on her hard drive (Hrg. Tr. 102-04 (Van Dinther)). The defendants had designated Mr. Patrick as a witness at the evidentiary hearing, but then elected not to call him to testify. We credit Ms. Van Dinther's testimony on this point--but do not conclude that Mr. Elliott bears responsibility for the actions of Mr. Patrick, who was at the staff meeting and plainly was told not to discard documents.

2. The Purging of Terminated Employees' Computers.

There is a dispute in the testimony concerning whether Mr. Urban, who was in charge of purging e-mails of terminated employees, was told of the need to preserve documents for the litigation. Mr. Urban testified that the only knowledge he had of the pending litigation was through "hearsay," and that he was not instructed that e-mail files or other electronically stored documents had to be preserved as a result of pending litigation (Hrg. Tr. 53 (Urban)). Mr. Urban's supervisor, Charles Struble, was at the staff meeting where Mr. Monson gave the direction that documents had to be preserved. However, while Mr. Struble said that he informed his staff of this requirement, and that this would have included Mr. Urban, he did not specifically testify that he discussed with Mr. Urban the need to preserve documents as a result of the litigation (Hrg. Tr. 358 (Struble)).

In any event, there is no evidence that Mr. Urban was instructed to take special steps to modify the system of purging the e-mail files of terminated employees to make sure that potentially discoverable documents were preserved. Nor were there systematic efforts made to archive e-mails as of the commencement of this litigation until shortly before the sale of USN assets to CoreComm in May 1999. The Court nonetheless finds it unlikely that as a result of this omission, discoverable computer information was lost.

***19** *First*, Plaintiffs' suggestion that this program constituted a "systematic purging" of USN's LAN server drives (Pls.' 7/25/00 Mem. at 9) is a misleading characterization of the evidence. The program of purging e-mail files applied not to all employees, but only to *terminated* employees (Hrg. Tr. 43-44, 46, 90-91 (Urban)). [FN8] And the people who were being terminated after the lawsuit were sales employees; no evidence has been offered that their e-mail files were likely to contain discoverable information that was not available elsewhere.

FN8. The Court notes that in making this argument, plaintiffs selectively quote from a November 10, 1998 e-mail from Mr. Urban indicating that shortly he would be deleting data from network servers and workstations unless there was a request to maintain it (Pls.' 7/25/00 Mem. at 9 n. 7 and Pls.' App. 18). The portion of the e-mail that plaintiffs neglect to quote plainly states that this program would apply only to former employees, not current ones.

Second, USN's senior executives plainly were aware of the need to preserve documents, and the uncontradicted testimony is that with respect to their personal files (including e-mail files), they took that responsibility seriously and in fact preserved documents. It is undisputed that the outside directors preserved and produced their personal files (Outside Dirs.' Mem., Exs. 1-5), and that hard copy and computer files of senior executives were preserved and produced (*see* Defs.' Mem., App. 1 (Walton Dec., § 7)). Plaintiffs do not assert that information from these files is missing. [FN9]

FN9. Indeed, the undisputed evidence is that in May 1999, when a change in computer systems led Mr. Gavillet to be concerned that certain of his e-mails had been lost, efforts were undertaken--successfully--to restore them (Hrg. Tr. 84 (Urban); 316-18 (Alpers); 467-68 (Gavillet)).

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Third, while a few important senior executives left the company in the summer of 1998 (specifically, Mr. Sweas and Mr. Mullaney), there is no evidence that their e-mail files still existed as of the time this litigation commenced in November 1998. To the contrary, Mr. Urban's testimony establishes that pursuant to the program of purging e-mail files that he put into place, the e-mail files of executives who left USN in the summer of 1998 would likely have been purged before November 1998 (Hrg. Tr. 90-91 (Urban)).

Fourth, the undisputed testimony established that Mr. Urban had responsibility only for the NT server side of USN's electronic data system. Mr. Urban had no responsibility whatsoever for USN's UNIX databases, which came under the responsibility of another employee, Mr. Rohrman. There is no evidence that the electronically stored billing and financial data on the UNIX system--which would include information on revenues and costs--was destroyed afer the lawsuit commenced.

To the contrary, the evidence establishes that USN in fact did take measures to preserve that data. In January 1999, backup tapes were made of the REPGEN files then existing in the UNIX system, in connection with the implementation of a new software application; "Quick Reports" (Hrg. Tr. 380 (Struble)). And in May 1999, after USN filed bankruptcy and its assets (including the computers) were about to be sold to CoreComm, USN made backup tapes of all of the data on the UNIX servers, so that information would be preserved after the sale of assets (*Id.*, at 374).

J. The Discovery in This Case.

The documentary discovery in this case got off to a late start, as the result of a number of factors--not the least of which was the fact that USN was in bankruptcy, and a dispute arose as to the ability to obtain documents from USN in light of the pending bankruptcy proceeding. The Court resolved that dispute on January 27, 2000 (doc. # 135), and shortly thereafter, documents from USN were made available--in a volume that apparently no one expected. While counsel for the individual defendants originally indicated that USN had thirty-five boxes of documents to produce, some 587 boxes ultimately were produced, comprising more than one million pages of documents and various computer tapes containing countless additional (or duplicative) documents (Defs.' Mem., App. 1 (Walton Dec., § 5)). The computer tapes produced included the backup tapes made of the UNIX computer system shortly before the sale to CoreComm in May 1999; however, it does not appear that the January 1999 backup tape was produced. Plaintiffs selected more than 500,000 pages of those documents for copying (Defs.' Mem., App. 1 (Walton Dec. § 6)), and created a computer database for storing the documents electronically. According to plaintiffs' counsel, the database has word search capability to facilitate location and retrieval of documents (7/25/00 Tr. at 42).

***20** Despite this sophisticated system, it is clear that even as of the time that the amended motion for sanctions was refiled on July 25, 2000, plaintiffs did not have a firm grasp of what documents they possessed--and the individual defendants did do much to help plaintiffs figure it out. We focus the following discussion on the particular categories of information the plaintiffs claim are missing.

1. Sales Information.

In their amended motion, plaintiffs assert that no Monthly Sales Roll Up Reports had been produced, and that this information is critical to their case (Pls.' 7/25/00 Am. Mem. at 7). Plaintiffs' evidence fails to establish either point.

As discussed above, while it appears to be the case that no documents entitled "Monthly Sales Roll Up Report" have been produced, the individual defendants have produced reports that contain the same information as plaintiffs assert was contained in the Sales Roll Up Reports. It is clear that the defendants have produced raw sales data, as reported by the field, in "roll-up" form for every month since January 1997, in the form either of the State Directors Reports or the Summary Sales Reports generated from the Vantive database.

The testimony establishes that the State Directors Reports contain the same information as the Monthly Sales Roll Up reports. Ms. Reynolds testified that the State Directors Reports were the same as the Monthly Sales Roll Up Reports (Defs.' Mem., App. 6 (Reynolds Dep. 82-84)). And, while Ms. Van Dinther said that the Roll Up Reports differed somewhat from the State Directors Reports, she also testified that they were based on the same source of information (Hrg. Tr. 124-25), and that any differences between them were not major (*Id.*, at 113-14). USN has produced State Directors Reports for each month

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from January through November 1997.

The evidence also establishes that beginning in mid-December 1997, USN began generating a Sales Summary Report from the Vantive system. The individual defendants produced to plaintiffs those reports covering the entire time period from December 15, 1997 through September 18, 1998 (Defs.' 09/05/00 Submission, Ex. A). The Sales Summary Reports generated from the Vantive system set forth the same information as the State Directors Reports (*compare* Defs.' Exhibit 2 (State Directors Report) *and* Defs.' Exhibit 3 (Sales Summary Report)). Both are based on information reported from the sales department, and both contain the same categories of information (*Id.; see also* Hrg. Tr. 425 (Dundon)). [FN10]

FN10. There is a dispute as to whether USN continued to generate hard copy Monthly Sales Roll Up Reports or State Directors Reports after November 1997. Ms. Van Dinther says that she continued to prepare Monthly Sales Roll Up Reports in 1998 (Hrg. Tr. 100 (Van Dinther)). By contrast, Mr. Dundon testified that the Monthly Sales Roll Up Reports and/or the State Directors Reports were not used after the implementation of Vantive in late 1997 (*i.e.*, late November or December 1997) (Hrg. Tr. 422, 426, 435-36 (Dundon)), and that the Vantive reports were "meant to be replacement for [the] sales roll-up reports" as "the place that the company was capturing its sales data for reporting" (*Id.*, at 425). We credit Mr. Dundon's testimony, which also is consistent with the fact that, while defendants produced State Directors Reports for each month through November 1997, no such reports were produced after that time. In any event, since the Vantive Sales Summary Reports contain the same sales data as the Monthly Sales Roll Up Reports or State Directors Reports, this dispute is immaterial to the outcome of the motion.

Based on the foregoing, the Court finds that the State Directors Reports and the Sales Summary Reports produced by defendants contain essentially the same information the plaintiffs sought in the Monthly Sales Roll Up Reports. The Court therefore concludes that the plaintiffs have received the information they have sought regarding the raw, unprovisioned, sales data necessary to test their theory that the publicly-reported revenue numbers were based on inflated and untested sales data. Moreover, the Court finds plaintiffs' assertions to the contrary troubling in two regards.

***21** *First*, in a response to a request to admit served on July 18, 2000 (on the eve of the amended sanctions motion), plaintiffs asserted that they had received only "a very limited number" of State Directors Reports and the Sales Summary Reports generated by the Vantive system (Defs.' Mem., Ex. 25 (Request No. 11)). Thatgrudging admission is belied by the evidence: the individual defendants have produced State Directors reports for each month from January through November 1997, and have submitted Sales Summary Reports generated by the Vantive system for the entire period from December 15, 1997 through September 18, 1998 (*see* Defs.' 09/05/00 Submission, App. A; Defs.' 09/07/00 Submission, App. A-1).

Second, the Court finds that plaintiffs plainly would have known--had they examined their computerized document data base--that they had received State Directors Reports for each month from January through November 1997. Plaintiffs also should have known that the Sales Summary Reports from the Vantive provided the same information. The documents generated from the Vantive database were voluminous, consisting of some 124 boxes which were produced for plaintiffs' review during the week of May 29, 2000. But, despite the volume of the documents, plaintiffs clearly were able to identify the Sales Summary Reports that contained the same categories of information as roll up reports: we know that because plaintiffs requested copies of three months worth of those reports (April 15 through July 15, 1998). However, plaintiffs inexplicably failed to copy the Sales Summary Reports from the Vantive system covering the period December 16, 1997 through April 15, 1998, and the period July 16 through September 18, 1998 (Defs.' 09/05/00 Submission, App. A). Thus, to the extent that plaintiffs do not have the sales information they seek, it is not as a result of the defendants destroying it or failing to produce it--it is a result of plaintiffs failing to copy it.

The failure of plaintiffs to copy all of the Sales Summary Reports is particularly puzzling, since plaintiffs had expressed to the Court an urgent need

to obtain them. During a hearing on April 11, 2000, plaintiffs stated that they had received only one Monthly Sales Roll Up Report, and while defendants disagreed, they were unable to specify how many of them (or how many State Directors Reports) had been produced and for what periods of time (4/11/00 Tr. at 24). Plaintiffs argued that they needed this sales information to show that the publicly reported revenue was based on information concerning sales that never actually matured into real billings, with the result being that the publicly reported revenue was overstated (*Id.*, at 22-23). The Court accepted plaintiffs' argument, and ordered the individual defendants to rebuild a computer system and application program that could access the Vantive sales data from the backup tapes of the UNIX databases made before the sale to CoreComm in May 1999. The Court ruled that while the backup tapes meant that the sales information on the Vantive system was not destroyed, the absence of a computer system capable of running the tapes to extract the information rendered that information unavailable, and that in those circumstances, it was fair to require the individual defendants to shoulder the cost of extracting that information (*Id.*, at 36-38).

***22** The individual defendants did so, and the cost was substantial: they place it at $159,632.63 (Elliott's 09/29/00 Submission, at Ex. G). Subsequent events have persuaded the Court that this was a cost that plaintiffs needlessly inflicted on defendants.

The failure to copy that information suggests what the Court finds the evidence shows: that the sales information does not command the central importance of this case that plaintiffs originally alleged. In the initial motion and in numerous statements to the Court thereafter, plaintiffs took the position that USN used inflated sales projection numbers set forth in the Monthly Sales Roll Up Reports as the basis for the publicly reported revenue figures. However, after extensive briefing and in court testimony, plaintiffs have offered no credible evidence that this was the case. The principal source of this allegation was Ms. Van Dinther, who has no financial background, who had no role in preparing the publicly reported financial statements, and who admitted that the sole source for her belief was overhearing a conference call that she had set up where those involved stated that the sales numbers were going to be "reported." Ms. Van Dinther admitted that she did not know to whom the sales numbers were being "reported," that she had no actual knowledge that rollups were used to report revenue publicly, and that her initial allegation that roll up reports were the basis for reported revenue could be mistaken (Defs.' Mem.App. 7 (Van Dinther Dep. 108-09, 115, 123)). The other source for this allegation, Ms. Reynolds, likewise offered no factual basis for her assertion that roll up reports were the basis for reported revenue, and admitted that she did not know how the company tracked revenue (*Id.*, App. 6 (Reynolds Dep. 85, 103-104, 123)). [FN11]

FN11. Plaintiffs also have asserted that testimony by Mr. Parrish, USN's former executive vice president of operations, "confirmed" that the Monthly Sales Roll Up Reports were the "sole source" of USN's information on lines sold (Pls.' 07/25/00 Am.. Mem., at 7 and App. 9, at 97-101). However, Mr. Parrish's testimony refutes that assertion: he made it clear that the rollups were *not* the foundation of the lines sold information (*Id.*, at 98), and that lines sold statistics were based on what was provisioned after the "scrubbing" process described above at pp. 13-15 (*id.*, at 99-101).

Indeed, in the amended motion, plaintiffs now urge that publicly reported revenue was derived not from internally reported sales information, but rather from what was actually billed to customers (Pls.' 7/25/00 Am. Mem. at 13). Plaintiffs should have known, long before filing the amended sanctions motion filed on July 25, 2000, that they suffered no prejudice from any loss of any Monthly Sales Roll Up Reports. [FN12]

FN12. Plaintiffs nonetheless continue to assert that those reports would show that the revenues that were publicly reported were fictitious, and they assert that no such reports were produced for the period August 1997 through February 1998 (Pls.' Reply Mem. at 10-11). However, the evidence contradicts that assertion: the State Directors Reports and Vantive Sales Summary Reports--which, if they are not the same as roll up reports, contain the same information--were produced for that entire period (with the exception of a two-week gap December 1 through December 15, 1997).

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2. Final Sums/Final Sum Summary Reports.

In the amended motion for sanctions, plaintiffs asserted that "not a single Final Sum or Final Sum Summary Report (in either hard copy or in Excel spread sheet format) was ever produced to plaintiffs by USN or any other defendant" (Pls.' 7/25/00 Am. Mem. at 13). However, plaintiffs' counsel conceded at the close of the evidentiary hearing what the evidence has clearly established: "[t]hat was an incorrect statement" (Hrg. Tr. at 486).

The individual defendants have produced Final Sum Summaries in hard copy form for each month during the period August 1996 through January 1999 (Defs.' 09/05/00 Submission, App. B). These reports are titled "Final Sum Summary," and thus plaintiffs would have known they had these documents had they looked for them on their computerized database. [FN13] This makes all the more disappointing plaintiffs' assurance in open court on July 25, 2000--the date the amended motion was filed--that plaintiffs' counsel had searched their litigation database and could verify that no Final Sum Summaries had been produced (07/25/00 Tr. at 42, 57-58).

FN13. The Court has determined this not from a computer database, but by a manual review of the documents listed by defendants as Final Sum *or* Final Sum Summaries (*see* Defs.' 09/05/00 Submission, App. B).

***23** The record is murkier with respect to the individual defendants' production of Final Sum Reports because even now, after the exchange of hundreds of thousands of pages of documents and the taking of scores of depositions, the parties cannot agree on precisely what a Final Sum Report is. Plaintiffs claim that the Final Sum Report is a voluminous document (one sample of which is Plaintiffs' Exhibit 2), an assertion that finds some support in the testimony of Mr. Doyle from Spectrum (Hrg. Tr. 164); but elsewhere in his testimony, Mr. Doyle referred to that document as a Final Sum "detailed file" (*Id.*, at 142, 164). On the other hand, the individual responsible at USN for dealing with such reports, Mr. Pellino, has testified that Plaintiffs' Exhibit 2 is not a Final Sum Report, but rather is a report generated from the REPGEN database file, which provides backup information for the much thinner Final Sum Report (Hrg. Tr. 294). Mr. Pellino identified Defendants' Exhibit 5 as an example of a Final Sum Report (*Id.* at 295). But, Mr. Pellino also described Defendants' Exhibit 7 as a Final Sum Report (*Id.* at 294-95)--even though it bears the title "Final Sum Summary." Mr. Struble tended to support Mr. Pellino's testimony, by identifying Plaintiff's Exhibit 2 as a Final Sum "detail report" (Hrg. Tr. 384), and his description of the information in the REPGEN database is consistent with the information contained in Plaintiffs' Exhibit 2.

The Court is inclined to credit Mr. Pellino's testimony on this score: he is the individual who was responsible at USN for dealing with these documents, and DX5 in fact bears the label "Final Sum," whereas PX2 bears no such label. However, whichever way this question is resolved provides no particular comfort to the individual defendants, because they have failed to make full production of either of these types of documents.

Even after extensive briefing and an evidentiary hearing, the individual defendants have never identified for the Court the extent of their production of Final Sum Reports. Thus, the Court has undertaken a manual review of all the documents that the defendants have identified as Final Sum or Final Sum Summaries. In so doing, the Court has found that 54 of the documents listed by the individual defendants as Final Sum or Final Sum Summary Reports (Defs.' 09/05/00 Submission, App. B) were not provided to the Court as requested. Based on the title of the documents the individual defendants have provided, or on a comparison of them to Defendants' Exhibit 5 (which the individual defendants identified as a Final Sum Report), if the Final Sum Report is the type of document described by Mr. Pellino, defendants have produced them only for a smattering on months: June 1998, August-September 1998, November 1998 and January 1999. [FN14] Given that Final Sum Summaries covering the entire period for August 1996 through January 1999 were produced, these gaps are substantial. If the document that Mr. Pellino describes as being generated from the REPGEN database is instead a Final Sum Report, as Mr. Doyle suggests, the gaps in defendants' production are even more substantial: the individual defendants have not produced *any* of those reports.

FN14. The Bates Numbers of these

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documents are USN3049587-96; USN12000877-79; USN1200040-41, 000892-93; USN6008101-102; and USN2-035369.

***24** This lack of production may stem in part from a lack of preservation of the information since, according to Mr. Doyle, prior to December 1997 some Final Sum Reports were sent by e-mail. However, the presence of so many Final Sum Summaries, andso few Final Sum Reports, leads this Court to conclude there was no intentional destruction, and that given the lack of any system of document preservation prior to this lawsuit, the missing reports may no longer have been retained by USN when this suit was filed. But the failure to implement a clear and rigorous document preservation program after this lawsuit commenced makes it difficult to determine when these hard copy Final Sums Reports were lost and why.

Despite this absence of hard copy Final Sum Reports, the evidence suggests that copies of those documents were preserved by USN in electronic form. Thus, the failure to produce that information may reflect the failure by the individual defendants to search for and produce information available to them. We focus on three sources in particular that the individual defendants have failed to explore.

First, Mr. Struble testified that the volumes of data underlying the Final Sum Reports was always put onto the FTP server and downloaded to the REPGEN database on the UNIX server (Hrg. Tr. 371 (Struble)). Mr. Struble testified that in January 1999, a backup tape was made containing all information in the REPGEN database. Mr. Struble testified that this occurred because USN, for business and not litigation reasons, replaced the REPGEN system with a system called "Quick Reports," and then archived the REPGEN database on the backup tape (*Id.*, at 380-81, 384-86). Mr. Struble testified that this backup tape was conveyed to CoreComm in the sale of USN assets in May 1999, and that CoreComm still possesses that backup tape (*Id.*). Moreover, Mr. Struble testified that this January backup tape could be accessed at CoreComm, by restoring it to the UNIX servers presently at CoreComm (Hrg. Tr. 379)--a process that would take only "a few days" (*Id.* at 386).

Nonetheless, at the time of the hearing, the individual defendants had not asked CoreComm to examine that backup tape to see what REPGEN information was available on it. Mr. Struble testified that he had only been requested to look for backup tapes on September 11, 2000 (after Mr. Doyle's testimony), and had found backup tapes containing what he believed were credit files preserved from the REPGEN backup in January 1999, and which he produced for the first time when he came to court for the evidentiary hearing on September 12, 2000 (Hrg. Tr. 382-83).

Second, Mr. Struble testified that in May 1999, prior to the consummation of the sale to CoreComm, USN made a "snapshot" of the information on the UNIX servers, which would have "preserved all the data that existed" at the time on USN's production servers (Hrg. Tr. 360). [FN15] That information was then provided to counsel for the individual defendants (*Id.* at 360-61). However, the individual defendants did not take steps to ensure that a computer system would be available to search for and extract the data on those tapes, as may be needed for the litigation (Hrg. Tr. 391 (Struble)). [FN16]

FN15. At the hearing, Mr. Struble testified that the "snapshot" was taken of all the UNIX production servers,, as opposed to development servers, because the idea was to save the "production, operational, and financial information" not the development information (Hrg. Tr. 390). Although the Vantive database was saved to a CD Rom, Mr. Struble was not certain that Vantive was saved on the Snapshot, because he did not know if a snapshot was taken of the development servers, and he thought that Vantive was run on a development server (*Id.*, 389-90).

FN16. At the April 11, 2000 hearing, during which the Court ordered the defendants to rebuild the computer system sufficiently to extract the Vantive sales information, the Court declined to order the individual defendants to recreate the system (and the software applications) to the extent that was necessary to run the financial and accounting information on that system. The Court did so based on the representation, unrebutted by the plaintiffs, that the defendants had produced in hard copy form all relevant financial records (4/11/00 Tr.

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13-14, 39). Given the admitted importance of the Final Sum Reports as the starting point for USN's publicly reported revenue figures (Hrg. Tr. 296-297 (Pellino)), that representation clearly was incorrect.

***25** *Third,* the individual defendants did not ask CoreComm to search its active computer databases for Final Sum Reports until late August 2000--at which time the individual defendants learned that those computers have Final Sum Reports going back to August 1998 (Hrg. Tr. 362-63), which in early September they produced in disk form. In offering possible explanations for the lack of Final Sum Reports prior to August 1998, Mr. Struble testified CoreComm might have deleted that information for space reasons (*Id.* at 368). Mr. Struble testified that if that information was deleted for space reasons, it would be archived and preserved; but he was not asked by the defendants to look on any archived tapes for Final Sums Reports prior to August 1998 (*Id.*)

The Court finds that the individual defendants failed to conduct a sufficiently thorough search to locate Final Sum/REPGEN reports. The Court does not find convincing defendants' argument that there was no need to make such a search until they were ordered by the Court to do so on July 25, 2000 (Hrg. Tr. 372). On July 13, 1999, the District Court ordered mandatory disclosure in this case pursuant to Rule 26(a)(1) (doc. # 23); that disclosure was due by October 25, 1999 (doc. # 63). There could be no legitimate doubt about the discoverability of the Final Sum/REPGEN information, which Mr. Pellino described as the starting point for the revenue information contained in the public financial statements (Pls.' 07/25/00 Am. Mem., Ex. 19 (Pellino Dep. 51- 57, 107)). Moreover, as described above, even the search for Final Sum Reports by the individual defendants after the July 25 order leaves much to be desired--they did not ask CoreComm to search for archived information, and they did not examine what might be on the January 1999 tapes. In ordering the search for Final Sum Reports (and certain other categories of documents raised in plaintiffs' motion), the Court directed that the individual defendants focus their search on the places where it is "most likely that a document will be found" (7/15/00 Tr. at 57)--which the individual defendants certainly should have known would be the tapes.

The Court is mindful of the difficulties created by the bankruptcy of USN, which deprived the individual defendants of ready access to a going-concern client which could provide thorough explanations of the documents and databases at USN (Hrg. Tr. 498-500). However, USN's bankruptcy was declared in February 1999. The sale to CoreComm did not close until May 1999; the testimony indicates that during that three-month period, outside counsel for the individual defendants spent time at USN reviewing and assembling documents. One would expect that as a part of that process, there would be a discussion of what documents went into preparing the public financial reports--and such a discussion would have disclosed the existence and importance of the Final Sum Reports, and the REPGEN database from which it was drawn.

***26** Moreover, USN's sale of assets imposed on CoreComm a contractual obligation to aid the individual defendants in their search for discoverable information. The speed with which Mr. Struble was able to locate the January 1999 backup tapes and the relative ease of accessing the data on them is evidence that earlier requests by the individual defendants likely would have yielded fruitful information forboth sides and for the Court and thus may have obviated--or drastically reshaped--this sanctions motion.

The failure of the individual defendants to produce the Final Sum Reports or information from the REPGEN database is mitigated only by the fact that, fortuitously for them, the plaintiffs have obtained this information from a non-party: Spectrum, the company that generated those documents. On or about July 18, 2000, plaintiffs received four CD Roms from Spectrum containing a wealth of information that passed between Spectrum and USN with respect to the billing of customers. At the evidentiary hearing, Mr. Doyle testified that the directory to the CD Roms showed that they contain what he referred to as Final Sum Reports (and what the individual defendants say is REPGEN) for the period July 1996 through September 1997, January 1998, and March 1998 through January 1999 (Hrg. Tr. 178-81). The only gaps in the Final Sum information from Spectrum may be October through December 1997 and February 1998: and we say that these "may" be gaps because further analysis of the CD Roms may yield additional information. [FN17]

FN17. Plaintiffs may seek to assign significance to the fact that these missing

> months occurred shortly before the initial public offering in February 1998, to suggest that the absence implies intentional destruction. The Court finds otherwise. Given that Mr. Doyle was a "friendly" witness to the plaintiffs, who testified at their request, the fact that he could not retrieve or find Final Sum Reports for those months from the independent records of Spectrum, which generated the reports, is consistent with those reports being absent for independent reasons. In fact, the Arthur Andersen Report indicated as early as September 25, 1998 (before the inception of the lawsuits) that certain USN's financial documents used to calculate revenues (such as the Final Sum Reports) were missing or "not as detailed" in the fourth quarter of 1997 as in the first and second quarters of 1998 (Pls. Reply Mem., App. A, at 2, 4) (billing information for the company's financial statements missing in the third and fourth quarters of 1997; and "historical financial supporting documents for Q3 and Q4 1997 is not as detailed as it is for Q1 and Q2 1998").

Thus, at the time that plaintiffs represented in their July 25, 2000 amended motion for sanctions that they had not received Final Sum Reports from USN "or any other defendant," they in fact were in possession of the CD Roms from Spectrum that contained the Final Sum information. Plaintiffs' counsel indicated that plaintiffs did not understand that this information was on the CD Roms from Spectrum until September 10, 2000, the day before the hearing (Hrg. Tr. 485-86). However, even to the uninitiated, the index to the CD Roms (Defendants' Exhibit 8) plainly shows multiple entries that should have alerted plaintiffs to the possible presence of the Final Sum Reports *See, e.g.*, Defendants' Exhibit 8 at 2 (five entries bearing the name "Final Sum"); 4 (one document entitled "Final Sum spec. doc"); 8-9 (a document referred to as Fnl ____ Sums. Zip," and entries bearing the labels "fs" for each month from July 1996 through September 1997); 16 (entries bearing the label "Final Sum. DB" for January 1998 and March 1998--January 1999). If plaintiffs did not understand what was on the CD Roms, it is because for two months they failed to make sufficient inquiry either of Spectrum or the individual defendants.

Nor have plaintiffs explained why they delayed in producing these CD Roms to defendants. Plaintiffs obtained these CDs from Spectrum on or about July 20, 2000, and the individual defendants had requested copies of any CDs received by plaintiffs. However, plaintiffs did not provide copies of those CDs until on or about September 5, 2000.

***27** What emerges from this thicket concerning the FinalSum/REPGEN documents is that even as of the hearing, neither the plaintiffs nor defendants have full command over what documents they possessed. Perhaps the most apt comment is the one made by plaintiffs' counsel at the close of the hearing, in which he stated that the understanding of the documents "was very much a learning process" that continued even through the time of the hearing (Hrg. Tr. 489). It appears to have been a learning process for both sides. That learning process has been protracted and rendered more difficult--and costly--by the fact that the parties have failed to use the tools available to get a handle on what documents exist. [FN18]

> FN18. Plaintiffs have also claimed that defendants have destroyed, or improperly failed to produce, detailed statements showing what credits were applied to various accounts, and the reason for the credit (a sample of such a document is Plaintiffs' Exhibit 3). A number of those credit reports are on the tape received from Spectrum, but many others are unavailable because the information was corrupted (Hrg. Tr. 151) (Doyle). However, in an earlier ruling, the Court denied a motion to compel production of these documents, reasoning that information about what credits had been applied to which accounts would be available in the Final Sum Reports (7/25/00 Tr. at 64-65). And, in fact, the document identified by Mr. Doyle as a Final Sum Report (and by Mr. Pellino as a report from the REPGEN database) shows, for each account, what credit was applied against the customers' bill in a particular month. Having reviewed a full credit report, the Court is unpersuaded that the plaintiffs had been prejudiced by the fact that the credit report provides a description of the reason for the credit, while the Final Sum/REPGEN report does not. Moreover, Mr. Doyle testified that even without the detailed credit reports, one could calculate the amounts that were billed

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and then credited back (Hrg. Tr. 167-68).

3. Aged Accounts Receivable Information.

According to plaintiffs, aged accounts receivable information is critical because it would show that many of the receivables publicly reported by USN as revenue in fact were very old, that USN did not sufficiently reserve for the collectability of these older receivables, and that the revenues were therefore inflated. On July 18, 2000, shortly before filing the amended motion, plaintiffs answered a request to admit by denying that "any aged accounts receivable reports were produced" (Defs.' Mem., App. 25 (Request to Admit No. 10)). One month later, when they filed their reply brief on the sanctions motion, plaintiffs asserted that they have received only scant production of documents showing aged accounts receivable information (Pls.' Reply Mem. 11- 12), and that no such information was provided for the period prior to February 1998.

The evidence contradicts plaintiffs' assertion. The evidence shows that the individual defendants produced aged accounts receivable information in various forms for the period September 1996 through October 1997, which is virtually the entire time period before the beginning of the class period. Moreover, this time period encompasses the period relevant to the initial public offering, as that was based on financial information through October 1997 (Defs.' 09/08/00 Mem., at 9). Thereafter, there are account receivable reports for December 1997, March 1998, June 1998 through January 1999, and March through April 1999; (Defs.' 09/05/00 Submission, Exhibit C). [FN19] Moreover, while there are no reports for November 1997, January through February 1998, April through May 1998 and February 1999 aged receivable information for these months can be found in certain other documents for April and May 1998 (*see* USN 2-038332, USN 22-021567).

FN19. Subsequent to this submission, the individual defendants identified another report setting forth aged accounts receivable information (Defendants' Exhibit 11), which covered the period of December 1997.

Plaintiffs argue that these missing months reflect an "unusual pattern of destruction," as they encompass "the critical [three-month] period" prior to the initial public offering and two months in the middle of the class period (Pls.' 09/07/00 Notice, at 10). The Court does not find that these gaps, or the time periods they cover, constitute persuasive evidence of intentional destruction. The prospectus only included information through November 1997; with the exception of November 1997, the individual defendants produced aged receivable information for each month from September 1996 through December 1997. While there are some missing months during the class period, there are far more months when the aged accounts receivable information has been produced.

***28** There is no testimony or evidence indicating that the missing aged receivable data is contained on the January 1999 back up tapes or on the snapshot taken of the UNIX production server (and thus exists in an unproduced form). While the absence of a preservation program raises questions as to whether reports for these months existed as of the initiation of this lawsuit and then were lost, the record also supports the inference that these missing documents may have been missing before the inception of this lawsuit. The Arthur Andersen Report states that with respect to "[t]he Company's accounts receivable agings (excluding wireless) as of June 30, 1998, March 31, 1998, December 31, 1997 and September 30, 1997 ... The company could only provide a detailed aging for the Midwest region as of June 30, 1998. Management stated that other detailed agings were not currently available due to system conversions, and the limited utility of the old systems" (Pls.' Reply Mem., Ex. A, at 17).

4. Monthly Close Packages/Revenue Close Packages.

Plaintiffs amended motion asserted that the individual defendants had failed to produce Monthly Close Packages or Revenue Close Packages (Pls.' 07/25/00 Am. Mem. at 10). On the day that the amended motion was filed, when asked in open court whether they had searched their database of documents produced by the defendants to locate any such reports, plaintiffs represented that they "absolutely" had done so and had verified that "we do not have those documents" (7/25/00 Tr. at 45). Once again, that assertion proved incorrect.

In a written submission filed on September 7, 2000--four days before the hearing--plaintiffs conceded that they had received the Monthly Close Packages, and

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withdrew reliance on the alleged non-production of those reports as a basis for their amended motion. When asked at the conclusion of the evidentiary hearing to explain why plaintiffs had provided the Court with incorrect information, plaintiffs' counsel indicated that the documents were not clearly labeled as Monthly Close or Revenue Close Packages, and that the plaintiffs thus were unaware that they had them (Hrg. Tr. 482-84). This explanation, however, is not satisfactory. If the database used by plaintiffs to store and retrieve documents produced in the lawsuit has word search capability, as plaintiffs have represented (7/25/00 Tr. 42), then a word search would have disclosed that many of the documents identified by the individual defendants bear the label of Revenue Close or Revenue Closing Check List.

K. Prejudice.

Plaintiffs have failed to establish substantive prejudice from the failure of USN to institute an appropriate document preservation plan in the face of the commencement of this lawsuit. Virtually all of the information that plaintiffs claim they has been deprived of has been produced to them--either by the individual defendants or non-parties.

First, the evidence has established that the information contained in the Monthly Sales Roll Up Reports referred to by Ms. Van Dinther is the same information that has been produced to plaintiffs in the form of the State Directors Reports and Sales Summary Reports produced from the Vantive database. Thus, the information that plaintiffs claim was destroyed was in fact made available to them--even though, in the case of the Sales Summary Reports, plaintiffs elected not to obtain copies of most of that information. Moreover, plaintiffs' Rule 26 expert reports do not indicate that any of the sales information that plaintiffs chose to copy (such as the monthly Sales Directors Reports from January through November 1997) was given to plaintiffs' experts to use in forming their opinions. Had this information been critical to showing that the publicly reported revenue was inflated, because it was based on unreliable sales figures, one would have expected plaintiffs to provide the sales data to their experts so that they could test that hypothesis. Plaintiffs' failure to do so further undermines any claim of prejudice from the absence of what plaintiffs have labeled Monthly Sales Roll Up Reports.

***29** *Second,* the plaintiffs have received from the individual defendants aged accounts receivable information for all but one of the months in the period leading to the initial public offering, and for most of the period thereafter. While there are some gaps in the time period of production, they are small in relation to what has been produced. And plaintiffs have not offered any evidence as to what an analysis of the aged accounts receivable information they have received shows; indeed, the Rule 26 reports do not indicate that that information has ever been provided to their experts. The Court finds that plaintiffs cannot claim prejudice from the missing months of aged accounts receivable information, when they have not even used the information they have received with their experts.

Third, while plaintiffs have received from the individual defendants Final Sum Summary Reports for the entire relevant time period, the individual defendants clearly have failed to produce Final Sum Reports for every month in the class period. This failure to produce is material because the REPGEN source data and the Final Sum Reports generated by Spectrum were, by all accounts, central to USN's publically-reported revenue numbers: Mr. Dundon testified that this data was "vitally important" to the revenue process (Hrg. Tr. 444), and Mr. Pellino testified that it was the "starting point" for his revenue calculations (Hrg. Tr. 294). While it appears that the defendants preserved the electronically-stored information that would include the Final Sum /REPGEN information, even now they have not searched the available sources (such as the backup tapes located at CoreComm) to see what information is there.

Any substantive prejudice in prosecuting the case, however, has been eliminated by the fact that plaintiffs now have received the Final Sum/REPGEN reports from Spectrum covering virtually the entire period from August 1996 through January 1999. The Court notes that plaintiffs have not made--and thus have waived--the argument that they have been prejudiced because of a delay in obtaining the Final Sums/REPGEN reports. Even if such an argument had been made, the Court would not find it persuasive. According to plaintiffs, it was the testimony of Mr. Doyle in his deposition on June 13, 2000 that highlighted the significance of the Final Sum Reports as providing "the backbone of USN's publicly reported revenues and accounts receivable" (Pls.' Reply Mem. at 10). However, after receiving the CD Roms from Mr. Doyle by about July 20, 2000, plaintiffs--even as of the time of the evidentiary hearing on September 11 and 12, 2000--

had not taken the steps necessary to fully examine the information on the CDs. Once they obtained the CD Roms from Spectrum, plaintiffs did not act with the urgency one would expect in examining the information that they claimed to be so critical to the case. Moreover, the plaintiffs did not make use of the Final Sum Summaries and Final Sum Reports that they did have in their possession in the expert reports they submitted.

***30** The Court finds that there is one element of prejudice that plaintiffs suffered from the failure of the individual defendants to produce the Final Sum/REPGEN information: cost. The assertion by the individual defendants that it would be easier for plaintiffs to get the information from Spectrum than for the individual defendants to search for it (*see* 07/25/00 Tr. at 62-63) is belied by Mr. Struble's testimony that it would take CoreComm only a few days to restore the January 1999 backup tapes containing Final Sum/REPGEN files (Hrg. Tr. 386 (Struble)). The fact that the individual defendants had to go to Spectrum, a third-party, to obtain what the individual defendants should have produced resulted in the plaintiffs incurring costs they should not have been forced to shoulder. The Court is skeptical about the fees and costs plaintiffs assign to getting and understanding the Spectrum data--$53,192.75 in fees and costs, and $125,583.00 in experts fees. But certainly, as plaintiffs did to defendants with the rebuilding of a computer system to run the Vantive database, defendants have saddled plaintiffs with some level of unnecessary fees and costs.

II.

As presented by plaintiffs' amended motion for sanctions, the question before the Court is the alleged destruction of documents by USN (and the responsibility of Mr. Elliott and certain outside directors for any such destruction). As the evidence has unfolded, the Court views the issue as more complex: it presents not only a destruction issue, but an issue as to how each side has conducted itself in this discovery process.

For the reasons set forth below, the Court concludes that USN failed to implement an adequate document preservation policy and that Mr. Elliott is responsible for that failure; the outside directors are not. The Court further finds that the absence of an adequate document preservation policy has not substantively prejudiced plaintiffs; however, the conduct of each side in discovery has inflicted needless cost on the other.

In Part A, we discuss the governing legal principles. In Part B, we explain the reasoning that leads us to the foregoing findings. In Part C, we set further the recommendations that flow from those findings.

A. The Applicable Legal Standards.

The Court's authority to sanction a party for the failure to preserve and/or produce documents is both inherent and statutory. *Chambers v. NASCO, Inc.*, 501 U.S. 32, 50-51 (1991) (federal courts may sanction bad faith conduct by its inherent powers or by the Federal Rules of Civil Procedure); *Barnhill v. United States*, 11 F.3d 1360, 1368 (7th Cir.1993) (same). Whether proceeding under Rule 37 of the Federal Rules of Civil Procedure or under a court's inherent powers, the "analysis is essentially the same." *Cobell v. Babbit*, 37 F.Supp.2d 6, 18 (D.D.C.1999); *GatesRubber Co. v. Bando Chem. Indus., Ltd.*, 167 F.R.D. 90, 107 (D.Col.1996) ("any distinctions between Rule 37 and the inherent powers of the court are distinctions without differences"). However, the power to enter a default judgment or to dismiss a case for noncompliance with an order to preserve and produce documents for discovery "depends exclusively upon Rule 37, which addresses itself with particularity to the consequences of a failure to make discovery" by "any party" and authorizes "any order which is 'just.' " *Societe Internationale Pour Participations Industrielles et Commerciales, S. v. Rogers*,357 U.S. 197, 207 (1958).

***31** In general, sanctions are intended to serve one or more of the following purposes: (1) to ameliorate the prejudice caused to an innocent party by a discovery violation; (2) to punish the party who violates his or her obligations; and/or (3) to deter others from committing like violations. *See generally National Hockey League v. Metropolitan Hockey Club, Inc.*, 427 U.S. 639, 643 (1976) (noting dual purpose of punishment and deterrence); *Marrocco v. General Motors Corp.*, 966 F.2d 220, 224 (7th Cir.1997) (discussing compensatory purpose of directed verdict as sanction for prejudice resulting from lost documents: "sanctions can be employed for a wide array of purposes, but they cannot replace lost evidence"); *Telectron v. Overhead Door Corp.*, 116 F.R.D. 107, 135 (S.D.Fla.1987) (discussing three purposes of sanctions: punishment, deterrence and compensation for prejudice). A district court considering the imposition of sanctions "must be guided by a certain measure of restraint[,]" *Barnhill,*

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11 F.3d at 1368, and any sanction leveled must adhere to "the norm of proportionality...." *Newman v. Metropolitan Pier & Exposition Authority*, 962 F.2d 589, 591 (7th Cir.1992).

This is not to say that a court is always required "to fire a warning shot" before imposing a stiff sanction; it is not. *Hal Commodity Cycles Mgmt. Co. v. Kirsch*, 825 F.2d 1136, 1139 (7th Cir.1987). Nor must a court select the "least drastic" or "most reasonable" sanction. *Melendez v. Illinois Bell Telephone Co.*, 79 F.3d 661, 672 (7th Cir.1996) (citing cases). Dismissal or default, although harsh, may be appropriate so long as "the sanction selected [is] one that a reasonable jurist, apprized of all the circumstances, would have chosen as proportionate to the infraction." *Long*, 213 F.3d at 986 (*quoting Salgado v. General Motors Corp.*, 150 F.3d 735, 740 (7th Cir.1998)). *See also Langley v. Union Elec. Co.*, 107 F.3d 510, 515 (7th Cir.1997) ("An award of sanctions must be proportionate to the circumstances surrounding the failure to comply with discovery"); *Melendez*, 79 F.3d at 672 (same). *See generally Anderson v. Beatrice Foods Co .*, 900 F.2d 388, 395 (1st Cir.1990) (judges must "take pains neither to use an elephant gun to slay a mouse nor to wield a cardboard sword if a dragon looms").

A court is given broad discretion to choose the appropriate sanction for a discovery violation given the unique factual circumstances of every case. *National Hockey League*, 427 U.S. at 642. The Seventh Circuit has directed that any sanctions rendered be proportionate to the offending conduct, *United States v. Golden Elevator, Inc.*, 27 F.3d 301, 303 (7th Cir.1994); *Crown Life Ins. Co. v. Craig*, 995 F.2d 1376, 1382 (7th Cir.1993), and that the harsh sanction of default be reserved for extreme circumstances. *Ellingsworth v. Chrysler*, 665 F.2d 180, 185 (7th Cir.1981). In our view, the Court's discretion in this case is informed by three principle factors: (1) a breach of the duty to preserve or produce documents; (2) the level of culpability for the breach; and (3) the prejudice that results from the breach.

1. Breach of the Duty to Preserve and/or Produce.

***32** The duty to preserve documents in the face of pending litigation is not a passive obligation. Rather, it must be discharged actively:

> [i]t was incumbent on senior management to advise its employees of the pending litigation ..., to provide them with a copy of the Court's order, and to acquaint its employees with the potential sanctions ... that could issue for noncompliance with [the] Court's Order.
>
> When senior management fails to establish and distribute a comprehensive document retention policy, it cannot shield itself from responsibility because of field office actions. The obligation to preserve documents that are potentially discoverable materials is an affirmative one that rests squarely on the shoulders of senior corporate officers.

In re Prudential Ins. Co. of Am. Sales Practices Litig., 169 F .R.D. 598, 615 (D.N.J.1997). *See also Nat'l Assoc. of Radiation Survivors v. Turnage*, 115 F.R.D. 543, 557-58 (N.D.Cal.1987) ("The obligation to retain discoverable materials is an affirmative one; it requires that the agency or corporate officers having notice of discovery obligations communicate those obligations to employees in possession of discoverable materials"); *Cohn v. Taco Bell Corp .*, 1995 WL 519968,* 9 n. 3 (N.D.Ill.1995) (court did not "countenance" a "failure to warn its employees to preserve documents known to be relevant to the issues in the instant litigation"); *see generally Marrocco*, 966 F.2d at 224-25 (court awarded sanction where defendant acted with gross negligence in flagrantly disregarding its assumed duty to preserve and monitor the condition of physical evidence critical to plaintiffs' proof); *China Ocean Shipping Group Co. v. Simone Metals Inc.*, NO. 97 C 2694, 1999 WL 966443,* 4 (N.D.Ill.1999) (defendant "took no specific, direct action to maintain and preserve" the evidence and "never directly contacted anyone ... to ensure" preservation).

The scope of the duty to preserve is a broad one, commensurate with the breadth of discovery permissible under Fed.R.Civ.P. 26. "The duty to preserve evidence includes any relevant evidence over which the nonpreserving entity had control and reasonably knew or could reasonably foresee was material to a potential legal action." *China Ocean*, 1999 WL 966443,* 3 (*citing inter alia Langley*, 107 F.3d at 514; *Melendez*, 79 F.3d at 671; and *Marrocco*, 955 F.2d at 223-225). In this case, the duty to preserve also arises from statute. The PSLRA requires that a defendant in a securities action preserve evidence. [FN20]

FN20. The PSLRA provides that sanctions may be awarded under the PSLRA "only" when a party is "aggrieved by the *willful* failure of an opposing party to comply" with

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> the dictates of the statute, 15 U.S.C. § 78u-4(b)(3)(C)(i) (emphasis added). The PSLRA, which was cited by the District Judge in her preservation order of February 2, 1999, imposed an obligation requiring the preservation of evidence once the federal securities claims in this case were filed. However, unlike the case with Rule 37, sanctions may be imposed under the PSLRA only for willful document destruction.

To be sure, the duty to preserve does not require a litigant to keep every scrap of paper in its file. *See* 7 JAMES WM. MOORE *et al.,* MOORE'S FEDERAL PRACTICE § 37.120 (3d ed. 1999) ("A party is not obligated to retain every document or tangible item that is in its possession, or subject to its control, after a complaint has been filed"); *see also Wm. T. Thompson Co. v. General Nutrition Corp., Inc.*, 593 F.Supp. 1443, 1455 (C.D.Cal.1984) (same). But a litigant "is under a duty to preserve what it knows, or reasonably should know, is relevant in the action, is reasonably calculated to lead to the discovery of admissible evidence, is reasonably likely to be requested during discovery, and/or is the subject of a pending discovery request." *Wm. T. Thompson, Co.*, 593 F.Supp. at 1455.

***33** Moreover, the case law establishes that a discovery request is not necessary to trigger this duty. "A party clearly is on notice of [t]he relevance of evidence once it receives a discovery request. However, the complaint itself may also alert a party that certain information is relevant and likely to be sought in discovery." *Cohn*, 1995 WL 519968, at * 5 (*citing, e.g., Turner v. Hudson Transit Lines, Inc.*, 142 F.R.D. 68, 72 (S.D.N.Y.1991)); *see also Alliance to End Repression v. Rochford*, 75 F.R.D. 438, 440 (N.D.Ill.1976).

Preservation duties do not exist in the abstract, but to serve a purpose: that is, to ensure that discoverable documents are available to be produced. Thus, along with the duty of preservation, there exists a concomitant obligation by all parties to produce the discoverable information within their custody and control. *See* Fed.R.Civ.P. 26(a)(1) ("a party shall, without awaiting a discovery request, provide to other parties ...."); 37(b)(2) ("if a party or an officer, director, or managing agent ... fails to obey an order to provide or permit discovery ... the court ... may make such orders in regard to the failure as are just....").

Both the duty to preserve and the duty to produce are issues in this case. With respect to preservation, the question is whether individual defendants to this motion breached a duty to preserve; with respect to production, the question is whether these individual defendants breached a duty to produce discoverable information that was preserved.

2. Culpability.

Although Rule 37 permits a variety of sanctions to effectuate one or more of its purposes, the most severe sanction is the entry of a default judgment. The case law interpreting Rule 37 has established, however, that the sanction of default (or its equivalent, dismissal) is reserved only for the most egregious violations of the discovery process. In particular, the United States Supreme Court has cautioned that "there are constitutional limitations upon the power of courts, even in aid of their own valid processes, to dismiss an action without affording a party the opportunity for a hearing on the merits of [the] cause." *Societe Internationale*, 357 U.S. at 209. These "constitutional limitations" are derived from the Fifth Amendment's guarantee that "no person shall be deprived of property without due process of law." *Id.*

Because a default judgment deprives a party of a hearing on the merits, the harsh nature of this sanction should usually be employed only in extreme situations where there is evidence of willfulness, bad faith or fault by the noncomplying party. *Societe Internationale*, 357 U.S. at 212. *See also Marrocco*, 966 F.2d at 223 (quoting other cases); *Long v. Steepro*, 213 F.3d 983, 985 (7th Cir.2000) (citing cases):

> Although wilfulness and bad faith are associated with conduct that is intentional or reckless, the same is not true for fault. Fault does not speak to the noncomplying party's disposition at all, but rather only describes the reasonableness of the conduct--or lack thereof--which eventually culminated in the violation. Fault, however, is not a catch-all for any minor blunder that a litigant or his counsel might make. Fault, in this context, suggests objectively unreasonable behavior; it does not include conduct that we would classify as a mere mistake or slight error in judgment.

***34** (internal quotations omitted). To justify a dismissal or default judgment, the level of "fault" must reflect "extraordinarily poor judgment," "gross negligence," or "a flagrant disregard" of the duty to

"preserve and monitor the condition of evidence which could be pivotal in a lawsuit." *Marrocco*, 966 F.2d at 224. [FN21]

FN21. The Seventh Circuit has also held that dismissal may be appropriate where there is a "clear record of delay" or "contumacious conduct," or when "other less drastic sanctions have proven unavailable." *See, e.g.*, *Marrocco*, 966 F.2d at 224. "Contumacious" conduct is defined as "stubbornly disobedient" or "rebellious." MERRIAM WEBSTER'S COLLEGIATE DICTIONARY (10th Ed .). We do not read the cases as indicating--nor do we perceive--any substantive difference between a finding of contumacious conduct, and conduct that is willful or in bad faith. Conversely, the case law does not equate contumacious conduct with fault and, to that extent, there is a difference between the two standards. *See* M. Rosenberg, Sanctions To Effectuate Pretrial Discovery, 58 Col.L.Rev. 480, 491 (1958) (noting that the failure to act as well as action, may be willful, but the flavor of "willful" in the statute "seems more appropriate to the term 'refusal' (*i.e.*, "rejection") than to "fails,' which ordinarily signifies an omission by default").

The Seventh Circuit has not indicated the quantum of proof necessary for a moving party to establish such culpability under Rule 37. With respect to a court's *inherent powers*, cases outside this Circuit apply a clear and convincing evidence standard for default judgments. *Compare* *Shepherd v. Am. Broadcasting Companies, Inc.*, 62 F.3d 1469, 1472, 1477 (D.D.C.1995) (because sanction of dismissal serves same purpose as contempt, same standard of proof, clear and convincing evidence, should apply) *with* *Gates Rubber Co.*, 167 F.R.D. at 108 ("burden of proof for sanctions should be as stringent as the circumstances require" and "if a judge intends to order dismissal or default judgment ... the judge should do so only ... by evidence which is clear and convincing"). Because there is no material difference between an analysis under the Court's inherent powers and under Rule 37, we believe the rationale for applying a clear and convincing evidence standard applies with equal force to Rule 37 cases, and in the absence of any contrary authority, adopt the clear and convincing evidence standard in this case. [FN22]

FN22. Issue-related sanctions, such as adverse inferences, preclusion of evidence, and jury instructions do not require clear and convincing evidence but may be imposed by preponderance of the evidence showings "that a party's misconduct has tainted the evidentiary resolution of the issue." *Shepherd*, 62 F.3d at 1478. This is because "issue-related sanctions are fundamentally remedial rather than punitive and do not preclude a trial on the merits." *Id.* Fines, however, still require clear and convincing evidence under the *Shepherd* rationale because they are "fundamentally penal." *Id.*

3. Prejudice.

Although careful to "eschew grafting a requirement of prejudice onto a district court's ability to dismiss or enter judgment as a sanction under its inherent power[,]" the Seventh Circuit has recognized that "dismissal or judgment is such a serious sanction that it should not be invoked without first considering what effect--if any--the challenged conduct has had on the course of the litigation." *Barnhill*, 11 F.3d at 1368. Some misconduct may prove to be so "contumacious" that the entry of a default judgment is warranted to preserve the integrity of the judicial process, *Barnhill*, 11 F.3d at 1368, but in cases where the noncompliance is the result of fault rather than a more culpable mental state, courts often have used prejudice as a balancing tool or fulcrum upon which the scales may tip in favor of default or against it. *See, e .g.*, *Marrocco*, 966 F.2d at 224-25 (directed verdict for plaintiffs affirmed where court found defendant at fault for failing to preserve unique physical evidence essential to plaintiffs' proof because plaintiffs were irreparably prejudiced by destruction of this evidence); *Langley v. Union Elec. Co.*, 107 F.3d 510, 515 (7th Cir.1997) (court affirmed district court's decision to exclude plaintiff's use of physical evidence claimed to be "crucial" to case as a sanction for loss of such evidence based on fault where loss of evidence prejudiced the defense and led to speculation regarding plaintiff's proof). *See also* *China Ocean Shipping Co.*, 1999 WL 966443,*5 (district court dismissed case because the destruction of physical evidence, caused by the fault of certain parties, *i.e.*, the failure to take specific steps to preserve the evidence, irreparably prejudiced certain

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other parties' defense of the case).

***35** The prejudice suffered from the destruction of documents can take many forms, the most severe of which occurs when the evidence destroyed is the only proof available on an issue or defense in the case. *See, e.g.*, *Marrocco*, 966 F.2d at 225 (loss of tire's side ring prevented plaintiffs from establishing prima facie case of negligent manufacturing). In such cases, evidence of fault in conjunction with such prejudice would support the entry of severe sanctions, such as a default judgment. This is because "the dilemma of lost evidence is that the aggrieved party can never know what it was, and can therefore never know the value that it may have had to the aggrieved party's case[,]" *Gates*, 167 F.R.D. at 105, and "therein lies the prejudice." *Marrocco*, 966 F.2d at 223.

However, in cases where fault, rather than a culpable state of mind, gives rise to the destruction of evidence and the prejudice suffered is because some--perhaps even the "best," but not necessarily the only--evidence has been destroyed, then the choice of the severest sanction is not necessarily justified. *Compare* *Cohn*, 1995 WL 519968,*9 (reports lost were relevant but "not the only relevant evidence on the issue" before the court; plaintiffs had produced an abundance of cumulative information via different documents that minimized and eliminated prejudice to plaintiffs case) *with* *China Ocean*, 1999 WL 966443, at *2, 4 (court dismissed case against plaintiff and cross- claimant where parties were at fault for failure to preserve "critical piece of evidence").

There are two basic principles that motivate the entry of a lesser, issue- related sanction, as opposed to a default or a dismissal in cases of misconduct that do not result in destruction of the *only* critical evidence in the case. *First*, Rule 37 does not impose a duty on a party to preserve every piece of paper for purposes of discovery. *Second*, the purposes for sanctions do not support the entry of a default judgment--which deprives parties of a trial on the merits--when there is at least *some* evidence that allows the plaintiff to prove the case and where there are less drastic remedies available to cure the absence of certain evidence, deter others from similar conduct, and to punish the wrongdoer for destruction of this evidence. *See, e.g.*, *Societe Internationale*, 357 U.S. at 212 (although absence of "complete disclosure" may justify a variety of curative remedies under Rule 37, it does not warrant dismissal with prejudice that deprives party of trial on the merits, especially where failure to comply due to inability "fostered neither by its own conduct nor by circumstances within its control"); *Gates Rubber Co.*, 167 F.R.D. at 109-10 (production of large number of relevant documents shows good faith of party seeking to avoid sanctions and lack of prejudice to party moving for sanctions).

B. Analysis.

With these legal standards in mind, we turn to an analysis of the evidence as it relates to the following questions: (1) whether there was a duty to preserve, and if so, when it arose and what scope it embraced; (2) was the duty breached; (3) if so, who is responsible for the breach, and what level of culpability is involved; and (4) what prejudice resulted from any breach of the duty to preserve documents, or the concomitant duty to produce them.

1. The Duty To Preserve.

***36** The threshold issue in deciding any sanctions motion under Rule 37 is whether the accused party had a duty to preserve and produce the documents that were allegedly destroyed and/or not produced. *Langley*, 107 F.3d at 514; *Melendez*, 79 F.3d at 571; *Marrocco*, 966 F.2d at 223-25. The duty to preserve and produce discoverable evidence only covers the discoverable information that a party knows or reasonably should know may be relevant to the pending or impending litigation. *Wm. T. Thompson, Co.*, 593 F.Supp. at 1455. As outlined above, a party is on notice when it receives a complaint and/or a discovery request. *See, e.g.*, *Cohn*, 1995 WL 519968, at *5.

In this case, the individual defendants received the complaint in *Glotzer* on November 12, 1998. The Court finds that the allegations in that original complaint--although not as specific as the allegations in the Consolidated Complaint--were sufficient to put the individual defendants on notice that sales data, as well as the financial data and source material for it, including the documents now allegedly missing (*e.g.*, Revenue or Monthly Close Packages; Final Sum and Final Sum Summary Reports; Aged Accounts Receivable data and reports; and the Monthly Sales Roll Up Reports) likely would be discoverable.

Indeed, one step Mr. Monson did take in his attempt to alert senior management of the litigation was distribution of the original complaint to them (Hrg. Tr. 216, 217 (Monson)). Although USN's former senior managers may not have been trained in the

law, the dissemination of this complaint--along with Mr. Monson's comments at the meeting with departmental heads--should have been sufficient to alert them to the general categories of documents that they should preserve, *e.g.*, sales and financial information, including source data.

The individual defendants assert that they did not know that these types of documents needed to be preserved, because the *Glotzer* complaint did not specifically challenge the "accuracy of USN's prior financial statements, billing, accounting or sales practices, or the capability of USN's billing vendors" (Defs.' Mem. 3-4). This argument is unavailing for several reasons.

First, it takes too narrow a view of what was plead in the original complaint. The *Glotzer* complaint, plainly challenged the veracity of USN's public financial statements, and claimed that those statements materially misrepresented USN's financial condition. The plaintiff in that case made allegations that specifically called into question USN's stated revenues (*see* § 60) and costs (*see* § § 66, 71(c)). While those allegations lack the detail of the Consolidated Complaint, they were sufficient to put USN on notice that documents concerning its sales, revenues and costs would be discoverable--and thus should be preserved.

Second, defendants' argument is inconsistent with the uniform testimony that at the time, USN viewed the original complaint as triggering a broad preservation obligation. The Board gave Mr. Elliott a broad directive, which at least one Board member has recalled as being "to preserve and not destroy *any* corporate files" (Outside Dir. Mem.App. 5 (Aff. of E. Sekulow, § 3)) (emphasis added). Mr. Monson conveyed that directive to certain USN managers in terms that were interpreted as equally broad: Mr. Dundon recalled that the message was "don't throw anything out" (Defs.' Mem.App. 4) (Jeavons Dep. 95)). The reason was that "most everything that the company had would need to be looked at by the lawyers" (Defs.' Mem.App. 18 (Dundon Dep. 255)). Mr. Monson gave the instruction to USN managers to preserve any and all documents that were subject to discovery. Those who attended the meeting uniformly understood the obligation to preserve was exceedingly broad (*e.g.*, Defs.' Mem., App. 4 (Jeavons Dep. 94); App. 18 (Dundon Dep. 255)). The individual defendants' current litigation position is thus undermined by the contrary understanding USN had at the time suit was filed.

2. Breach of the Duty.

***37** Given notice and understanding of the obligations to preserve all discoverable hard copy and electronic data, one would expect that USN's next step would have been to implement a comprehensive written document preservation plan with specific criteria for finding and securing (although "ensuring" is not a legal requirement) relevant evidence for the litigation. This is especially true given the urgency of Skadden's directive and the importance of that duty, as Mr. Elliott and everyone in a position of authority admittedly understood it.

Regrettably, that was not done. Skadden was apparently cast aside, and the task of conveying the duty to preserve and the obligation to see that this duty was satisfied was assigned to Mr. Monson, USN's general counsel, a person who did not know how to devise and manage document preservation in a company under severe financial distress with new securities fraud lawsuits being filed against it virtually every day.

The steps--or lack of steps--Mr. Monson took to carry out the duty to preserve documents speak volumes about his inexperience. There was no general dissemination in writing to all employees of the need to preserve documents and the consequences of not doing that (Hrg. Tr. 216-17 (Monson); Tr. 247 (Elliott)); there were no specific criteria regarding what should be saved and what should not be saved related to the lawsuit (especially on the 4th Floor during the closing of those offices (*Id.* at 247-48)); and there was no attorney review of what was in the offices being closed before uninformed persons were sent in to throw away dumpsters full of documents (*Id.* at 218 (Monson); 248 (Elliott)). Skadden attorneys did not come back on to the scene to begin document collection for discovery until early March 1998--nearly four months after the first complaint was filed (*Id.* at 218-19). That is not the kind of "comprehensive document retention policy" that the case law envisions, or that the urgency of the warning delivered by Mr. Kraus required. *See, e.g.*, *In Re Prudential Ins. Co.*, 169 F.R.D. at 615.

We hasten to add that there is no evidence of a purposeful effort to destroy key documents: there were no written memoranda or direct testimony offered indicating that people were told to destroy evidence, and there is no evidence of systematic purging of relevant evidence. [FN23] There was,

however, direct--and unrebutted--testimony to the contrary. The witnesses who testified were repeatedly asked whether they were ordered to destroy documents, to which they answered "no" (Hrg. Tr. 264 (Elliott) (he never threw away or instructed Ms. Alpers to throw away his documents); 426-27 (Dundon) (there was no directive issued at USN to destroy documents, if there had been he would have known about it; and he only heard an allegation that someone had directed document destruction); 369 (Struble) (he was never told to and never did destroy documents; and no destruction took place without a backup tape being made); 318 (Alpers) ((she "never saw an order from anyone at USN to destroy documents because of this litigation"); 234 (Monson) (he never learned that any documents that Skadden was looking for had been destroyed by the company)). Moreover, the individual defendants and senior management took steps to preserve their own personal files (*see,* p. 27, *supra*).

> FN23. The plaintiffs have alleged that various e-mail accounts were "systematically purged" following the commencement of this litigation (Pls.' 07/25/00 Am. Mem. at 8-9) (*citing* Pls.' App. Ex. 17, § 10). For the reasons stated above (*see* pp. 32-34, *supra*), the Court rejects this assertion.

***38** The question of intent and/or bad faith, of course, may encompass not only direct destruction, but also "willful blindness" (especially in the face of office closings where documents were being thrown out without criteria based on a systematized document preservation plan in place that officers of the company were monitoring with vigor). But the plaintiffs have not offered any evidence to support the willful blindness theory (*e.g.*, they have not shown the Court that Mr. Elliott knew that relevant, discoverable financial data had been left on the 4th Floor of the executive offices, or in his office, but nonetheless allowed those offices to be swept clean and purged of documents).

Thus, the Court does not believe there was intentional destruction. But we also believe that more than good intentions were required; those intentions had to be followed up with concrete actions reasonably calculated to ensure that relevant materials would be preserved. We believe that the failure to put into place clear procedures and standards concerning document preservation, and the failure to do any follow-up to see that the general oral directive was broadly disseminated and followed, constitutes fault--that is, "extraordinarily poor judgment" or "gross negligence." *Marrocco,* 966 F.2d at 224.

3. Assigning Responsibility.

In most cases that involve a corporation's failure to take sufficient steps to preserve documents, the responsibility for that failure would rest squarely with the corporation. *Lewy v. Remington Arms Co., Inc.,* 836 F.2d 1104, 1113 (8 th Cir.1988) (corporation responsible for preserving documents it knew or should have known would be material at some point in the future and document retention policies would not shield intentional destruction of documents). This case presents a more complex situation, due to the fact that USN is not a defendant in this case and is in bankruptcy. Thus, this Court has no authority to hold USN responsible for the failure to implement a suitable document preservation plan.

However, the inability to hold USN to account for that failure does not mean that no one can be held responsible. To the contrary, corporate officers and managers can be held personally responsible for a corporation's failure to preserve relevant evidence. *See, e.g., In re Prudential Ins. Co. of America Sales Practices Litigation,* 169 F.R.D. 598 (1997); *Turner v. Hudson Transit Lines, Inc.,* 142 F.R.D. 58, 72 (S.D.N.Y.1991). *See also National Ass'n of Radiation Survivors v. Turnage,* 115 F.R.D. 543, 556 (N.D.Cal.1987) (same); *Kansas-Nebraska Natural Gas Co. v. Marathon Oil Co.,* 109 F.R.D. 12, 18 & n * (D.Neb.1983) (same). In this case, plaintiffs seek to hold accountable USN's CEO, Mr. Elliott, as well as the five outside directors who attended the November 12, 1998 Board meeting; plaintiffs do not name in their sanctions motions the director defendants in this case who did not attend that meeting.

***39** We address separately the responsibility *vel non* of Mr. Elliott on the one hand, and the outside directors on the other hand.

a. Mr. Elliott.

The evidence does not support a finding of willful or intentional destruction by Mr. Elliott. Mr. Elliott did not ignore altogether the mandate of the Board to preserve documents. There is no evidence that he personally destroyed evidence, or directed others to

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do so--indeed, the evidence is to the contrary (Hrg. Tr. 264 (Elliott) (he never threw away or instructed Ms. Alpers to throw away his documents); 426-27 (Dundon) (there was no directive issued at USN to destroy documents, if there had been he would have known about it; and he only heard an allegation that someone had directed document destruction); 369 (Struble) (he was never told toand never did destroy documents; and no destruction took place without a backup tape being made); 318 (Alpers) ((she "never saw an order from anyone at USN to destroy documents because of this litigation"); 234 (Monson) (he never learned that any documents that Skadden was looking for had been destroyed by the company)).

However, as the findings above made clear, the evidence establishes that Mr. Elliott was legally at "fault" for the failure to implement a suitable document preservation program. The Seventh Circuit has defined "fault" in this context as "gross negligence" or "extraordinarily poor judgment," *Marrocco*, 966 F.2d at 224--and there is plenty of evidence that Mr. Elliott's conduct falls squarely in this category.

In so concluding the Court is mindful that the types of steps that must be taken to satisfy the obligation to preserve evidence may vary from case to case, based on the circumstances facing the defendant. *See generally National Hockey League*, 427 U.S. at 642 (the unique factual circumstances of a case guide a court's decision regarding sanctions). In this case, however, we believe that Mr. Elliott did not take steps to tailor a plan that took into account the realities of the situation facing USN as of November 12, 1998, when this lawsuit was initiated. USN was in financial distress (Hrg. Tr. 414, 440 (Dundon)); offices were being closed and employees were leaving (*Id.*, at 414); documents (both hard copy and electronic) were being discarded as part of those office closings and employee departures (Hrg. Tr. 102, 104) (Van Dinther)); and the company had "no formal written document retention policy at USN at that time" (*Id.* at 215 (Monson)). The only policy USN had in place simply governed the preservation of documents during office closures for *business* purposes (Hrg. Tr. 249 (Elliott)), not for *litigation* purposes.

Given these facts, together with the admonition by outside counsel of the critical importance of preserving documents (Hrg. Tr. 247 (Elliott)), and the Board's directive to implement a document preservation plan (*Id.*), Mr. Elliott's actions simply were insufficient, and reflected extraordinarily poor judgment. Mr. Elliott did not personally take steps to implement a comprehensive document preservation plan (Hrg. Tr. 215-216 (Monson); 247 (Elliott)). Nor did Mr. Elliott enlist outside counsel in developing and implementing such a plan: there was no request that Skadden prepare a written preservation policy (Hrg. Tr. 215, 216 (Monson)) and there were no arrangements for Skadden to meet with employees to convey specific criteria for preserving documents (*Id.*).

***40** Of course, we do not suggest that a company always must retain an army of outside lawyers to implement a document preservation plan. But a company must see to it that the person(s)--whether inside or outside the company--given the task have the ability to perform the task, and to do so capably.

Here, Mr. Elliott delegated the responsibility to Mr. Monson, who did not have that ability. The "plan" that Mr. Monson implemented had only these elements: he gave senior management a copy of the complaint (Hrg. Tr. 216, 217 (Monson)), and he orally instructed a group of department managers to inform their employees of the need to preserve documents (*Id.* at 256 (Elliott)). Neither Mr. Elliott nor Mr. Monson put into writing--for all employees to see-- precisely what the preservation duty involve and how to comply with it (Hrg. Tr. 217 (Monson); 247 (Elliott)).

Nor did Mr. Elliott or Mr. Monson follow up to see what the department managers or their employees actually were doing to see to it that documents were preserved (Hrg. Tr. 256 (Elliott); 221 (Monson)). Mr. Monson left the duty to preserve documents up to the judgment of the managers and employees of USN (*Id.* at Tr. 247, 248 (Elliott); 244 (Monson)). In Mr. Elliott's own words "[t]here was nothing, nothing formally done" (*Id.* at 256).

Mr. Monson explained that he did not think anything "formal" or "specific" needed to be done because it was his "expectation" that people who were intending to discard potentially relevant documents "against the backdrop of this litigation" would contact him for "further clarification" (Hrg. Tr. 245 (Monson)), which he says they did (*Id.*). He further stated that it was his "belief" that:

> anything that was relevant to the company was being packed up and brought back to Chicago either for storage at our office here in Chicago or

> for off- site storage ... the relevant information would have been forwarded to our operations center for processing, or the sales information would have been forwarded to or committed to electronic form and would have been in the company's possession. So it was not my view that there were sensitive documents from the standpoint of this litigation that existed in the sales offices ... [or] the 4th Floor [since] the material there would have consisted of marketing materials and other things that wouldn't really be relevant to the litigation. So I didn't--do anything specific.
> (Hrg. Tr. 221, 222).

As a result of not doing anything "specific," large quantities of documents were discarded from closed offices without any attorney first reviewing them to see if they should be preserved. And, while the documents discarded may not have been relevant, as Mr. Monson believed, no steps were taken to verify that this was so. Skadden did not begin its process of reviewing documents at USN until March 1999 (Hrg. Tr. 218, 219 (Monson)) and the USN employees who were culling out what to save and what to discard from closed offices were not given criteria to use to decide what was needed for litigation--and may not even have known that the litigation imposed special preservation requirements (Hrg. Tr. 111) (Van Dinther); 17, 19-20 (Coleman)). Although the law does not require every piece of paper to be saved, *Wm. T. Thompson, Co.*, 593 F.Supp. at 1455, certainly specific criteria are necessary to ensure that relevant information is preserved. *Turnage*, 115 F.R.D. at 557-58. The affirmative obligation to preserve documents does not exist in a vacuum; its effective implementation requires criteria by which employees may have some idea of what documents they must preserve and how to accomplish that task. *See In re Prudential*, 169 F.R.D. at 615; *Cohn*, 1995 WL 519968,*9 and n. 3. In this case, where a corporation is closing its offices and discarding documents (in contrast to an existing corporation where documents stay in place during the pendency of the suit), we believe that the requirement to initiate a written comprehensive document preservation plan disseminated to all employees was crucial.

***41** Nor may Mr. Elliott escape responsibility by virtue of the fact that he assigned Mr. Monson the task of handling document preservation. The buck must stop somewhere--and here, the Court believes that the appropriate place is with Mr. Elliott: he was the CEO, he was directed by the Board to see to it that documents were preserved, and he was on the scene with the ability to follow through and see that the job was completed. Delegating wholesale the obligation to Mr. Monson, who did not craft the criteria or the plan necessary to satisfy the obligation, was a case of "extraordinarily poor judgment" that constitutes fault. [FN24]

> FN24. We reject the suggestion that Mr. Elliott cannot be held accountable because the people who discarded documents "did not even know about the litigation," and were doing as a result of office closures and not "to destroy [documents] because of the litigation" (Defs.' Mem. at 18 n. 17). This only further underscores the problem with the preservation program that Mr. Elliott (through Mr. Monson) put into place: it permitted many documents to be discarded without a review to ensure that nothing relevant was lost.

b. The Outside Directors.

Plaintiffs also seek to hold the outside directors responsible for the failure to preserve documents. However the outside directors who are defendants on this sanctions motion stand on a different footing from Mr. Elliott. They did not have a physical presence at USN on a day-to-day basis, and thus had less opportunity--and ability--to follow up than would Mr. Elliott, who was on the scene. Outside directors are not primarily responsible for the inner workings of the company and its employees. Rather, they serve as advisors to the company, and although they are responsible fiduciaries under the securities laws, practically speaking, they do not do the work of the company, nor do they carry out the duties and responsibilities attendant to litigation against the company.

This is not to suggest that the outside directors had no duty to preserve, but the distinction is relevant to an analysis of what they must do to discharge that duty. Certainly, had the outside directors disregarded Skadden's admonition to preserve documents (or, worse yet, had directed their destruction), the Court would have no difficulty in finding them at fault or guilty of intentional destruction. But that is not the case here. There is no evidence that the outside directors destroyed documents in their possession, or instructed others to destroy evidence; but there is ample evidence to the contrary. (Hrg. Tr. 264 (Elliott)

(he never threw away or instructed Ms. Alpers to throw away his documents); 426-27 (Dundon) (there was no directive issued at USN to destroy documents, if there had been he would have known about it; and he only heard an allegation that someone had directed document destruction); 369 (Struble) (he was never told to and never did destroy documents; and no destruction took place without a backup tape being made); 318 (Alpers) (she "never saw an order from anyone at USN to destroy documents because of this litigation"); 234 (Monson) (he never learned that any documents that Skadden was looking for had been destroyed by the company)).

The outside directors who attended the November 12, 1998 meeting acted on Skadden's advice by directing that documents be preserved. While they justly may be criticized for not following up to see what was done, the Court does not believe that this lack of follow up equates to "extraordinarily poor judgment" that would support sanctions. In that regard, we note that plaintiffs have chosen to pursue this motion only against the directors who attended the November 12, 1998 Board meeting; the motion does not target those who were absent--even though all directors are properly charged with knowledge of the directive given to Mr. Elliott in that meeting, and none of them followed up. Thus, if we were to hold the outside directors liable for the lack of followup, there would be no reason to distinguish between those who attended the Board meeting and those who did not--as plaintiffs do in their motion.

***42** Rule 37(b) provides that sanctions may run against directors: "[i]f a party *or* an officer, director, or managing agent of a party ... fails to obey an order to provide or permit discovery, ... the court .... may make such orders in regard to the failure as are just, ..." Fed.R.Civ.P. 37(b)(2) (emphasis added). While Rule 37 does not specifically distinguish between inside and outside directors, we believe that the consideration of a "just" order must consider the practical distinction between them. The parties have not cited, and this Court has not found, a single case where a court has found an outside director personally responsible for the destruction of corporate documents under Rule 37 or its inherent powers. The Court concludes that the outside director defendants named in the sanctions motion are not responsible for the shortcomings in the document preservation program, and thus should not be sanctioned for them. [FN25]

FN25. In their brief, the outside directors cite cases that speak not to the document preservation issue, but rather to the issue of liability under Sections 10(b) and 20(a) of the Securities and Exchange Act of 1934, 15 U.S.C. § § 78j(b) and 78t(a). *Kaufman v. Motorola, Inc.*, No. 95 C 1069, 1999 WL 688780 (N.D.Ill.1999), and *Cohn v. Taco Bell Corp.*, No. 92 C 5852, 1995 WL 519968 (N.D.Ill.1995). Those cases (and the cases cited therein) do not resolve the separate question of an outside director's personal responsibility for the preservation of documents under Rule 37. Thus, in recommending denial of sanctions against the outside directors, we do not suggest--and should not be construed as suggesting--any view on the merits of plaintiffs' securities law claims against the outside directors.

4. Prejudice.

Because we conclude that Mr. Elliott is at fault for USN's failure to implement an appropriate program for preserving documents, we consider the question of what prejudice resulted. For the reasons set forth in Part a. below, the Court concludes that plaintiffs have failed to demonstrate any substantive prejudice from the shortcomings that existed in USN's document preservation program.

Because the duty to preserve documents exists to insure that relevant documents are available to be produced, we also consider whether the failure of the individual defendants to search for and produce certain documents during discovery has caused plaintiffs any prejudice. For the reasons set forth in Part b. below, we conclude that there has been a failure to search for and produce the Final Sum Reports that has caused plaintiffs financial prejudice in that it has increased their cost of discovery--but that this cost has been offset by unnecessary costs that plaintiffs have inflicted on defendants in discovery.

a. The Absence of Substantive Prejudice.

The Court has no doubt that it was the intent of Mr. Elliott to follow the instruction of the outside directors and to see to it that documents were preserved for the litigation. And, in fact, a vast quantity of documents was indeed preserved and produced in this lawsuit. In response to discovery

requests, USN produced more than one million pages of documents, of which plaintiffs selected 560,624 for copying (Defs.' Mem.App. 1 (Walton Dec. at § § 5-6)). These documents included the files of key USN personnel from every department in the company (*id.*, at § 7); numerous accounting and finance department files, which included USN's draft and final monthly and quarterly statements, accounts payable registers and journal entries, invoices, cash balance reports, draft and final budgets, and memoranda relating to accounts receivable, accounts payable, and "cash burn" rates (*id.*, at § § 8-9); and nearly 100,000 pages of customer files (*id.*, at § § 10-13).

***43** At the same time, it is clear that as a result of the failure to implement a suitable document preservation plan, to communicate that plan effectively to all employees, and to follow up to insure that the directive was being followed, there were holes in the document preservation plan through which discoverable materials may have been lost. Large quantities of documents were discarded from closed sales offices without attorneys first reviewing them, and without the employees who selected what to preserve and what to discard knowing what criteria to use for purposes of preserving documents necessary for the litigation. E-mail files of terminated employees also were purged, without there being a systematic procedure for insuring that nothing on those files needed to be preserved for the lawsuit.

Because the inadequacies in the document preservation program were the result of fault (that is "extraordinarily poor judgment") and not intentional efforts to destroy responsive documents, the Court does not draw the inference that these gaps caused plaintiffs to lose responsive documents that were, as plaintiffs allege, "critical to plaintiffs' proof" in the case (Pls. 07/25/00 Am. Mem. at 1). That conclusion is bolstered by the fact the evidence shows that the closed sales offices and the e-mail files of the employees terminated in those closings were not likely to contain the sole versions of documents "critical" to plaintiffs' case. Moreover, the individual defendants have produced many documents that plaintiffs certainly would label as damaging to the individual defendants' case: that is clear from plaintiffs' assertion in the amended sanctions motion that they have alleged "certain core claims which have been borne out through discovery" (Pls.' 07/25/00 Am. Mem. at 4). In the face of this evidence the Court will not infer that these gaps led to large-scale destruction of documents to the prejudice of plaintiffs.

Rather, the Court will focus--as have plaintiffs in their amended motion--on specific categories of documents that plaintiffs claim were lost through destruction: the sales information as reported from the field; aged account receivable information; and Final Sum Reports. We discuss each of those categories in turn. [FN26]

FN26. There are no longer any destruction or production issues with respect to the "Revenue Close Packages" or "Monthly Close Packages." According to Mr. Pellino's deposition testimony, taken on June 1 and 2, 2000, those reports were used to prepare the financial statements that were the basis for the February 1998 IPO. Plaintiffs' amended motion asserted that those documents had not been produced (Pls.' 07/25/00 Mem. at 7); but plaintiffs withdrew that assertion on the eve of the evidentiary hearing (Pls.' 09/07/00 Notice at 10-11). And with good reason--the individual defendants produced those reports for each month from January 1997 through February 1999 (*see* Defs.' 09/05/00 Submission, App. D.) The Court does not accept plaintiffs' suggestion that their claims regarding the missing Revenue Close Packages earlier in the case were justified because these documents were only produced pursuant to an agreement between counsel sometime after this Court's ruling denying plaintiffs' motions to compel on July 25, 2000 regarding these documents. In response to a question raised by the Court at the hearing, the defendants revealed that they had produced all of these materials in February and March 2000 (Elliott's 09/29/00 Submission, App. D). Thus, when plaintiffs filed their amended motion for sanctions based in part on the alleged destruction of Revenue Close Packages, they in fact had had those reports in their possession for at least four months.

Sales Data. The evidence establishes that the individual defendants have produced sales information, as reported from the field, for virtually the entire period from January 1997 through the end of the class period on November 20, 1998. The only gaps in that information are a two week period from

December 1 through December 16, 1997, and a two month period from September 18 through November 20, 1998 (Defs.' 09/05/00 Submission, App. A). These gaps are explainable for reasons independent from shortcomings in the documents preservation program. As to the two-week gap in December 1997, that was at a time when USN was in transition from the manually prepared sales reports to the computer generated sales reports from the Vantive system. As to the two-month gap between September 18 and November 20, 1998, that was during a time when USN began laying off its sales force and closing its sales offices (*e.g.*, Hearing Tr. 104 (Van Dinther); 409 (Dundon)). Moreover, these gaps are small in relation to the period for which the information has been produced, and thus we find it difficult to perceive any real prejudice to plaintiffs from these gaps.

***44** Nor does the evidence demonstrate that plaintiffs have been prejudiced because the sales data has been produced in the form of documents entitled State Directors Reports and Sales Summary Reports, rather than in the form of documents entitled Monthly Sales Roll Up Reports. In determining prejudice, we look beyond the question of form and focus on substance. And here, the testimony establishes that even if the State Directors Reports were not the same document as the Monthly Sales Roll Up Reports, a matter about which the witnesses disagree (*see*, pp. 35-40, *supra*), the information in them comes from the same sources and is substantially the same (Hrg. Tr. 113-14, 124-25 (Van Dinther)). That weighs heavily against the finding of prejudice. *See*, *e.g.*, *Cohn*, 1995 WL 519968, at *9 (plaintiffs did not suffer any real prejudice where the reports that were lost were relevant but were "not the only relevant evidence on the issue," and where similar information had been produced by way of other documents).

Plaintiffs assertion of prejudice from the absence of Monthly Sales Roll Up Reports is further undermined by four additional factors.

First, the plaintiffs elected not to make copies of many months of sales reports that were generated from the Vantive system. The Court finds it inexplicable that plaintiffs would neglect to copy these reports, which plaintiffs demanded that defendants should produce despite the great cost involved, if the sales information truly was as significant as plaintiffs insist.

Second, plaintiffs have offered no evidence that they used the substantial amount of sales information that was produced to test their theory that the sales information was being used as the basis for publicly reported revenue. The plaintiffs' Rule 26 expert reports do not indicate that the sales information was provided to plaintiffs' experts, so that they could compare that information to the publicly reported revenue figures. It is hard to find prejudice from the absence of certain sales information when plaintiffs did not use the substantial amount of sales information that they possessed.

Third, plaintiffs have offered no evidence to support their assertion that untested sales information from the field was used as the basis for USN's publicly reported revenue numbers. The only support for that assertion came from untested statements by Ms. Van Dinther and Ms. Reynolds in last 1999, which were given to plaintiffs on oath in a question and answer format but outside the presence--and without the knowledge--of defense counsel. When those statements were tested in depositions Ms. Van Dinther and Ms. Reynolds gave in May and July of 2000, it should have been clear to plaintiffs that these individuals had no basis for their speculation that sales numbers were being used to publicly report revenue (*see*, 39-40, *supra*).

Fourth, the plaintiffs' theory--as it evolved through the sanctions motion-- further suggests that, in fact, the sales information does not command the importance that plaintiffs have asserted. Mr. Pellino testified clearly that the Final Sum Reports, which reflected USN's billings as reported by Spectrum (and earlier Profitec) and not sales reports, provided the critical starting point for USN's publicly reported revenue numbers. Plaintiffs have not disputed that assertion, but in fact have embraced it (Pls.' 07/25/00 Mem. at 13) (identifying the Final Sum Reports as one of the "fundamental building blocks utilized by USN to publicly report its revenue"). In light of the central importance that plaintiffs now attach to the Final Sum Reports, and their failure to provide any demonstrable link between the sales reports and the publicly reported revenue numbers, the Court finds that plaintiffs have failed to show any prejudice from the small gaps in the sales information produced.

***45** *Aged Accounts Receivable Information.* The evidence has established that plaintiffs' assertion that they received only a smattering of aged accounts receivable information is unfounded. USN has produced aged accounts receivable information for

the entire period covering September 1996 through the class period of November 20, 1998, with the exception of the following months: November 1997 and January, February, April, May, and July 1998 (Defs.' 09/05/00 Submission, Ex. C). In addition, it is clear that this information was produced to the plaintiffs in February and March of 2000 (Elliott's 09/29/00 Submission, Ex. D), and thus had been in plaintiffs' possession for many months prior to the filing of the amended sanctions motion in July 2000. [FN27]

FN27. On September 12, 2000, the second day of the evidentiary hearing, the defendants produced to the plaintiffs (and the Court) a one page document identified as aged accounts receivable information for December 1997, previously unproduced to the plaintiffs (Hrg. Tr. 334).

Moreover, a review of the accounts receivable information produced by USN indicates that even though reports have not been produced for each of these four months, other reports provide information that appears to cover certain of those months. There are documents that show accounts receivable aging information for virtually all of April 1998 (USN 2-038332), and for the month ending May 31, 1998 (USN 22-021567). Nonetheless, gaps do remain for November 1997 and January through February and July 1998. The question remains whether these gaps are the result of the shortcomings in the document preservation program, and if so, what prejudice this has caused to the plaintiffs.

On the first question, the record supports the inference that these documents may have been missing before the inception of this lawsuit. An Arthur Andersen Report issued in September 1998 states that with respect to "[t]he Company's accounts receivable agings (excluding wireless) as of June 30, 1998, March 31, 1998, December 31, 1997 and September 30, 1997 ... the company could only provide a detailed aging for the Midwest region as of June 30, 1998. Management stated that other detailed agings were not currently available due to system conversions, and the limited utility of the old systems" (Pls. Reply Mem., Ex. A, at 17). If certain documents did not exist at USN as of the time this litigation commenced, as the Arthur Andersen report suggests, then the absence of those documents is not the result of the shortcomings in the post-litigation preservation program.

Moreover, the Court finds that plaintiffs have failed to establish prejudice from these gaps in the information. The significance of this information, according to plaintiffs, is that it would show that USN's publicly reported revenues were inflated, because USN did not take into account that many of the receivables it was counting as revenue were so old that they were not likely to be collectible. Plaintiffs have offered no explanation why the substantial volume of aged receivable information they possess is insufficient to test that theory. Nor is there any evidence that, as of the time of the evidentiary hearing, they had given the aged accounts receivable information they possess to their experts for analysis. In these circumstances, the Court finds that the missing months of aged accounts receivable information have not prejudiced the plaintiffs. [FN28]

FN28. Nor does the Court find persuasive the plaintiffs' argument that the fact that the missing months occur right before and shortly after the February 1998 initial public offering supports the inference of intentional destruction or concealment of material information. The February 1998 initial public offering was based on financial reports through November 1997 (Defs. 09/08/00 Submission, at 9), and plaintiffs have received aged receivable information from January through October 1997, with only November 1997 missing. Moreover, the Court can discern no particular pattern from the missing months of aged account receivable information that would suggest intentional destruction: the information was not produced in January, February, March and July 1998, but aging information was produced for every month through the class period.

***46** *The Final Sum Reports.* Plaintiffs' categorical assertion that "not a single FINAL SUM or Final Sum Summary report (in either hard copy or in Excel spread sheet format) was ever produced to plaintiffs by USN or any other defendant" (Pls.' 07/25/00 Am. Mem. at 13) has proven incorrect. USN in fact has produced Final Sum Summary Reports for every month from August 1996 through the class period (Defs. 09/05/00 Submission, Ex. B). Moreover, these

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reports all were produced in February and March 2000 (Elliott's 09/29/00 Submission, Ex. C), more than four months prior to the time that plaintiffs filed the amended motion. Thus, had plaintiffs reviewed the document production before filing their motion, they would have known that basing the sanctions motion on alleged nonproduction of Final Sum Summary Reports was unfounded.

The Final Sum Reports present a different matter. As explained above (pp. 40- 48, *supra*), however one defines the Final Sum Report, it is clear that the individual defendants have produced either none or next to none of them. The testimony establishes that those reports should have existed as USN as of the time of this lawsuit: Spectrum has copies of the Final Sum Reports (or the REPGEN files from which they are generated) going back to January 1996 (Hrg. Tr. 149-50 (Doyle)), and Spectrum transmitted that information to USN on a regular basis (*id.* at 152, 154). If Spectrum retained these files, then USN should have had these files on its databases as of the time this lawsuit commenced in November 1998.

Thus, the failure of USN to produce these documents leads to one of two conclusions: either the documents were not preserved, as a result of the shortcomings in the preservation program put into effect by USN after this lawsuit, or they were preserved but have not been produced in this litigation. The Court finds that the evidence tends to support the latter conclusion, for several reasons.

First, Mr. Struble testified that in January 1999, shortly after this litigation commenced, USN made a set of backup tapes of the UNIX servers that would include the REPGEN files (Hrg. Tr. 380-81). The fact that these backup tapes were made for business reasons (because USN was shifting to a different software package) rather than for litigation reasons is immaterial: the point is that these tapes should have captured the Final Sum or REPGEN information that existed. And the evidence shows that as of the time of the evidentiary hearing on this motion, the individual defendants had never asked anyone to examine those backup tapes to see what Final Sum or REPGEN information could be extracted from them--even though it would take only a few days to restore those tapes to the UNIX servers being used at CoreComm (Hrg. Tr. 379, 386 (Struble)), and even though CoreComm has an obligation, pursuant to its asset purchase agreement with USN, to provide assistance to USN as necessary for the litigation. The defendants did not ask Mr. Struble to look for the January 1999 backup tapes until after Mr. Doyle's testimony on September 11; overnight, he located those tapes and produced them in Court on September 12 (Hrg. Tr. 363- 64, 382-83 (Struble)). But, as of that time, he had not looked on the tapes to see what Final Sum information they might contain.

***47** *Second*, the individual defendants did not make efforts to examine the backup tapes made in May 1999 immediately prior to the sale of assets to CoreComm. Those tapes contained a "snapshot" of all the information on the production servers on the UNIX system, which would include the REPGEN database (Hrg. Tr. 360 (Struble)). [FN29]

FN29. It is unclear to the Court whether examination of these tapes would require the rebuilding of a computer system and software application, as was the case with the Vantive database that contained the summary sales reports. The Court did not order the individual defendants to rebuild a system to run these tapes at the April 11, 2000 hearings, when the Court ordered a system to be rebuilt to run the Vantive sales data. At that time, the Court was informed by the defendants that any financial data stored on those tapes had already been produced in hard copy form. That turned out to be incorrect.
In the event that building a database would be necessary, the individual defendants failed in their duty to preserve documents in a retrievable form. Making the backup tapes is useless without insuring that there is a system capable of running it, and Mr. Struble testified that after making the backup tapes, very little or nothing was done to insure that a system was capable of running these backup tapes (Hrg. Tr. 391).

Third, it was not until late August 2000, shortly before the evidentiary hearing, that the individual defendants asked CoreComm to check its computer database to see if Final Sum Reports were available on it (Hrg. Tr. 363-64, 371-72 (Struble)). And when that inquiry was made, Mr. Struble only examined the active CoreComm network database, which he found contained Final Sum Reports dating from August 1998 through March 2000 (Hrg. Tr. 373). Even then, Mr. Struble did not look for what he characterized as the REPGEN database, which is

source information for the Final Sum Reports (*Id.* at 372). Nor did he search backup tapes made by CoreComm after the sale to see what they contained (*Id.*).

Based on this evidence, it appears to the Court that the Final Sum/REPGEN information likely exists on these tapes that USN (or CoreComm) preserved, but that the individual defendants have failed to access and produce in usable form during discovery. However, any substantive prejudice resulting from that failure to produce the Final Sum/REPGEN information has been mitigated by the ability of the plaintiffs to obtain that information from another source: Spectrum. Mr. Doyle testified that Spectrum was able to retrieve from its database and produce to plaintiffs the files that contain the Final Sum/REPGEN information for virtually all of the period from July 1996 through January 1999: the only gaps are for October through December 1997, and February 1998 (Hrg. Tr. 179-181). The Court does not believe that these missing documents are attributable to intentional destruction or inadvertent loss due to gaps in the document preservation policy--the fact that the gaps exist in the information produced by Spectrum, which would have no motive to purge that information and which appeared (through Mr. Doyle) as a friendly witness for plaintiffs, would undermine any such inference.

Moreover, the Court does not believe that these missing four months of Final Sum information prejudiced the plaintiffs in light of the substantial body of Final Sum/REPGEN information that is available for more than one year prior to and nearly one year after this "gap." Indeed, this gap is consistent with Arthur Andersen's observations concerning the lack of billing information for the last quarter of 1997 and the first quarter of 1998--even prior to the commencement of this lawsuit.

Finally, although not raised by plaintiffs, the Court does not believe that the timing of this production from Spectrum has resulted in prejudice to the plaintiffs. As explained above (pp. 82-86, *supra*), plaintiffs had received the CD Roms containing this information from Spectrum on or about July 20, 2000. However, nearly two months later (and, according to plaintiffs, after the expenditure of $178,000 in attorneys and expert fees), plaintiffs claimed not to know precisely what information was on those CDs (Hrg. Tr. 484-85)--even though a simple review of a printout of the directory to the CDs made it plain that they contained a large volume of Final Sum information. Given the importance of this information, which plaintiffs admit they knew of at least as of the time of Mr. Pellino's deposition in early June 2000, one would have expected plaintiffs to move with much greater alacrity in extracting this information from the CD Roms. In light of their failure to do so for two months after receiving them, the Court finds no prejudice from the timing of the production of the CD Roms.

b. Financial Prejudice.

***48** The absence of substantive prejudice, however, does not mean that the failure of the individual defendants to produce Final Sum/REPGEN information caused no prejudice of any kind. The Court finds that plaintiffs have suffered financial prejudice due to the individual defendants' failure to produce the data contained on the January 1999 backup tapes and/or the Snapshot tapes in usable form. The plaintiffs clearly have been required to spend money-- according to them, substantial sums of money--to get from Spectrum information that the individual defendants were required to produce.

We are not persuaded by the defendants' argument that they had a good faith basis to object to production, and thus had no obligation to search for or produce that information prior to the Court compelling them to do so on July 25, 2000. That argument ignores the fact that USN management have testified to the central role of the Final Sum information in preparing the USN publicly reported revenue numbers. Mr. Dundon testified that this data was "vitally important" to the revenue process (Hrg. Tr. 444), and Mr. Pellino testified that it was the "starting point" for his revenue calculations (Hrg. Tr. 294).

Given what these knowledgeable people say about the Final Sum Reports, the individual defendants cannot legitimately contend that they could question the discoverability of these documents in a case where plaintiffs from the start have challenged the veracity of USN's publicly reported revenue figures. Moreover, the individual defendants had a duty to produce this information, long before the plaintiffs asked for it. The District Judge ordered initial disclosures pursuant to Rule 26(a)(1) to be made by October 25, 1999 (doc. # 62). As a result, the individual defendants were required to disclose documents (and data compilations) "relevant to disputed facts alleged with particularity in the pleadings." Fed.R.Civ.P. 26(a)(1)(B). By the time

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this disclosure was due, the Consolidated Complaint was on file, which should have dispelled any arguable doubt concerning the relevance of the Final Sum information.

The individual defendants did not search for, much less produce, the Final Sum/REPGEN data and thus did not comply with Rule 26(a)(1). Nor did they comply with this Court's July 25, 2000 order to search for final sums in the most likely places they might be found (07/25/00 Tr. at 57, 62-63)--they did not review the January 1999 backup tapes, even though it would take only a few days to get those up and running at CoreComm.

The phrase "no harm, no foul" does not fully apply here: while the preservation and production of Final Sum Reports and REPGEN data from Spectrum eliminates any real substantive harm caused by the individual defendants' failure to produce the information, that does not eliminate the cost plaintiffs needlessly incurred by having to go to Spectrum for the information. Mr. Struble made very clear that the individual defendants never asked him to look for backup tapes with archived REPGEN source material or Final Sum Reports prior to September 11, 2000. Instead, the individual defendants argued it was too burdensome for them to search for this information (07/25/00 Tr. at 62-63), even through it could be accessed in relatively short order by CoreComm. Thus, plaintiffs were required to find the Final Sum Reports now available through Spectrum, a non-party, on their own and at great cost and expense of time to them. This is not the kind of discovery process envisioned by Rule 26(a)(1) or by this Court's July 25 order.

***49** We do not believe that the individual defendants intentionally withheld those tapes in bad faith; we are inclined to accept the explanation of the individual defendants' counsel that they did not know what they had. That has been a recurring problem throughout this case, both for defendants (who initially said USN had 35 boxes of documents to produce, when ultimately more than 500 boxes were produced) and for plaintiffs (who, as detailed above, repeatedly have protested that they were deprived of documents that in fact they possessed).

However, to ignore the individual defendants' violation of the rules of full disclosure would be tantamount to creating an "ignorance" exception (*i.e.*, a "judge, we just didn't know those tapes existed" exception). At some point, a party and/or its attorneys must be held responsible for knowing what documents are discoverable and where to find them, since certainly neither the party's opponent nor the Court can answer those questions. The case law indicates that a refusal to provide discovery may be sanctionable, *Societe*, 357 U.S. at 207, and that a "refusal to obey" need not be willful, but is sanctionable even if the refusal is simply a simple failure to comply with the dictates of the federal rules. *Id.* That is what we find here.

Having said this, the Court would be remiss in failing to address the fact that plaintiffs, too, have unnecessarily inflicted costs on the individual defendants by the manner in which they have conducted discovery, and the manner in which they have litigated this sanctions motion. As the Court has explained above, the defendants successfully urged this Court to require the individual defendants to rebuild the Vantive database and application software, in order to extract from backup tapes sales data that plaintiffs urged was critical to their proof of this case. It turned out that this evidence not only was far from "critical" to plaintiffs' case, but in fact was so unimportant that plaintiffs elected not to copy most of it.

At the time this Court ordered the individual defendants to rebuild the Vantive database and application software, the Court did not--under Rule 26(b)(2)--elect to shift the cost of doing that to the plaintiffs, on the reasoning that the defendants were to blame for failing to preserve the information in a form that did not require maintenance of a database capable of extracting it. However, subsequent developments have persuaded the Court that this cost was unnecessarily and unfairly inflicted upon the individual defendants. And that cost was substantial, according to the defendants: $159,632 .63.

In addition, having reviewed all of the evidence presented by the parties, the Court has reached the conclusion that while plaintiffs were correct in challenging the efficacy of the individual defendants' document preservation program, they litigated the motion on a breadth and scope that was entirely unwarranted by the facts. Plaintiffs repeatedly asserted that they had been deprived of documents that long had been produced to them, such as the Revenue Close Packages, the Aged Accounts Receivable Information, and the Final Sum Summary Reports. They protested that they had not received sales information in the form of Monthly Sales Roll Up Reports, despite the fact that (1) their own lead

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witness on the point, Ms. Van Dinther, admitted that the State Directors Reports (which were produced) contained substantially the same information, and (2) the uncontradicted evidence established that the Sales Summary Reports from the Vantive system--most of which plaintiffs did not copy--also contained the same type of information from the same sources. Plaintiffs continued to advance the proposition that the sales information provided the basis for the revenue figures, relying on uncrossexamined statements by witnesses (Ms. Van Dinther and Ms. Reynolds) which were discredited during their deposition testimony.

***50** Based on these assertions, which plaintiffs should have known were not meritorious when they filed the amended sanctions motion, plaintiffs continued to insist that a default judgment was in order when, based on the case law, there was no evidence of intentional misconduct or prejudice of the type that would warrant that most extreme of all sanctions. When the dust settles from the mountain of paper and accusations that the parties have hurled at one another, what emerges is far from the "wholesale destruction of documents" that are "critical to plaintiffs' proof" (Pls.' 07/25/00 Am. Mem. 1, 2). Instead, the evidence shows that there were shortcomings in the document preservation program that USN attempted to implement which, while serious, at the end of the day did not deprive plaintiffs of the documents and other information that will allow them to attempt to prove their claims at trial. This is not the stuff of which default judgments are made, and plaintiffs should have known that. While courts have a responsibility "neither to use an elephant gun to slay a mouse nor to wield a cardboard sword if the dragon looms," *Anderson*, 900 F.2d at 395, litigants as well have a responsibility to be measured and proportionate when they assert that their opponents have committed sanctionable conduct.

Regrettably, plaintiffs failed in that responsibility, a failing which has helped exact a serious cost on the plaintiffs and the individual defendants alike. By the parties' calculations, they have spent an enormous sum of money litigating the sanctions issue: a collective total of $1,524,762.03. That expenditure has been used solely for the purpose of "litigating the litigation," and has not contributed to advancing this case to the disposition on the merits that the parties in this case deserve. The thousands of hours that the plaintiffs and the individual defendants' attorneys have spent on this issue are hours that would have been far better spent evaluating the evidence in this case, and preparing for trial. Indeed, the Court cannot help but wonder whether, if the parties had spent some of those thousands of hours investigating and gaining mastery over the documents, the plaintiffs would have understood that they long had had in their possession key documents (sales information, Revenue Close Packages, Final Sum Summaries, and Aged Accounts Receivable information) that they claimed had been destroyed or otherwise were missing; whether the individual defendants would have straightforwardly told plaintiffs what they had, without the need for the Court to order them to do so; and whether the individual defendants would have thought to ask Mr. Struble to investigate all backup tapes to see what information they might contain.

Finally, even given the serious charges raised by plaintiffs, the Court was stunned to learn that the parties had spent $1,524,762.03 on the litigation of the sanctions issue (and the Court emphasizes that this figure is in addition to the amount that plaintiffs say that they spent on obtaining the CDs from Spectrum and analyzing them, and that the individual defendants say that they spent in rebuilding the Vantive system). The Court finds it astonishing that plaintiffs and the individual defendants alike say that they *each* spent in excess of $170,000 on the original sanctions motion filed in December 1999--a motion that involved only a few briefs, and never proceeded to an evidentiary hearing. The Court is no less stunned that the parties claimed to have spent collectively nearly $400,000 on discovery related solely to the sanctions issue. And, the fees and costs that the parties attribute to litigation of the amended sanctions motion--$300,000 for the plaintiffs and some $480,000 by the individual defendants--defies logic. It is difficult for the Court to conceive of how the parties could have incurred more than three quarters of a million dollars of attorneys' fees and costs on an amended sanctions motion that involved (1) an opening memorandum and exhibits by the plaintiffs; (2) separate responses by Mr. Elliott on the one hand and the individual defendants on the other hand with exhibits; (3) a reply memorandum with exhibits by the plaintiffs; (4) a few short supplemental memoranda submitted by the parties at the Court's request (largely to fill in important details that were missing from the defendants' filings); and (5) a two-day evidentiary hearing. [FN30]

FN30. On the amended sanctions motion, counsel for Mr. Elliott--who took the lead--

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> listed nearly $380,000 in fees and costs. The outside directors had separate representation from Mr. Elliott; Mr. Hynes was represented by one set of counsel, and their outside directors by another. Each of those two additional sets of counsel say that it cost them approximately $50,000 to litigate the sanctions motion, a figure which in some ways is even more mind boggling--particularly in the case of counsel for Mr. Hynes, who did not file a separate memorandum on the sanctions motion and who attended the evidentiary hearing only on the first day. Moreover, the witness preparation for Mr. Hynes' brief testimony could not have been too difficult or time consuming.

***51** These number speak for themselves, and require no further comment from the Court other than this observation: no one reasonably could believe that this sanctions issue deserved the amount of money that the parties lavished on it.

C. Sanctions.

Based on the foregoing findings and conclusions, the Court believes that the following sanctions are a measured and proportionate response to the conduct that occurred.

First, because the Court has found that none of the outside director defendants are at fault for the failings and the document preservation, the Court recommends that no sanctions be issued against them.

Second, because the Court has found Mr. Elliott to be at fault for the failures in the document preservation program, the Court believes sanctions are appropriate against him. Given the lack of substantive prejudice that the Court has found from the shortcomings in that program, the Court finds that it would be wholly inappropriate to issue a default judgment against Mr. Elliott, or to issue a preclusion order barring him from using certain documents. However, the Court believes that some sanction must be imposed against Mr. Elliott, to impress upon him the importance of the preservation duties that he failed to properly discharge and to deter others from taking that obligation lightly. Accordingly, the Court recommends that an appropriate sanction against Mr. Elliott be that he pay the sum of $10,000 into the registry of this Court. While the imposition of a fine is not one of the sanctions specifically enumerated in Rule 37(b)(2), the language of Rule 37(b)(2) makes it clear that the enumerated sanctions are "among others" that a Court may enter, and that they are therefore not intended to be exclusive. WRIGHT, MILLER & MARCUS, Civil: § 2284, at 612 (1994 Ed.). In other words, a Court is not limited to the particular sanctions set forth in Rule 37(b).

Third, the Court recommends that with respect to the gaps in production of certain documents (the Final Sum Reports for October through December 1997 and February 1998; the Aged Accounts Receivable information for November 1997, January through February 1998 and June 1998; and the sales information for December 1 through 16, 1997 and September 18 through November 20, 1998), at trial the jury be instructed that plaintiffs sought production of that information, but that USN failed to produce those documents for those respective time periods. This sanction is consistent with Rule 37(c), which authorizes the Court to "inform [ ] the jury of the failure to make the disclosure." The Court does not believe it appropriate to instruct the jury that these documents were destroyed because of an inadequate document preservation program, because the evidence has not demonstrated whether the absence of these documents is attributable to the shortcomings in USN's post- litigation document preservation program as opposed to inadequacies in the pre-litigation document retention policies. However, we believe that this recommended instruction would be fair, in that it would make clear to the jury that the responsibility for the absence of those documents rests not with plaintiffs, but with USN.

***52** *Fourth*, the Court believes that each side has abused the other in the discovery process: plaintiffs by demanding the rebuilding of the Vantive system, then failing to copy the sales information that was produced, and defendants by failing to search for and produce the Final Sum/REPGEN information likely available on the January 1999 backup tapes and on the CoreComm system. As a result of that conduct, the plaintiffs could be required to bear the costs of rebuilding of the Vantive system (which defendants state was $159,632.63), and the defendants could be ordered to pay the costs that the plaintiffs incurred in getting the Final Sum information from Spectrum (which, according to plaintiffs, is $178,775.75). The Court believes that in light of the vast sums that have already been (over)spent on this sanctions issue, the last thing that should be done here is to issue an order

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that will lead to further dispute and litigation between the parties about the reasonableness of those respective figures. Accordingly, inasmuch as those figures are comparable, the Court believes that ordering each side to pay the others' costs is not prudent at this point: in substance, each side already has paid--albeit indirectly--for their respective discovery missteps.

Fifth, the Court does not believe that any award of attorneys' fees and costs is appropriate in this case. We are mindful that under Rule 37(b), a party who engages in sanctionable conduct must pay the opponents "reasonable expenses, including attorneys' fees, caused by the failure, unless the Court finds that the failure was substantially justified or that other circumstances make an award of expenses unjust." Plaintiffs have prevailed on the amended sanctions motion, to a limited extent: they have established that the document preservation program was inadequate, and that discoverable documents might have been lost as a result. But they have failed to demonstrate that the outside directors are responsible for those shortcomings; they failed to demonstrate that Mr. Elliott, while responsible, was guilty of intentional or willful misconduct; and they failed to show any substantive prejudice as a result of the shortcomings in the document preservation program. Moreover, as recounted above, in the course of the amended sanctions motion, plaintiffs advanced a number of factual assertions concerning missing documents that proved to be inaccurate, and that plaintiffs should have known were inaccurate at the time that they filed the amended motion. Finally, the amount of attorneys' fees and costs plaintiffs claimed to have expended on the sanctions motions-- $757,559.61--is grossly excessive in relation to the issue presented and the victory achieved.

The Court finds that in these circumstances an award of attorneys' fees and costs to plaintiffs in any amount would be unjust.

CONCLUSION

For all of the foregoing reasons, the Court respectfully recommends that plaintiffs' amended motion for sanctions (doc. # 208-1) be granted in part and denied in part as follows:

***53** 1. The Court recommends that the motion be denied as to the outside director defendants.

2. The Court recommends that the motion be granted as to Mr. Elliot, but that the plaintiffs' request for a default against him be denied. Instead, the Court recommends that Mr. Elliott be required to pay a $10,000 fine into the registry of this Court.

3. The Court further recommends that at trial, the jury be instructed that plaintiffs sought production of certain missing documents (Final Sum Reports for October through December 1997 and February 1998; sales data from December 1 through December 16, 1997 and September 18 through November 20, 1998; and Aged Accounts Receivable information for November 1997, January through February 1998 and June 1998), but that USN did not produce those categories of documents for those time periods.

4. The Court recommends that no monetary sanctions be imposed in connection with the discovery conduct by plaintiffs or the individual defendants.

5. The Court recommends that no attorneys fees and costs be awarded to plaintiffs on this amended sanctions motion.

Specific written objections to this report and recommendation may be served and filed within 10 business days from the date that this order is served. Fed.R.Civ.P. 72(a). Failure to file objections with the district court within the specified time will result in a waiver of the right to appeal all findings, factual and legal, made by this court in the report and recommendation. *See Video Views, Inc. v. Studio 21, Ltd.*, 797 F.2d 538, 539 (7th Cir.1986).

END OF DOCUMENT

United States District Court,
D. New Jersey.

In re the PRUDENTIAL INSURANCE COMPANY OF AMERICA SALES PRACTICES LITIGATION.
This Document Relates to All Actions.

MDL No. 1061.
Civil Action No. 95-4704.

Jan. 6, 1997.

OPINION

WOLIN, District Judge.

[1] This Opinion addresses the persistent and recurrent destruction of documents by agents and employees of The Prudential Insurance Company of America ("Prudential"). Because the preservation of documents and their availability for production is essential to the orderly and expeditious disposition of litigation, document destruction impedes the litigation process and merits the imposition of sanctions. Notwithstanding the absence of evidence of willful document destruction, repeated destruction of potentially discoverable materials demands that this Court preserve and protect its jurisdiction and the integrity of the proceedings before it.

INTRODUCTION

Because of the need to resolve the destruction of document issue without delay, the Court has excerpted much of pages 1 through 30 of the Report of Investigation. [FN1] ***600** The Court has incorporated by reference herein and relied upon the Compendium of Prudential Document Retention Notices ("the Compendium"), the fifty-two depositions taken in response to the Court's Order of December 18, 1996, the Affidavit of Reid L. Ashinoff in Opposition to Motion for Sanctions and Response of the Prudential Insurance Company of America to Plaintiffs' Report of Investigation dated December 31, 1996 ("Prudential's Response"). The Court has filed the Report of Investigation, the Compendium, and Prudential's Response with the Clerk of the Court.

> FN1. The Court takes this opportunity to express its appreciation to the firm of Milberg Weiss Bershad Hynes & Lerach, for the prompt preparation and delivery of this report to the Court. The Court specifically acknowledges the dedication and effort of Melvyn I. Weiss, Barry A. Weprin, Brad N. Friedman, Keith M. Fleischman, Salvatore J. Graziano, and Seth Ottensoser as the draftsmen of this report. Additionally, the Court expresses its appreciation to all the lawyers who participated in the taking of fifty-two depositions over a four-day period at a time of the year, December 20-24, when most legal machinery comes to a grinding halt, and deservedly so. The firm of Sonnenschein Nath & Rosenthal is to be equally complimented for its willingness on behalf of Prudential to staff and defend these fifty-two depositions.

In February and March 1995, Prudential policyholders commenced class actions against Prudential alleging that during the 1980s and early 1990s Prudential engaged in a scheme to sell life insurance through deceptive sales practices. On August 3, 1995, the Judicial Panel on Multidistrict Litigation transferred all related lawsuits throughout the country, including all class actions, individual actions, and former agent "whistleblower" actions, to this Court.

On September 15, 1995, this Court entered its first Order in the multidistrict litigation (the "September 15, 1995 Order"). The September 15, 1995 Order required, among other things, that all parties "preserve all documents and other records containing information potentially relevant to the subject matter of this litigation." September 15, 1995 Order at 4(d).

Subsequent to the September 15, 1995 Order, and throughout the pendency of this litigation, Prudential's preservation of documents has been a pervasive issue. For example:

On December 13, 1995, agents' lead counsel, Bruce Miller , raised in open court that Prudential was closing offices throughout the country, and requested an order "that the records that exist in these places must remain secure." December 13, 1995 Tr. at 112. Prudential's counsel, Reid Ashinoff, responded: "I don't have a problem with the substance of Mr. Miller's request." *Id.* at 113. Ashinoff noted that Prudential could not agree never to destroy *any* document in the ordinary course of business, but otherwise confirmed: "Yet I agree in principle and substance to a point." *Id.*

In July 1996, the parties learned that a Prudential employee, David Fastenberg, had been accused of destroying Prudential documents. Thus, on July 23, 1996, plaintiffs' counsel and Miller brought this matter to the Court's attention, only to hear from Ashinoff that plaintiffs' counsel were engaged in "the rankest kind of smear campaign," and that once Ashinoff was retained in February/March 1995, warnings were issued that documents should not be destroyed. July 23, 1996 Tr. at 22, 24-25, 27.

Document destruction issues were also discussed in open court on October 21, 1996, December 6, 1996, and December 13, 1996.

On Saturday, December 14, 1996, Prudential's counsel informed plaintiffs' co- lead counsel in the class actions that documents relevant to this litigation in the Prudential Preferred Financial Services ("PPFS") Boston area office located in Cambridge, Massachusetts (the "Cambridge Office"), had improperly been destroyed by the Managing Director of the Cambridge Office during the pendency of this litigation. That this document destruction violated the September 1995 Order is not contested. Gillen 111-12. [FN2]

FN2. A list of deponents is contained in Appendix 3 to the Report of Investigation filed herewith.

On Monday, December 16, 1996, plaintiffs obtained an Order to Show Cause why sanctions should not be imposed in connection with this document destruction (the "December 16, 1996 Order"). Specifically, the Court ordered Prudential to show cause on December 18, 1996 why the Court should not impose sanctions and other appropriate relief for "Prudential's destruction of relevant documents during the pendency of this litigation." *See* December 16, 1996 Order. The Order to Show Cause was served upon all parties who had entered an appearance in this multidistrict litigation.

***601** On December 18, 1996, the Court held a hearing and, *inter alia,* ordered plaintiffs to conduct an investigation into the Cambridge Office document destruction incident and to ascertain "whether Prudential's notification on destruction of documents was or was not satisfactory." *See* December 18, 1996 Tr. at 44.

1. Scope of the Investigation

Pursuant to the Court's instructions, on December 18, 1996, plaintiffs' counsel undertook an extensive investigation into the circumstances and events surrounding the destruction of documents in Prudential's Cambridge Office. Accordingly, plaintiffs' counsel thoroughly investigated the timeliness of the actions taken upon the discovery of this incident and the adequacy of Prudential's document retention policies and/or guidelines, and the enforcement thereof. *See* December 18, 1996 Tr. at 44.

Between December 18 and December 24, 1996, plaintiffs' counsel reviewed hundreds of Prudential documents, including numerous documents that Prudential contends evidence its written policy concerning the proper handling and retention and/or destruction of documents.

Between December 20 and December 24, 1996, plaintiffs' counsel conducted fifty-two depositions. Plaintiffs' counsel deposed, among others: Arthur F. Ryan, Prudential's Chairman and Chief Executive Officer; Marc Grier, Prudential's Chief Financial Officer; James Gillen, Prudential's General Counsel; Rodger Lawson, a Prudential Executive Vice President; John M. Breedlove, the Managing Director of the Cambridge Office; Cheryl Rizzo, who was Breedlove's assistant; Melissa Gonzalez and Russ Spaulding, the members of the Prudential Compliance team who discovered the document destruction incident in the Cambridge Office; and each and every other person identified by Prudential's attorneys as associated with, or having knowledge of, the incident.

In addition, plaintiffs' counsel randomly selected and deposed thirteen agents associated with the Cambridge Office. Prior to these depositions, approximately fifty agents were requested to complete a questionnaire that plaintiffs' counsel created, to ascertain each agent's understanding and knowledge of any Prudential document preservation guidelines and the details of the Cambridge incident. Prior to taking any depositions, plaintiffs' counsel also interviewed David Greenbaum, one of Prudential's outside counsel who had investigated the Cambridge incident.

Throughout the depositions, additional documents were produced by the deponents and/or their counsel, including internal Prudential memoranda, questionnaires completed by Cambridge agents, and other documents relating to the Cambridge incident.

Furthermore, because plaintiffs' counsel learned that there had potentially been a destruction of relevant documents by Prudential employees in Prudential's Syracuse, New York office, plaintiffs' counsel deposed Paul Berrafato, General Manager of Prudential's Syracuse office.

2. Prudential's Document Destruction Policy and Document Retention Guidelines

A. Implementation/Communication

In early 1994, in response to a regulatory directive issued to most life insurance companies, Prudential undertook a sweep of all of its sales materials to avoid the use of unauthorized sales materials. All unapproved or outdated sales materials were collected, catalogued, and warehoused. Following that 1994 sweep, Prudential initiated a document destruction policy, which required the destruction of all unauthorized or outdated sales material. Prudential did not attempt to catalogue how many documents were destroyed, the locations they were taken from, or any other crucial details, such as who destroyed them. Nor did Prudential implement any training program. Rather, according to Prudential's senior management, Prudential policy was to keep a single copy of each piece of sales material so that it would be available to counsel for plaintiffs and to state regulators. Prudential distributed its document retention instructions on a number of occasions, typically through an e-mail system referred to as PROFS notes.

***602 (i) Prudential's Managing Director Audit Blueprint**

Prior to May 1995, PPFS had no written instructions, policies, or procedures regarding the retention and/or destruction of unapproved material. *See* Tignanelli 250; Cataldo 14; Reynolds 34.

On May 26, 1995, PPFS issued "The Managing Director Marketing Material Audit Blueprint," which was designed to allow Managing Directors systematically to monitor and control the use of marketing material: "The Audit Blueprint is designed to provide a standardized procedure and checklist for Managing Directors to keep up with the on-going changes in marketing material so they can know what is and is not approved material." *See* Soderstrom Ex. 1 at 5. [FN3]

FN3. Exhibits from the depositions are denoted as "__ Ex. __."

The Audit Blueprint is a written manual, printed in a format that permits it to be retained by individual company employees and placed on company bookshelves. It was distributed to all Prudential office managing directors. It provides--without qualification--that "disapproved material," *id.* at 7, and "out-of-date marketing

material," *id.* at 9, should be destroyed; there is no provision on these pages that any copies should be retained.

Later in the document, the Audit Blueprint instructs a Managing Director on actions to take when unapproved marketing material is found in a client file, including destroying additional copies of the material:

> If a Managing Director finds unapproved marketing material in a Special Agent's client file, s/he should require the Special Agent to destroy any *additional* copies of such material, [footnote 15] and should counsel the Special Agent regarding PPFS policy on the use on unapproved materials with the public.
> *Id.* at 14.

The only reference to document preservation in Prudential's Audit Blueprint is in footnote 15. This note states that unapproved marketing material found in a client file should not be destroyed:

> Unapproved marketing material found in a client file should not be destroyed. The Managing Director should, however, attach a signed and dated note to the material indicating that it is not approved material and that the Special Agent has been instructed not to use the material in the future.
> *Id.* at 14-15.

Prudential general counsel James Gillen confirmed that this corporate policy to destroy improper sales materials continues to this day with his approval. Gillen does not consider this destruction policy to be a violation of this Court's September 15, 1995 Order that required preservation of all potentially relevant documents. Gillen 105.

(ii) PROFS Notes and Other Document Retention Notices

Unlike the Audit Blueprint, which was a written document that dealt primarily with Prudential's document destruction policy rather than with document retention, Prudential's principal medium of communicating its "document retention" practices was PROFS notes (e-mail). *See* Compendium at 2, 4-9, 11- 14. Priscilla A. Myers, Prudential's Senior Vice President in charge of auditing, acknowledged that while electronic mail was a quick way to disseminate information, electronic mail notices "are usually followed up with a paper document." Myers 33. This was not done consistently in connection with document retention PROFS notes. Moreover, none of these PROFS notes indicate that they amend the Audit Blueprint, or that they should be kept with the Audit Blueprint.

Because Prudential's individual insurance organization is divided in three parts--PPFS, Prudential Select, and Prudential Insurance and Financial Services ("PIFS"), notices concerning document retention were sent to all three divisions, often by different management-level personnel of Prudential. The relevant notices were:

1. On August 9, 1995, a PROFS note addressed by Ira Kleinman to Prudential Select Associates stated that as a result of the multi-

state task force investigation, Prudential ***603** was amending all existing company document retention guidelines effective immediately. *See* Compendium at 2. The note stated:

> Do not destroy any documents currently being saved under any Company guidelines, even if the existing guidelines call for destruction (because of document age or other reasons).
>
> This includes, but is not limited to, any and all documents that relate to: insurance sales that used existing policy values (including dividends) or abbreviated pay plans ('APP'), such as agent training brochures or worksheets, marketing and point of sales materials, illustrations, policy disbursement records, client files and related materials, as well as customer complaints and Company disciplinary files.

This PROFS note provided telephone numbers which Prudential Select Associates could call if they had any questions and stated: "When in doubt about retaining a particular document, save it!" The PROFS note also warned that the Company and its employees could face severe sanctions if documents were destroyed and stated that "any willful or deliberate violation of these guidelines will result in serious disciplinary action, up to and including termination." *Id.*

2. On August 15, 1995, a hard-copy memorandum addressed by Thomas A. Croswell, Senior Vice President, Agencies, to all PIFS associates and representatives, repeated the contents of the above-described PROFS note, leaving out the warning that any willful or deliberate violation would result in disciplinary action and possible termination. Compendium at 3.

3. On August 17, 1995, a PROFS note addressed by Joseph P. Mahoney, to all PPFS associates, repeated the same message (again without the warning regarding possible termination). Compendium at 4.

4. On September 8, 1995, a PROFS note addressed by Joseph P. Mahoney to all PPFS associates instructed all Office Vision users to do the following, effective immediately:

> Do not destroy any Office Vision Notes which directly or indirectly relate to insurance sales involving the use of existing policy values (including dividends) or abbreviated pay plans ('APP'). This includes, but is not' limited to, Office Vision Notes which relate to agent training, marketing and point of sale materials, policy illustrations, customer complaints, or agent disciplinary files which concern the use of policy values (including dividends) or APP to sell life insurance.

Compendium at 6. The PROFS note stated that PPFS associates should contact their supervisor or the Law Department if they had any questions and stated: "When in doubt about a particular note, save it!" The PROFS note also warned that the Company and its employees could face severe sanctions if Office Vision Notes were destroyed. *Id.*

5. Also on September 8, 1995, PROFS notes containing the same text were addressed by Thomas A. Croswell to PIFS associates and representatives and by Ira Kleinman to all Prudential Select associates. Compendium at 5 and 6.

6. On September 14, 1995, Jeff Hahn, PPFS' Chief Legal Office and

Vice President, addressed a PROFS note to all PPFS associates, which referred to the August 1, 1995 PROFS note sent by Joseph Mahoney and provided the following supplementing instructions, effective immediately:

> Do not destroy any Office Vision Notes which directly or indirectly relate to insurance sales involving the use of existing policy values (including dividends) or abbreviated pay plans ('APP') which relate to agent training, marketing and point of sale materials, policy illustrations, customer complaints, or agent disciplinary files which concern the use of policy values (including dividends) or APP to sell life insurance.

Compendium at 8. This PROFS note also stated that PPFS associates should contact their supervisor or the Law Department if they had any questions and, in the middle of a paragraph, stated: "When in doubt about a particular note, save it!" This PROFS note again warned that the Company and its employees could face severe sanctions if Office Vision notes were destroyed. *Id.*

***604** 7. On March 14, 1996, Bill Therrien addressed a PROFS note to all PROFS users repeating the above supplementary instruction, and substituting the term "PROFS notes" for "Office Vision Notes." Compendium at 13.

8. On August 14, 1996, Arthur Ryan addressed a PROFS note to Prudential associates which reported that David Fastenberg, the head of the Individual Insurance Group's Greater Southern Territory, was dismissed for failing to abide by and enforce Company directives to preserve documents. Compendium at 15.

9. On November 6, 1996, Kevin Frawley, Prudential's Chief Compliance Officer, addressed a hard-copy memorandum to all individual insurance employees and agents, stating that it was important to continue preserving documents that might relate to Prudential's recent class-action settlement and other lawsuits and investigations Prudential was facing. Attached to his memorandum was a document entitled "Interim Document Retention Guidelines." This document provided a detailed list of the types of documents that all employees and agents were instructed to retain. Compendium at 16.

10. On November 13, 1996, Kevin Frawley addressed the same memorandum to all individual insurance employees and agents, but added a sentence that such records might also be relevant to the Policy Remediation Program. Compendium at 17.

(iii) The Distribution of Prudential's Notices

Most of the above-described notices were never circulated in hard copy. In fact, prior to November 6, 1996, only PIFS associates received a hard-copy memorandum regarding document retention; all others were sent only PROFS notes. Numerous witnesses testified that they received so many e-mails that they ignored any new e-mails transmitted into their system. *See* Lublin 25- 27. A number of deponents confirmed that not all associates have access to e- mail and that, therefore, many individuals never received any of the PROFS notes regarding document retention (unless personswith access

to e-mail had made copies for them). *See, e.g.,* Myers 35 (not all associates have computers); Mariani 59-60 ("not each rep had their own terminal which they would access"); Sullivan 18 ("Not everybody is on the system."); Melquist 32-33 (approximately 1100/2700 agents have e-mail).

Nor were the various PROFS Notes ever printed and made available for general review. In fact, while Prudential's counsel provided plaintiffs with a list of all of the notices that were distributed with regard to document destruction, that list was not produced until December 24, 1996, after almost all of the depositions were completed or already in progress. *See* Ryan Ex. 1. In addition, as of December 25, 1996, defendants' counsel had yet to locate and produce almost half of the documents identified on the list.

There was no communication to anyone in any written or PROFS note format regarding the entry of the Court's document preservation order, its import, or the ramifications of violating such a Court order. Grier 97. To date, discovery has shown that neither Prudential, nor its counsel, have ever circulated to anyone at Prudential a copy of the Court's document preservation order or any written directive regarding the Order itself. [FN4] *See* Grier 97; Ryan 31.

> FN4. The notices also failed to make any mention of improper sales practices relating to investment or retirement claims. *See generally* Compendium.

B. Testimony of Prudential Top Management

Prudential top management--Chairman Arthur Ryan, Executive Vice President Rodger Lawson, Chief Financial Officer Marc Grier, and General Counsel James Gillen--all recognized that the sales practices lawsuits and regulatory investigations are an extremely important part of Prudential's business. *See, e.g.,* Grier 14; Gillen 27. More importantly, they all recognized Prudential's obligation to preserve documents in connection with the lawsuits and investigations. Yet, none took an active role in formulating, implementing, communicating, or conducting a document retention policy. ***605** Rather, all of them relied on others to do these tasks. *See, e.g.,* Ryan 35, 50.

Arthur Ryan, Prudential's Chief Executive Officer, recognized that it was management's responsibility to communicate the Company's document retention directives to its employees. Chairman Ryan kept abreast of the litigation on a regular basis. In 1995, Chairman Ryan held monthly meetings on the litigation and investigation. Ryan 19. In 1996, William Yelverton, head of individual insurance, took over the monthly meetings, but he and Gillen kept Ryan regularly informed. *Id.* Chairman Ryan stated that with respect to document retention he had:

> a pretty good understanding of what is required to insure that people understand what they are supposed to do. The management did communicate through certain written vehicles, but equally important, in all *communications, it's the obligation of management to insure that people understand* that laws are to be followed,

> regulations are to be followed, and doing the right thing is to be followed.
> Ryan 27-28 (emphasis added).

According to Chairman Ryan, he fulfilled his own personal obligation in this regard by referring the preservation of documents issue to the Prudential Legal Department and felt comfortable that the proper policy would be implemented. *See* Ryan 35-36. Ryan stated that:

> The interpretation of what is required by the law, the regulation is the responsibility of the law department. It is also their responsibility to communicate it to line management. The business unit is then responsible for understanding what goes on in their operations, and would be the ones responsible as they learned it, to communicate it immediately.
> Ryan 50.

When Chairman Ryan was informed that virtually every Prudential agent who was interviewed or deposed in connection with the Cambridge incident denied having knowledge of communications concerning document retention, he indicated that if this were true he "would be extremely dissatisfied." Ryan 28.

Marc Grier, Prudential's Chief Financial Officer, had very little knowledge or understanding about document preservation requirements. He testified that he had never seen "something in writing" which "demonstrated what the clear policy of the Company was." *See, e.g.,* Grier 54. Grier did not recall ever seeing the Audit Blueprint. *Id.* 56. Grier acknowledged that management has a responsibility to make important things clear to people within the organization, and also agreed that when it comes to observing court orders, an organization not only must advise the organization of any court- ordered responsibility, but also must audit its compliance. *See id.* 92-94.

Grier never inquired into whether the Mahoney PROFS note communication of August 15, 1995 was part of a printed manual that was in the libraries of offices around the country for people to access easily. *Id.* 91. Moreover, Grier admitted his concern that information about this Court's September 15, 1995 document preservation order was never disseminated to Prudential employees:

> Q. Do you believe today that the employees of Pru were made aware of Judge Wolin's document preservation order?
> A. No, I don't believe that.
> Q. Does that concern you?
> A. Yes, it does.
> Grier 97-98.

Rodger Lawson, Prudential's Executive Vice President in charge of planning and marketing, joined the company in June 1996. Lawson 7-8. Lawson testified that he was sure that the company had an adequate policy, but that he was not directly involved in implementing or communicating it:

> I am quite certain that the insurance company has clear instructions as to the preservation of documents. I am quite certain that they exist in some volume. Precisely what is in each

> of those documents, I cannot attest to. I have seen some of them and I have not read them in detail, and I believe the insurance company is ***606** responsible for issuing those instructions and maintaining them.
> Lawson 14.

Senior Vice President in charge of auditing, Priscilla A. Myers, was personally aware of the preservation order, but did not know whether compliance review employees were made aware of it. Myers 42-43.

James Gillen, Prudential's Senior Vice President and General Counsel, relied heavily on Richard Meade and Deborah Bello-Monaco, two attorneys for the individual insurance division of Prudential, to see that proper document retention procedures were developed and implemented. Gillen had little personal involvement in this issue. Gillen 25.

Gillen testified that over the past two years Prudential has issued a variety of communications on document retention, primarily in the form of PROFS notes. Gillen 21. Gillen testified that with respect to messages sent by PROFS notes:

> Anybody who has a terminal on their desk would have received this. And they're in offices where typically these kinds of instructions provide that people are--that the people in offices that have terminals should share the documents with others that don't.
> Gillen 86.

Thus, Gillen testified that Prudential relies upon associates being apprised of PROFS notes by those who have the equipment to receive them. *Id.* 87. When asked whether he had taken any steps to notify Prudential employees and agents that the Court had entered a document preservation order, Gillen replied that he "felt that our [Prudential's] existing policies of communications were adequate to meet the requirements of the order." *Id.* 93.

While Gillen did not believe that a separate communication concerning the September 15, 1995 Order was necessary, Gillen did notify Prudential employees of this Court's subsequent entry of an Order dealing with plaintiffs' communication with Prudential employees. Thus, on April 2, 1996, Gillen personally sent a PROFS note to all Prudential associates. This PROFS note, which was found in the Cambridge Office, stands in stark contrast to the absence of any such communication from Gillen regarding the September 15, 1995 order. It describes this Court's order concerning employee interviews and explains the implications for Prudential employees:

> As you know, Prudential has been sued in certain state and federal courts concerning allegedly improper practices in the sale of life insurance products. The federal actions have been consolidated for pre-trial purposes before Judge Wolin of the federal court in New Jersey under the caption 'In re: The Prudential Insurance Company of America Sales Practices Litigation,' Master Docket No. 95-4704 (AMW). We are vigorously defending these actions.
> Several current Prudential employees have expressed their concern to us that plaintiffs' counsel in the federal action have been

calling them trying to set up interviews to discuss their knowledge of the company's policies and procedures. You, too, may receive such a call. Judge Wolin has ruled that plaintiffs' counsel may contact you. However, he has also ruled that you need not talk to plaintiffs' counsel. In addition, Judge Wolin has ruled that you can discuss any contacts from plaintiffs' counsel with a member of Prudential's Law Department or with your own attorney. I have instructed all the attorneys in the Prudential Law Department to make themselves available to assist you in these matters.

Breedlove Cambridge Ex. 106. It should be noted that e-mail rather than hard copy distribution was used in this instance as well.

C. How Communications Worked in the Cambridge Office

John Breedlove, Managing Director of the Cambridge Office, testified that either his assistant, Mary McHugh, or business manager, Bette Komanski, was responsible for reviewing incoming PROFS notes and bringing important notes to his attention. Breedlove 126, 195. Breedlove would then direct McHugh to distribute those PROFS notes that he felt were worthy of distribution.

Several PROFS notes relating to document retention were found in binders on McHugh's desk marked "PROFS Notes Sent ***607** and PROFS Distributed to Associates." Breedlove Cambridge Ex. 106-111. Additionally, many PROFS notes were marked by either Breedlove or McHugh as "distributed," with a specific date of distribution. However, neither the August 15, 1995 Mahoney, nor the March 14, 1996 Thierren PROFS notes were marked for distribution, and most of the Cambridge Office agents who have been deposed or answered plaintiffs' questionnaires have denied ever seeing any of the PROFS notes relating to document retention. Rider 34; McGloughlin 48, 59; Sayan 30-32.

In addition, hard-copy memoranda were not sent to each individual agent. Rather, they were sent to Komanski for office-wide distribution. Akers 70. As of the beginning of December 1996, Komanski had not yet distributed the November 1996 Frawley memorandum to agents within the Cambridge office. Akers 70-71.

Many agents in Prudential's Cambridge Office were questioned by Prudential after the disclosure of the Breedlove incident about their awareness of the three document retention PROFS notes circulated within their division, PPFS. Mahoney 8/95, Hahn 9/95, Ryan 8/96. These agents uniformly were not aware that these memos even existed. At most, out of fifty-seven agents interviewed by Prudential and its counsel, [FN5] seven agents were aware of the Mahoney document retention e-mail; four were aware of Ryan's document retention e- mail; and eight were aware of Hahn's document retention e-mail. *See* Cambridge Ex. 12-33; Questionnaires completed during Prudential Interviews of Agents From Boston FSO, CAM 000567-CAM 000902.

FN5. Prudential produced its notes from these interviews to plaintiffs' counsel.

Similarly, many agents testified when deposed that they never received Prudential's document preservation notices. For example, Thomas F. Rider, an agent in the Cambridge Office, testified that he does not use the Computer Communication System at Prudential. *See* Rider 25. Accordingly, Rider testified he had never seen the Mahoney August 15, 1995 e-mail. Rider 34.

Similarly, William G. McGloughlin, III, an agent in the Cambridge Office, testified that he had never received documentation in a memo form that directed him to preserve documents because such documents could be evidence in a court proceeding. *See* McGloughlin 40. When asked if he accessed the electronic mail system at Prudential, McGloughlin testified that:

> I am on it but I don't access it, if that makes any sense. I am signed on but there are over 700 messages waiting there because I don't know how to use it and I don't have time to learn how to use it.
>
> McGloughlin 43.

3. The Cambridge Document Destruction Incident

A. Background

Like all PPFS offices, the Cambridge office is subject to both routine and unannounced compliance inspections. Gonzalez 53.

On January 27, 1995, prior to any 1995 compliance inspections, John Breedlove, Managing Director of PPFS' Cambridge Office, advised the associates in that office:

> It is *critical* that all *unapproved sales material* in your possession be destroyed. Use of unauthorized material is a very serious *violation* and we have just completed destruction of all outdated materials in our supply area.
>
> Gonzalez Ex. 7 (emphasis in original).

On April 5, 1995, members of Prudential's compliance review team, Bill Clark and Dean Schroeder, arrived at the Cambridge office unannounced, to perform a surprise compliance review. Tignanelli Ex. 28 at CAM 000966. The review team asked to check sales literature and all other items available to assist agents during the sales process. *Id.* During the inspection, the review team reviewed the supply areas, agent work spaces, and client files. *Id.* The Cambridge Office was cited for failure to adequately regulate the materials in the supply room, the agents' cabinet, and the training room. *Id.* at CAM 000968. Specifically, many of the sales materials that the review team found in these ***608** areas were not listed in the March 1995 Marketing Resources Guide ("MRG") and, thus, were unapproved. *Id.* Therefore, the auditors themselves discarded these outdated materials in accordance with Prudential's document destruction policy:

> We reviewed the materials in the supply room and the materials available to agents.... If the materials that we found on the shelves were not listed in the MRG, we *discarded* them. A listing of these materials can be found in Attachment I.... An old *CONCEPTS* manual was also destroyed by Jim Kenealy [BOSX Computer

> Specialist] when it was pointed out that it had a visual presentation of what was previously known as the 'Private Pension Plan.'...
> The training room contained many tapes and books. It also included old ACPP books (ORD 88672 & 88612) which we *discarded*....
> We also *discarded* some office stationery and blank business cards that did not comply with the guidelines....
> Tignanelli Ex. 28 at CAM 000968, 975, and 977 (some emphasis added and some in original).

During the April 5, 1995 investigation, the compliance review team also discovered that agent Zhen-Jing Sun was sending out unapproved correspondence. The unauthorized correspondence located in agent Sun's files was a letter in Chinese that when translated to English used terms such as "retirement Plan" and "Estate Planning." Pearson Ex. 5 at CAM 000463. On June 22, 1995, Michael Cataldo, Executive Director for the northeast marketing territory, sent a sanctions letter to agent Sun assessing him a fine of $250 for using a piece of unauthorized correspondence. *Id.* at CAM 000481.

On May 25, 1995, Bette Komanski, the office Business Manager, sent a letter to Breedlove advising him that she had discarded some outdated sales material:

> Reference was also made to the Silver Dollars Kit. To tell you the truth, I had no idea what was in this because they are shrink wrapped. So while most of the kit is good, there were brochures inside which were outdated. I *discarded* these.
> Breedlove Cambridge Ex. 104 at CAM 000982 (emphasis added).

Thereafter, a routine annual compliance review for the Cambridge office was scheduled for mid-August 1995. Tignanelli Ex. 28 at CAM 000994. In anticipation of this review and upset about the fine levied against agent Sun, Breedlove issued a memorandum dated August 7, 1995, directing all associates to "*please review your files during this week and discard any unapproved sales materials.*" Gonzalez Ex. 6 at CAM 000948 (emphasis in original).

On August 17 and August 18, 1995, auditors Jeff Soderstrom and Marty Lewis inspected the Cambridge Office. Tignanelli Ex. 28. Their report, dated October 10, 1995, does not discuss the existence of Komanski's May 25, 1995 letter to Breedlove or Breedlove's August 7, 1996 document destruction memorandum, nor does it mention any evidence of document destruction at the Cambridge Office *Id.* at CAM 000994-1007. Rather, the report commends Breedlove for doing a fine job of establishing an "In Control" operation and for instituting procedures to monitor sales material. *Id.* The report, however, did address other areas in which the auditors expressed specific concern. The auditors concluded that other areas of liability exposure existed at the FSO, and that the implementation of management controls was necessary. *Id.* The report specifically suggested that Breedlove implement individual agent marketing material audits. *Id.* The auditors also suggested that Breedlove implement a system to spot-check agent correspondence. *Id.*

Thereafter, in a written memorandum to his associates on February 1, 1996, Breedlove declared that his office would conduct a client

file review. Grier Ex. 1. Breedlove's directive stressed the need to "immediately" make sure that client files are "in compliance." He advised all associates that he had designated Cheryl Rizzo to assist with the audit of the client files and that this would reduce "exposure" and "liability":

> One area that we need to work on immediately is making sure that client files are in Compliance. To assist you in your efforts ***609** in this area, I am going to have Cheryl Rizzo visit with each agent and do an audit of your client files to make sure that they are in Compliance and to reduce your exposure and liability relative to this issue.

Id. The intention was to cleanse all the agent files prior to the next regular audit scheduled for November 1996. Komanski 31.

Hence, from February 1996 to November 1996, at Breedlove's direction, Rizzo reviewed every client's file from every active agent in the office, including the district office in Westborough. [FN6] Rizzo 30. Rizzo discarded all undated, handwritten notes, as well as any unapproved sales material that appeared to have been used following the 1994 moratorium on the use of such material. Gillen Ex. 3 at CAM 001033-34 (memo from David Greenbaum to Reid Ashinoff dated December 11, 1996). Rizzo's audit involved the cleansing of approximately 9,000 client files, and the destruction of approximately eighty "folders of documents." Rizzo 31; Gillen Ex. 3. In addition, Rizzo testified that she believed that some agents cleansed their files before her audit, and that additional documents may have been discarded. *Id.* at 73.

> FN6. Rizzo continuously worked on this project. Just before the November 20, 1996 compliance review, she worked overtime to ensure completion prior to the compliance inspection. Rizzo 30.

B. Discovery of Destruction

On November 20, 1996, Prudential compliance auditors Russ Spaulding and Melissa Gonzalez commenced the routine annual field office compliance review of the Cambridge Office. Spaulding 34, 40-41. At the start of this review, Breedlove reported his personal document destruction policy, Spaulding 36, and a short time later, Gonzalez discovered Breedlove's February 1, 1996 memo. Gonzalez 49-50. Breedlove also asked Rizzo to describe her actions for the auditors. Spaulding 68-71.

It appears that Russ Spaulding, the auditor in charge of the November 1996 Cambridge audit, did not consider the document destruction as a matter of urgency. Spaulding was informed of the Cambridge incident by Breedlove on Wednesday, November 20, 1996, but did not report the incident to his supervisor, William Reynolds, until a phone call on Tuesday, November 26, 1996. Spaulding 40-41. Spaulding completed the audit before further investigating the document destruction. *Id.* 55-56. He did not substantively discuss the incident with Reynolds until December 2, 1996. Reynolds 44-45. Spaulding did not include document destruction in his initial memo of significant issues that arose during the audit. Spaulding 48-49. On December 4, 1996, Spaulding prepared his first full written

report on the Cambridge incident. He prepared a "Compliance Memo" to the Development Unit regarding the document destruction incident. Spaulding 52-53. This memo stated that Breedlove had brought the document destruction incident to Spaulding's attention during the compliance review. *Id.* Spaulding recommended that Breedlove be punished for the document destruction incident by issuance of a warning letter rather than suspension or termination. Spaulding 63.

On Thursday, December 5, 1996, Jeff Soderstrom learned about the incident in a conversation with Spaulding. Soderstrom 67. Soderstrom then instructed Spaulding to contact James A. Tignanelli and apprise him of the destruction. Soderstrom 76-77. Spaulding sent an e-mail to Tignanelli and to Tignanelli's superior, Kevin Frawley. Soderstrom and Tignanelli established that Corporate Compliance should take the lead in further investigating the incident. Soderstrom 79-80, 82-83. Tignanelli sent a copy of Spaulding's e-mail to in-house counsel, Francine Boucher. Tignanelli 326, 337, 343.

On Friday, December 6, 1996, after discussing the matter with Tignanelli, Richard Mariani, Director of Development, called Spaulding and advised him that the Development Unit of the Compliance Department would take over the handling of the investigation. Spaulding 50. Tignanelli "was basically trying to cut off whatever activity Spaulding was trying to generate and then [turn] it over to Fran Boucher [of the law department]." Tignanelli 334-35. Tignanelli told Mariani to get copies of the compliance ***610** memo to him and the law department, "and then sit back and wait for them to tell us what to do, and I told him I would meet with Fran the next day [December 6]." Tignanelli 345.

Tignanelli met with Boucher at approximately eleven o'clock on December 6. Tignanelli 350. Boucher told Tignanelli that the law department would handle the situation. "They would be getting in touch with outside counsel. They would get in touch with whoever, and that we weren't to do anything until they told us what we were going to do. I said fine. Just let us know whatever you want us to do and we'll do it." Tignanelli 353. Tignanelli was "pretty sure" Boucher had read the memos because "she acted like she did." *Id.* 355- 56. Tignanelli told Boucher that Tignanelli's department had contacted the PPFS people and communicated to them not to do anything because the Law Department was now going to handle the situation. *Id.* 357. Assistant general counsel Richard Meade also learned of the incident in a brief conversation on December 6, 1996. (He didn't recall how he learned about it.) Meade 6.

On Monday, December 9, 1996, Prudential's lead outside attorney, Reid Ashinoff, was told of the document destruction. Ashinoff Affidavit at 5; December 18, 1996 Tr. at 33. Ashinoff asked one of his partners, David Greenbaum, to go to Cambridge to investigate. Ashinoff Affidavit at 5.

On either December 9 or December 10, 1996, Meade, the in-house lawyer in charge of these litigations, discussed the incident in brief conversations with another in-house attorney Deborah Bello-

Monaco and Gillen. Meade 9. Greenbaum, Rochelle Barstow (another attorney with Sonnenschein), and Sherry Akers (a Prudential compliance manager), interviewed Breedlove, Rizzo, and Komanski in Cambridge on December 10, 1996. CAM 001027-001032. After these interviews, Greenbaum gave Boucher an oral report about the Breedlove document destruction and Boucher relayed the information to her colleague Bello-Monaco. Boucher 38-39. Barstow prepared a memorandum to Greenbaum outlining the chronology of events and provided a summary of the employee interviews. CAM 001027-1032. Greenbaum received a facsimile transmission from Rizzo containing her "best guess" that 9,125 client files were reviewed. CAM 000903-906.

Senior Vice President and Auditor Priscilla Myers, to whom Tignanelli and Frawley reported, learned from Gillen on "Monday or Tuesday, December 10 or 11" that documents were discarded. Myers 88-89.

Late in the afternoon on December 11, 1996, Ashinoff met with Prudential senior management, Arthur Ryan, James Gillen, and Marc Grier, and apprised them for the first time of the Cambridge incident. Ashinoff Affidavit § 1a. According to Ryan and Grier, they had no prior knowledge of the incident. Ryan 45; Grier 63-64.

On Friday, December 13, 1996 there were meetings at Prudential's corporate office the entire day. Bello-Monaco 27-28. During the morning meeting, Ashinoff met with Prudential senior management Gillen and Bello-Monaco. Bello- Monaco 24-25. Later, Ashinoff left the meeting to attend the hearing in this Court on the motion for recusal brought by counsel for Kittle and Krell.

After the Court hearing on December 13, Ashinoff returned to Prudential's corporate office and met with Ryan, Grier, and others. Bello-Monaco 26-28. They made a tentative decision to terminate Breedlove, and public relations executives Robert DeFillippo and Richard Riley began to prepare a public relations statement. Bello-Monaco 46; DeFillippo 45-46.

Thus, by Wednesday, December 11, 1996, the essential facts about the Cambridge incident were known to senior management. Sonnenschein attorney David Greenbaum had completed his preliminary investigation. According to CFO Grier, it was apparent by that time that Breedlove would be fired. Grier 79. Prudential management acknowledged that they needed to notify the Court, plaintiffs' counsel, and the New Jersey Department of Insurance about the Cambridge incident, preferably simultaneously. Gillen 121 ("Our intent was to inform plaintiff's counsel, [the] regulator and the Court, as soon as possible andat the same time"). Prudential management continued to discuss ***611** the matter on Friday, December 13, 1996, Saturday, December 14, 1996, and Sunday, December 15, 1996. Ryan 76-77; Gillen 129-130; Grier 87-88. Plaintiffs' counsel was notified on December 14, 1996, and the New Jersey and Massachusetts regulators, and the Court, were notified on Monday, December 16, 1996. Also, Breedlove was notified of his firing on December 16, 1996.

4. The Syracuse Office

Several different allegations of improper treatment of documents have recently surfaced in connection with Prudential's Syracuse office.

A number of the incidents involved Paul J. Berrafato, the General Manager of the Syracuse office, who has served as General Manager in Syracuse for twenty years. [FN7] Berrafato 7. First, Berrafato removed approximately ten/fifteen tapes from that office immediately prior to a visit from Prudential's compliance personnel in the late summer or fall of 1996. *Id.* at 62-63, 84-87. Prudential learned of that incident as a result of allegations made by the ABC television program *Prime Time Live.* Tignanelli 281-82; Bello-Monaco 70-75.

> FN7. During the investigation, plaintiffs' counsel learned of an allegation that documents were removed from the Syracuse office and placed in the trunk of the office manager's car in advance of a compliance check by state regulators. Other than as described herein, Berrafato denied that this or any similar incident of document removal ever took place. Berrafato 89-91.

Berrafato testified that he needed to review the tapes to see whether they were still approved for use. Berrafato 63, 85-86. Because he did not have time to do that before the visit from Compliance, *id.* at 85, he put the tapes into the trunk of his car, allegedly intending to review them at home. *Id.* at 62-63. Berrafato admitted that, in doing so, he "may have used poor judgment." *Id.* at 63.

In fact, it is a fair inference that Berrafato attempted to conceal the tapes until the compliance review was over. He testified that he was concerned that if Compliance had found the tapes, they would have criticized him because he had not gone through them. *Id.* at 85-86. Berrafato did not reveal to Compliance that he had secreted the tapes and that they therefore were not available for Compliance to review. *Id.* at 86. Ultimately, in fact, despite his stated intention, Berrafato never did go through the tapes Instead, he admitted that they ended up "back in [his] office and in the same box, and [he] still did not have a chance, [he] never used them, and [he] just [has] not gone through them to see which is approved and which isn't." *Id.* at 63-64.

Berrafato admitted to instances in which he or the Syracuse office manager directed that documents be discarded, destroyed or thrown away. *See* Berrafato Ex. 5. Although Berrafato initially testified that he had done so in only one memorandum, Berrafato 66-67, the documents that he produced thereafter showed memoranda dated March 20, 1995, September 1, 1995 (discussed above), May 2, 1996, and May 9, 1996, all of which contained such directions. *See* Berrafato 73-84 (summarizing and quoting relevant portions of memoranda). A memorandum form the Syracuse Office Manager, Arlene Shore (also included in Berrafato Ex. 5), dated August 28, 1995, also ordered the disposal of documents. *Id.* Berrafato testified

that Shore was in charge of the Syracuse office's document retention function, and that he had never known her to deviate from Prudential company policy on that subject. Berrafato 69-70.

Two of Berrafato's memoranda (dated May 2 and May 9, 1996) that ordered sales people to "throw away" or "discard" documents, post-dated this Court's September 15, 1995 Order requiring the document preservation. Berrafato testified that he had never seen either the September 15, 1995 Order or its "Preservation of Documents" provision. *Id.* at 35-36, 37. He could not recall whether Prudential had issued any communication that advised that documents were to be preserved pursuant to a judge's order. *Id.* at 38-39. He testified that he might not have sent those memoranda if he had known of the existence of the Court's September 15, 1995 Order with the "Preservation of Documents" provision. *Id.* at 113.

Berrafato stated that he believed he was acting in accordance with Prudential corporate ***612** policy when he sent the 1995 and 1996 memoranda included in Berrafato Ex. 5. *Id.* at 114. Berrafato never saw either of the two e-mail messages (August 17 and September 14, 1995) that Prudential had sent regarding corporate document retention policy, and testified that those memoranda were not sent to PPFS offices such as Syracuse. *Id.* at 43-44. The first of the corporate communications on the subject that Berrafato saw was Ryan's memorandum of August 14, 1996. *Id.* at 44.

With Winston Churchill's admonition in mind that this is not the end; that this is not the beginning of the end; but this is the end of the beginning, the Court makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. The Court's Order of September 15, 1995 which required, *inter alia,* that all parties "preserve all documents and other records containing information potentially relevant to the subject matter of this litigation" was never disseminated to Prudential employees.

2. Senior management, inclusive of Arthur Ryan, Prudential's Chief Executive Officer, Marc Grier, Prudential's Chief Financial Officer, Priscilla A. Myers, Senior Vice President in charge of auditing, and James Gillen, Prudential's Senior Vice President and General Counsel, never directed that the Court's Order of September 15, 1995 to preserve documents be disseminated to Prudential employees. Gillen was satisfied that Prudential's existing communications policies were adequate to meet the requirements of the Court's Order. Thus, Gillen did not believe that a separate communication concerning the Court's Order was necessary.

3. Commencing in August 1995, Prudential issued several PROFS notes (e-mail) directed to document preservation. While they cautioned against the destruction of documents, these one-page memoranda failed to specifically mention the putative class action litigation then pending before this Court in the District of New Jersey. Moreover, the memoranda subsequent to September 15, 1995, failed to inform the recipients of the Court's document preservation Order.

[FN8] In these notes, "litigation" is referenced in the most general sense as "litigation alleging improper sales practices." Not until November 6, 1996, does a PROFS note mention a class action. Even then, the only reference is to the settlement agreement.

> FN8. Some of the PROFS notes caution that any willful or deliberate violation of these guidelines will result in serious disciplinary action, up to and including termination. No mention is made of sanctions provided for by the Federal Rules of Civil Procedure, civil contempt for violation of an Order of the Court, or criminal contempt pursuant to 18 U.S.C. § 401(3).

4. The record is devoid of any reference to a document that would encourage non-management employees to report evidence of document destruction, for example, through the use of a telephone hotline or otherwise.

5. PROFS notes provided the names and telephone numbers of individuals to contact in the event that questions arose about document retention. No specific individual was designated as the primary contact source for information about document preservation.

6. On August 14, 1996, Arthur F. Ryan, Chairman and Chief Executive Officer, issued a PROFS note addressed to Prudential associates. It was entitled "Announcement." The announcement centered on the destruction of documents that had occurred in the Greater Southern Regional Office located in Jacksonville, Florida. Ryan referenced three Prudential internal orders as the foundation of Prudential's policy to preserve documents. Ryan did not mention this Court's Order to preserve documents or the class action litigation pending before this Court. Finally, Ryan informed the recipients that Prudential had notified several regulatory authorities of the failure to preserve documents in Jacksonville. Notwithstanding the prior preservation Order issued by this Court and the violation of that Order, both Ryan and Prudential *failed to notify this Court* of the Jacksonville occurrence.

7. The admonition to preserve documents and not to destroy documents set forth in the PROFS notes was styled in ordinary print. Neither of these admonitions were delineated in emboldened or enlarged font:

***613**

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

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8. Prudential's use of PROFS notes to preserve documents and to prevent their destruction was ineffective and failed to implement this Court's document preservation Order. The Report of Investigation demonstrably highlights the PROFS notes inefficacy. Witnesses testified that they ignored e-mails, some testified that they lacked access to e-mail (approximately 1100/2700 agents have e-mail), and others testified that PROFS notes were not always printed and made available for general review. [FN9] Prudential, in its

response to plaintiffs' Report of Investigation, concedes that it could have done more to ensure compliance with its document preservation directives. [FN10]

FN9. Report of Investigation at 11.

FN10. Response of Prudential at 7.

9. Prudential's Managing Director Audit Blueprint is not a document preservation policy statement. It is a marketing document in the form of a written manual printed in a format that allows it to be retained by individual company employees and placed on company bookshelves. The Audit Blueprint was designed to provide a standardized procedure and checklist for Managing Directors to enable them to keep abreast of the on-going changes in marketing material so that they would know what was and was not approved material. [FN11] The Audit Blueprint is inconsistent in its posture towards document preservation. In at least two locations it counsels that "disapproved material" and "out-of-date marketing material" should be destroyed. As stated in the Report of Investigation at 6, the only reference in the Audit Blueprint to document preservation is found in footnote 15, which states that unapproved marketing material found in a client file should not be destroyed. The Audit Blueprint was dated and distributed to Managing Directors in May 1995, approximately four months prior to the issuance of this Court's document preservation Order.

FN11. *See* Soderstrom Ex. 1 and 5.

10. The Court has no record of any written manual that would evidence that Prudential possesses a clear and unequivocal document preservation policy capable of retention by Prudential employees and available for easy reference.

11. Although the PROFS notes specify the types of materials that should be preserved and counsel against document destruction, these PROFS notes do not constitute uniform guidelines and do not represent the systematic process necessary to preserve documents. Indeed, not until November 13, 1996, did Prudential prepare and distribute a document entitled "Interim Document Retention Guidelines."

12. As of the writing of this Opinion, document destruction has occurred on at least four occasions. Despite the PROFS notes, documents have been destroyed in Jacksonville, Florida, Cambridge, Massachusetts, Des Moines, Iowa, and in Syracuse, New York. Additionally, in Syracuse, materials were spirited out of the office and secreted to avoid detection by internal Prudential compliance review teams.

13. Prudential acknowledges that document destruction has occurred at all of the above locations.

14. The document destruction that occurred in Cambridge is particularly unfortunate because of its magnitude and the failure to prepare a document destruction index. Approximately 9000 client

files were cleansed and eighty "folders of documents" were destroyed. [FN12] Thus, the Court and the litigants are currently unaware of the documents that were destroyed and the files from which these documents were taken. Without a document destruction index or some other procedure, all concerned are forever foreclosed from the receipt of this information.

FN12. Report of Investigation at 22.

15. The document destruction in Cambridge occurred between February 1996 and ***614** November 1996, a period subsequent to the entry of this Court's document preservation Order.

16. Document destruction at the Des Moines, Iowa office involved 150 documents which were removed and discarded from 200 policyholder files. The activity that occurred in Des Moines clearly violated the Order of this Court. Moreover, Prudential concedes in its response to the Report of Investigation that "the document retention directives ... were not sufficiently clear on their import. Prudential management again must take responsibility for this failing." Response at 13.

17. Prudential's procedures to identify and report document destruction to senior management are unduly cumbersome and slow.

(a) Destruction of documents at the Cambridge, Massachusetts office was ascertained by routine audit on November 20, 1996.

(b) The auditor's supervisor was notified of the document destruction on November 26, 1996.

(c) The auditor's report, termed a "Compliance Memo," that described the document destruction was submitted to the Prudential Development Unit on December 4, 1996.

(d) Other Prudential employees learned of the document destruction on December 5, 1996.

(e) The Prudential Law Department learned of the document destruction on December 6, 1996. Assistant General Counsel Richard Meade also learned of the Cambridge incident on December 6, 1996.

(f) Prudential's lead outside counsel was told of the document destruction on Monday, December 9, 1996.

(g) Prudential's General Counsel James Gillen learned of the Cambridge destruction incident on either December 9 or December 10, 1996.

(h) Senior Vice President and Auditor Priscilla Myers learned of the document destruction from Gillen on either December 10 or December 11, 1996.

(i) Arthur Ryan, Chief Executive Officer, learned of the document destruction late in the afternoon of December 11, 1996 during a conference with Reid Ashinoff, James Gillen, and Marc Grier. Until

that meeting, Grier had no notice of the prior destruction incident.

(j) Insurance regulators and the Court were notified on December 16, 1996.

18. Approximately twenty-one days elapsed between discovery of the document destruction and its report to senior management Ryan, Grier and Myers. Twenty- six days elapsed between the discovery of document destruction and notification of insurance regulators and the Court.

19. Prudential's senior management has failed effectively to establish a comprehensive document retention policy. The PROFS messages, while reflective of Prudential's intentions, lack sufficient content and detail to constitute a "policy" on document preservation.

20. The insufficiency of the PROFS notes and the failure to prepare and distribute a written document preservation manual made document destruction inevitable.

21. The failure of senior management promptly to ascertain and notify the Court of the Cambridge document destruction episode in particular is inexcusable in light of the December 19, 1996 exclusion date that required Cambridge policyholders to decide whether to remain in the class action.

CONCLUSIONS OF LAW

[2] 1. The Federal Rules of Civil Procedure provide for sanctions when a party to a litigation fails to obey a pre-trial order. Fed.R.Civ.P. 16(f). Beyond the formal rules and legislative dictates, the Court possesses the inherent authority to punish those who abuse the judicial process. *Republic of the Philippines v. Westinghouse Electric Corporation,* 43 F.3d 65, 73 (3d Cir.1995). The reason for the rule and the warrant for its existence lies in the fact that a court, in order to achieve the orderly and expeditious disposition of cases, must have the control necessary to manage its own affairs. *Chambers v. NASCO,* 501 U.S. 32, 43, 111 S.Ct. 2123, 2132, 115 L.Ed.2d 27 (1991).

***615** [3] 2. 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. Because the destroyed records in Cambridge are permanently lost, the Court will draw the inference that the destroyed materials are relevant and if available would lead to the proof of a claim. *See National Association of Radiation Survivors v. Turnage,* 115 F.R.D. 543, 557 (N.D.Cal.1987).

[4] 3. When the September 15, 1995 Court Order to preserve documents was entered, it became the obligation of senior management to initiate a comprehensive document preservation plan and to distribute it to all employees. Moreover, it was incumbent on

senior management to advise its employees of the pending multi-district litigation venued in New Jersey, to provide them with a copy of the Court's Order, and to acquaint its employees with the potential sanctions, both civil and criminal, that the Court could issue for noncompliance with this Court's Order.

[5] 4. When senior management fails to establish and distribute a comprehensive document retention policy, it cannot shield itself from responsibility because of field office actions. The obligation to preserve documents that are potentially discoverable materials is an affirmative one that rests squarely on the shoulders of senior corporate officers.

SANCTIONS

[6] Through its findings of fact and conclusions of law, the Court is satisfied that the conduct of Prudential explicitly violates the mandate to preserve documents. The gravity of Prudential's conduct is especially troublesome in a complex litigation, such as this, that encompasses 10.7 million policyholders. From the very inception of this litigation, the allegations of document destruction have been a recurring theme. The accusations of document destruction not only threaten the integrity of this Court and the proceedings before it, but further serve to undermine the foundations of our system of justice. Corporations, like Prudential, who seek access to the federal courts, have an obligation to comply with both the spirit and intent of the rules. Failure to fulfill this responsibility should be met with unwavering judicial disapproval.

A. Rationale

In the exercise of its discretion to sanction, whether under the Federal Rules of Civil Procedure or under the Court's inherent power, the Court must consider the range of sanctions available and choose only those that are necessary to achieve the Court's purposes. Restraint and discretion are integral to the process. The adage "let the punishment fit the crime" is as true here as it was in Gilbert & Sullivan's "Mikado." W.S. Gilbert & Arthur Sullivan, *The Mikado, in* The Complete Plays of Gilbert & Sullivan 343, 352 (1938).

In the *Republic of the Philippines,* the Third Circuit provides a two-part test with concomitant factors to determine whether and which sanctions are appropriate. 43 F.3d at 74.

First, the Court must consider the conduct at issue and must explain why the conduct warrants sanctions. *Id.* A pattern of wrongdoing may require stiffer sanctions than an isolated incident. *Id.* A grave wrongdoing may compel more severe sanctions than a minor infraction. *Id.* And wrongdoing that prejudices the wrongdoer's opponent or hinders the administration of justice may demand a heftier response than wrongdoing that fails to achieve its "untoward object." *Id.* Mitigating factors, if any, must shape the Court's response also. *Id.*

Second, after evaluating the conduct at issue, the Court must consider the range of permissible sanctions and must explain why less severe sanctions are inadequate or inappropriate. *Id.*

1. Actual Factual Predicate

[7] Here, Prudential violated the Order of the Court to preserve documents and failed to advise its field offices (334 field ***616** offices) of the pendency of the litigation and the Court-ordered requirement to preserve documents. While e-mail is an appropriate means for a corporation to disseminate its policy, the internal orders directed to the field by Prudential lacked coordination and represented a haphazard response to a serious problem of judicial administration. Moreover, because documents have been destroyed, they can never be retrieved and the resultant harm is incalculable. It is inexcusable that reports of document destruction were unduly delayed at a time when urgency of notification was particularly relevant. [FN13] Thus, the Court concludes that there exists a more than adequate factual predicate to sanction.

FN13. The Court-ordered notice to policyholders required them to opt out by December 19, 1996.

(a) Pattern of Wrongdoing

The Court finds that Prudential's consistent pattern of failing to prevent unauthorized document destruction warrants the imposition of substantial sanctions. Four field offices have reported document destruction. One of those field offices has engaged in deceptive removal of documents to avoid audit. Prudential has acknowledged that its PROFS notes failed to achieve document retention and prevent document destruction. Yet, Prudential still has not sent the Order of this Court to the field, nor fully explained the need for document retention. Accordingly, the Court finds a repetitive circumstance that requires correction and that merits the imposition of sanctions.

(b) Willful Misconduct

The Court finds no willful misconduct to have occurred.

(c) Prejudice to a Party Opponent

The Court finds that the document destruction, particularly in the Cambridge, Massachusetts office, caused harm to party opponents. Over 9,000 files were cleansed. Prudential is unable to specify what documents were taken from files, nor is it able to identify the files from which the documents were taken. [FN14] Because the prejudice to affected party opponents is so substantial, Prudential's consistent pattern of failing to curb document destruction, which at the very least was grossly negligent conduct, merits sanctions, despite the Court's finding that Prudential's conduct was not willful.

FN14. Although the Alternative Dispute Process set forth in the settlement agreement contemplated that documents would be inadvertently destroyed, the Court is unable to ascertain

whether the remedial aspects of that agreement will fully address the harm incurred.

(d) Whether the Conduct Hindered the Administration of Justice

Document destruction inevitably hinders the administration of justice. The record is replete with references to document destruction and Prudential was repeatedly admonished by the Court that if Prudential engaged in document destruction, they would do so at their peril. By virtue of the time devoted to document destruction, both in and out of court, and the public frenzy it created, the Court is satisfied that the destruction of document issue has hindered and burdened the administration of justice.

(e) Mitigating Factors

The Court finds no mitigating factors for Prudential's senior management failure to comply with the Order of the Court.

2. Less Severe Alternatives

The Court has considered the range of sanctions available and has determined that each of the sanctions imposed below befits Prudential's conduct and is absolutely necessary to remedy the waste of judicial resources that Prudential has caused and to protect the authority of the Court.

C. Specific Sanctions

Although the considerations under Federal Rule of Civil Procedure 16(f) and under the inherent power of the Court are comparable, the Court will impose Federal Rule of Civil Procedure 16(f) sanctions as follows:

1. Within ten (10) days after the receipt of this Opinion, Prudential shall mail to every employee a copy of the Court's September 15, 1995 Order, together with a full explanation ***617** of the pending litigation and the civil and criminal sanctions that apply to the failure to follow an Order of the Court.

2. Within thirty (30) days, Prudential shall submit to the Court a written manual that embodies Prudential's document preservation policy. Such manual shall clearly and unequivocally establish guidelines for document retention, as well as the circumstances when a document may be discarded and the procedures to be employed when that event occurs. The plan shall include means to distribute the plan to each employee.

3. During the pendency of this litigation, Prudential shall dedicate a telephone "hotline" to facilitate reports of document destruction, if any. This hotline number shall be communicated to all employees and any caller's request for anonymity shall be respected. Each such call shall be recorded in a log to be monitored by a member of the Law Department. The date, the time of the call, and the field office involved are relevant matters that must be recorded. Reports of document destruction shall be

promptly reported to the General Counsel and appropriate action taken.

4. During the pendency of this litigation, Prudential shall establish a certification process wherein each field manager shall certify that his/her office is in compliance with the document retention manual and has not engaged in document destruction contrary to Prudential's established policy.

5. Within ten (10) days after the issuance of this Opinion, Prudential shall pay to the Clerk of the United States District Court for the District of New Jersey, the sum of One Million Dollars ($1,000,000). This sanction recognizes the unnecessary consumption of the Court's time and resources in regard to the issue of document destruction. Moreover, this sanction informs Prudential and the public of the gravity of repeated incidents of document destruction and the need of the Court to preserve and protect its jurisdiction and the integrity of the proceedings before it. In the assessment of this monetary sanction, the Court has considered the financial worth of Prudential and the minimal financial impact this sanction will have on Prudential's financial stability. [FN15]

> FN15. It is not uncommon for large corporations with vast resources to impede the discovery process through methods and processes that frustrate the production of relevant and unprivileged documents. Courts must be vigilant to prevent that type of conduct when it occurs and must impose meaningful sanctions to protect the integrity of the proceedings before it.

6. Prudential shall promptly reimburse plaintiffs' counsel for all fees and costs associated with the motion for sanctions, the order to show cause, the depositions and discovery in preparation for the depositions, and the preparation and distribution of the Report of Investigation to the Court and counsel.

7. The sanctions contained herein are without prejudice to the subsequent imposition of additional sanctions as may be fair and appropriate to remedy unknown harm to individual party opponents caused by document destruction.

CONCLUSION

Prudential has violated the Order of the Court on at least four occasions. It has no comprehensive document retention policy with informative guidelines and lacks a protocol that promptly notifies senior management of document destruction. These systemic failures impede the litigation process and merit the imposition of sanctions.

The sanctions imposed fall within the permissible range of sanctions. The imposition of any lesser sanctions would serve to diminish the harm that occurred, as well as the integrity of the proceedings before this Court.

169 F.R.D. 598
36 Fed.R.Serv.3d 767
(Cite as: 169 F.R.D. 598)

United States District Court,
D. New Jersey.

In re the PRUDENTIAL INSURANCE COMPANY OF AMERICA SALES PRACTICES LITIGATION.
This Document Relates to All Actions.

MDL No. 1061.
Civil Action No. 95-4704.

Jan. 6, 1997.

In class action against life insurer for deceptive sales practices, policyholders sought sanctions for destruction of documents in violation of court order. The District Court, Wolin, J., held that: (1) insurer's consistent pattern of failing to prevent unauthorized document destruction warranted sanctions, even though no willful misconduct occurred, and (2) court order to preserve documents imposed obligation on senior management to initiate comprehensive document preservation plan and to distribute it to all employees.

Sanctions imposed.

OPINION

WOLIN, District Judge.

[1] This Opinion addresses the persistent and recurrent destruction of documents by agents and employees of The Prudential Insurance Company of America ("Prudential"). Because the preservation of documents and their availability for production is essential to the orderly and expeditious disposition of litigation, document destruction impedes the litigation process and merits the imposition of sanctions. Notwithstanding the absence of evidence of willful document destruction, repeated destruction of potentially discoverable materials demands that this Court preserve and protect its jurisdiction and the integrity of the proceedings before it.

INTRODUCTION

Because of the need to resolve the destruction of document issue without delay, the Court has excerpted much of pages 1 through 30 of the Report of Investigation. [FN1] ***600** The Court has incorporated by reference herein and relied upon the Compendium of Prudential Document Retention Notices ("the Compendium"), the fifty-two depositions taken in response to the Court's Order of December 18, 1996, the Affidavit of Reid L. Ashinoff in Opposition to Motion for Sanctions and Response of the Prudential Insurance Company of America to Plaintiffs' Report of Investigation dated December 31, 1996 ("Prudential's Response"). The Court has filed the Report of Investigation, the Compendium, and Prudential's Response with the Clerk of the Court.

FN1. The Court takes this opportunity to express its appreciation to the firm of Milberg Weiss Bershad Hynes & Lerach, for the prompt preparation and delivery of this report to the Court. The Court specifically acknowledges the dedication and effort of Melvyn I. Weiss, Barry A. Weprin, Brad N. Friedman, Keith M. Fleischman, Salvatore J. Graziano, and Seth Ottensoser as the draftsmen of this report. Additionally, the Court expresses its appreciation to all the lawyers who participated in the taking of fifty-two depositions over a four-day period at a time of the year, December 20-24, when most legal machinery comes to a grinding halt, and deservedly so. The firm of Sonnenschein Nath & Rosenthal is to be equally complimented for its willingness on behalf of Prudential to staff and defend these fifty-two depositions.

In February and March 1995, Prudential policyholders commenced class actions against Prudential alleging that during the 1980s and early 1990s Prudential engaged in a scheme to sell life insurance through deceptive sales practices. On August 3, 1995, the Judicial Panel on Multidistrict Litigation transferred all related lawsuits throughout the country, including all class actions, individual actions, and former agent "whistleblower" actions, to this Court.

On September 15, 1995, this Court entered its first Order in the multidistrict litigation (the "September 15, 1995 Order"). The September 15, 1995 Order required, among other things, that all parties "preserve all documents and other records containing information potentially relevant to the subject matter of this litigation." September 15, 1995 Order at 4(d).

Subsequent to the September 15, 1995 Order, and throughout the pendency of this litigation, Prudential's preservation of documents has been a pervasive issue. For example:

On December 13, 1995, agents' lead counsel, Bruce Miller, raised in open court that Prudential was closing offices throughout the country, and requested an order "that the records that exist in these places must remain secure." December 13, 1995 Tr. at 112. Prudential's counsel, Reid Ashinoff, responded: "I don't have a problem with the substance of Mr. Miller's request." *Id.* at 113. Ashinoff noted that Prudential could not agree never to destroy *any* document in the ordinary course of business, but otherwise confirmed: "Yet I agree in principle and substance to a point." *Id.*

In July 1996, the parties learned that a Prudential employee, David Fastenberg, had been accused of destroying Prudential documents. Thus, on July 23, 1996, plaintiffs' counsel and Miller brought this matter to the Court's attention, only to hear from Ashinoff that plaintiffs' counsel were engaged in "the rankest kind of smear campaign," and that once Ashinoff was retained in February/March 1995, warnings were issued that documents should not be destroyed. July 23, 1996 Tr. at 22, 24-25, 27.

Document destruction issues were also discussed in open court on October 21, 1996, December 6, 1996, and December 13, 1996.

On Saturday, December 14, 1996, Prudential's counsel informed plaintiffs' co- lead counsel in the class actions that documents relevant to this litigation in the Prudential Preferred Financial Services ("PPFS") Boston area office located in Cambridge, Massachusetts (the "Cambridge Office"), had improperly been destroyed by the Managing Director of the Cambridge Office during the pendency of this litigation. That this document destruction violated the September 1995 Order is not contested. Gillen 111-12. [FN2]

> FN2. A list of deponents is contained in Appendix 3 to the Report of Investigation filed herewith.

On Monday, December 16, 1996, plaintiffs obtained an Order to Show Cause why sanctions should not be imposed in connection with this document destruction (the "December 16, 1996 Order"). Specifically, the Court ordered Prudential to show cause on December 18, 1996 why the Court should not impose sanctions and other appropriate relief for "Prudential's destruction of relevant documents during the pendency of this litigation." *See* December 16, 1996 Order. The Order to Show Cause was served upon all parties who had entered an appearance in this multidistrict litigation.

***601** On December 18, 1996, the Court held a hearing and, *inter alia,* ordered plaintiffs to conduct an investigation into the Cambridge Office document destruction incident and to ascertain "whether Prudential's notification on destruction of documents was or was not satisfactory." *See* December 18, 1996 Tr. at 44.

1. Scope of the Investigation

Pursuant to the Court's instructions, on December 18, 1996, plaintiffs' counsel undertook an extensive investigation into the circumstances and events surrounding the destruction of documents in Prudential's Cambridge Office. Accordingly, plaintiffs' counsel thoroughly investigated the timeliness of the actions taken upon the discovery of this incident and the adequacy of Prudential's document retention policies and/or guidelines, and the enforcement thereof. *See* December 18, 1996 Tr. at 44.

Between December 18 and December 24, 1996, plaintiffs' counsel reviewed hundreds of Prudential documents, including numerous documents that Prudential contends evidence its written policy concerning the proper handling and retention and/or destruction of documents.

Between December 20 and December 24, 1996, plaintiffs' counsel conducted fifty-two depositions. Plaintiffs' counsel deposed, among others: Arthur F. Ryan, Prudential's Chairman and Chief Executive Officer; Marc Grier, Prudential's Chief Financial Officer; James Gillen, Prudential's General Counsel; Rodger Lawson, a Prudential Executive Vice President; John M. Breedlove, the Managing Director of the Cambridge Office; Cheryl Rizzo, who was Breedlove's assistant; Melissa Gonzalez and Russ Spaulding, the members of the Prudential Compliance team who discovered the document destruction incident in the Cambridge Office; and each and every other person identified by Prudential's attorneys as associated with, or having knowledge of, the incident.

In addition, plaintiffs' counsel randomly selected and

deposed thirteen agents associated with the Cambridge Office. Prior to these depositions, approximately fifty agents were requested to complete a questionnaire that plaintiffs' counsel created, to ascertain each agent's understanding and knowledge of any Prudential document preservation guidelines and the details of the Cambridge incident. Prior to taking any depositions, plaintiffs' counsel also interviewed David Greenbaum, one of Prudential's outside counsel who had investigated the Cambridge incident.

Throughout the depositions, additional documents were produced by the deponents and/or their counsel, including internal Prudential memoranda, questionnaires completed by Cambridge agents, and other documents relating to the Cambridge incident.

Furthermore, because plaintiffs' counsel learned that there had potentially been a destruction of relevant documents by Prudential employees in Prudential's Syracuse, New York office, plaintiffs' counsel deposed Paul Berrafato, General Manager of Prudential's Syracuse office.

2. Prudential's Document Destruction Policy and Document Retention Guidelines

A. Implementation/Communication

In early 1994, in response to a regulatory directive issued to most life insurance companies, Prudential undertook a sweep of all of its sales materials to avoid the use of unauthorized sales materials. All unapproved or outdated sales materials were collected, catalogued, and warehoused. Following that 1994 sweep, Prudential initiated a document destruction policy, which required the destruction of all unauthorized or outdated sales material. Prudential did not attempt to catalogue how many documents were destroyed, the locations they were taken from, or any other crucial details, such as who destroyed them. Nor did Prudential implement any training program. Rather, according to Prudential's senior management, Prudential policy was to keep a single copy of each piece of sales material so that it would be available to counsel for plaintiffs and to state regulators. Prudential distributed its document retention instructions on a number of occasions, typically through an e-mail system referred to as PROFS notes.

***602 (i) Prudential's Managing Director Audit Blueprint**

Prior to May 1995, PPFS had no written instructions, policies, or procedures regarding the retention and/or destruction of unapproved material. *See* Tignanelli 250; Cataldo 14; Reynolds 34.

On May 26, 1995, PPFS issued "The Managing Director Marketing Material Audit Blueprint," which was designed to allow Managing Directors systematically to monitor and control the use of marketing material: "The Audit Blueprint is designed to provide a standardized procedure and checklist for Managing Directors to keep up with the on-going changes in marketing material so they can know what is and is not approved material." *See* Soderstrom Ex. 1 at 5. [FN3]

FN3. Exhibits from the depositions are denoted as "__ Ex. __."

The Audit Blueprint is a written manual, printed in a format that permits it to be retained by individual company employees and placed on company bookshelves. It was distributed to all Prudential office managing directors. It provides--without qualification--that "disapproved material," *id.* at 7, and "out-of-date marketing material," *id.* at 9, should be destroyed; there is no provision on these pages that any copies should be retained.

Later in the document, the Audit Blueprint instructs a Managing Director on actions to take when unapproved marketing material is found in a client file, including destroying additional copies of the material:

> If a Managing Director finds unapproved marketing material in a Special Agent's client file, s/he should require the Special Agent to destroy any *additional* copies of such material, [footnote 15] and should counsel the Special Agent regarding PPFS policy on the use on unapproved materials with the public.

Id. at 14.

The only reference to document preservation in Prudential's Audit Blueprint is in footnote 15. This note states that unapproved marketing material found in a client file should not be destroyed:

> Unapproved marketing material found in a client file should not be destroyed. The Managing Director should, however, attach a signed and dated note to the material indicating that it is not approved material and that the Special Agent has been instructed not to use the material in the future.

Id. at 14-15.

Prudential general counsel James Gillen confirmed that this corporate policy to destroy improper sales materials continues to this day with his approval. Gillen does not consider this destruction policy to be a violation of this Court's September 15, 1995 Order that required preservation of all potentially relevant documents. Gillen 105.

(ii) PROFS Notes and Other Document Retention Notices

Unlike the Audit Blueprint, which was a written document that dealt primarily with Prudential's document destruction policy rather than with document retention, Prudential's principal medium of communicating its "document retention" practices was PROFS notes (e-mail). *See* Compendium at 2, 4-9, 11- 14. Priscilla A. Myers, Prudential's Senior Vice President in charge of auditing, acknowledged that while electronic mail was a quick way to disseminate information, electronic mail notices "are usually followed up with a paper document." Myers 33. This was not done consistently in connection with document retention PROFS notes. Moreover, none of these PROFS notes indicate that they amend the Audit Blueprint, or that they should be kept with the Audit Blueprint.

Because Prudential's individual insurance organization is divided in three parts--PPFS, Prudential Select, and Prudential Insurance and Financial Services ("PIFS"), notices concerning document retention were sent to all three divisions, often by different management-level personnel of Prudential. The relevant notices were:

1. On August 9, 1995, a PROFS note addressed by Ira Kleinman to Prudential Select Associates stated that as a result of the multi-state task force investigation, Prudential ***603** was amending all existing company document retention guidelines effective immediately. *See* Compendium at 2. The note stated:

> Do not destroy any documents currently being saved under any Company guidelines, even if the existing guidelines call for destruction (because of document age or other reasons).
>
> This includes, but is not limited to, any and all documents that relate to: insurance sales that used existing policy values (including dividends) or abbreviated pay plans ('APP'), such as agent training brochures or worksheets, marketing and point of sales materials, illustrations, policy disbursement records, client files and related materials, as well as customer complaints and Company disciplinary files.

This PROFS note provided telephone numbers which Prudential Select Associates could call if they had any questions and stated: "When in doubt about retaining a particular document, save it!" The PROFS note also warned that the Company and its employees could face severe sanctions if documents were destroyed and stated that "any willful or deliberate violation of these guidelines will result in serious disciplinary action, up to and including termination." *Id.*

2. On August 15, 1995, a hard-copy memorandum addressed by Thomas A. Croswell, Senior Vice President, Agencies, to all PIFS associates and representatives, repeated the contents of the above-described PROFS note, leaving out the warning that any willful or deliberate violation would result in disciplinary action and possible termination. Compendium at 3.

3. On August 17, 1995, a PROFS note addressed by Joseph P. Mahoney, to all PPFS associates, repeated the same message (again without the warning regarding possible termination). Compendium at 4.

4. On September 8, 1995, a PROFS note addressed by Joseph P. Mahoney to all PPFS associates instructed all Office Vision users to do the following, effective immediately:

> Do not destroy any Office Vision Notes which directly or indirectly relate to insurance sales involving the use of existing policy values (including dividends) or abbreviated pay plans ('APP'). This includes, but is not' limited to, Office Vision Notes which relate to agent training, marketing and point of sale materials, policy illustrations, customer complaints, or agent disciplinary files which concern the use of policy values (including dividends) or APP to sell life insurance.

Compendium at 6. The PROFS note stated that PPFS associates should contact their supervisor or the Law Department if they had any questions and stated: "When in doubt about a particular note, save it!" The PROFS note also warned that the Company and its employees could face severe sanctions if Office Vision Notes were destroyed. *Id.*

5. Also on September 8, 1995, PROFS notes containing the same text were addressed by Thomas A. Croswell to PIFS associates and representatives and by Ira Kleinman to all Prudential Select associates. Compendium at 5 and 6.

6. On September 14, 1995, Jeff Hahn, PPFS' Chief Legal Office and Vice President, addressed a PROFS

note to all PPFS associates, which referred to the August 1, 1995 PROFS note sent by Joseph Mahoney and provided the following supplementing instructions, effective immediately:

> Do not destroy any Office Vision Notes which directly or indirectly relate to insurance sales involving the use of existing policy values (including dividends) or abbreviated pay plans ('APP') which relate to agent training, marketing and point of sale materials, policy illustrations, customer complaints, or agent disciplinary files which concern the use of policy values (including dividends) or APP to sell life insurance.

Compendium at 8. This PROFS note also stated that PPFS associates should contact their supervisor or the Law Department if they had any questions and, in the middle of a paragraph, stated: "When in doubt about a particular note, save it!" This PROFS note again warned that the Company and its employees could face severe sanctions if Office Vision notes were destroyed. *Id.*

***604** 7. On March 14, 1996, Bill Therrien addressed a PROFS note to all PROFS users repeating the above supplementary instruction, and substituting the term "PROFS notes" for "Office Vision Notes." Compendium at 13.

8. On August 14, 1996, Arthur Ryan addressed a PROFS note to Prudential associates which reported that David Fastenberg, the head of the Individual Insurance Group's Greater Southern Territory, was dismissed for failing to abide by and enforce Company directives to preserve documents. Compendium at 15.

9. On November 6, 1996, Kevin Frawley, Prudential's Chief Compliance Officer, addressed a hard-copy memorandum to all individual insurance employees and agents, stating that it was important to continue preserving documents that might relate to Prudential's recent class-action settlement and other lawsuits and investigations Prudential was facing. Attached to his memorandum was a document entitled "Interim Document Retention Guidelines." This document provided a detailed list of the types of documents that all employees and agents were instructed to retain. Compendium at 16.

10. On November 13, 1996, Kevin Frawley addressed the same memorandum to all individual insurance employees and agents, but added a sentence that such records might also be relevant to the Policy Remediation Program. Compendium at 17.

(iii) The Distribution of Prudential's Notices

Most of the above-described notices were never circulated in hard copy. In fact, prior to November 6, 1996, only PIFS associates received a hard-copy memorandum regarding document retention; all others were sent only PROFS notes. Numerous witnesses testified that they received so many e-mails that they ignored any new e-mails transmitted into their system. *See* Lublin 25- 27. A number of deponents confirmed that not all associates have access to e- mail and that, therefore, many individuals never received any of the PROFS notes regarding document retention (unless personswith access to e-mail had made copies for them). *See, e.g.*, Myers 35 (not all associates have computers); Mariani 59-60 ("not each rep had their own terminal which they would access"); Sullivan 18 ("Not everybody is on the system."); Melquist 32-33 (approximately 1100/2700 agents have e-mail).

Nor were the various PROFS Notes ever printed and made available for general review. In fact, while Prudential's counsel provided plaintiffs with a list of all of the notices that were distributed with regard to document destruction, that list was not produced until December 24, 1996, after almost all of the depositions were completed or already in progress. *See* Ryan Ex. 1. In addition, as of December 25, 1996, defendants' counsel had yet to locate and produce almost half of the documents identified on the list.

There was no communication to anyone in any written or PROFS note format regarding the entry of the Court's document preservation order, its import, or the ramifications of violating such a Court order. Grier 97. To date, discovery has shown that neither Prudential, nor its counsel, have ever circulated to anyone at Prudential a copy of the Court's document preservation order or any written directive regarding the Order itself. [FN4] *See* Grier 97; Ryan 31.

> FN4. The notices also failed to make any mention of improper sales practices relating to investment or retirement claims. *See generally* Compendium.

B. Testimony of Prudential Top Management

Prudential top management--Chairman Arthur Ryan, Executive Vice President Rodger Lawson, Chief Financial Officer Marc Grier, and General Counsel James Gillen--all recognized that the sales practices

lawsuits and regulatory investigations are an extremely important part of Prudential's business. *See, e.g.*, Grier 14; Gillen 27. More importantly, they all recognized Prudential's obligation to preserve documents in connection with the lawsuits and investigations. Yet, none took an active role in formulating, implementing, communicating, or conducting a document retention policy. ***605** Rather, all of them relied on others to do these tasks. *See, e.g.*, Ryan 35, 50.

Arthur Ryan, Prudential's Chief Executive Officer, recognized that it was management's responsibility to communicate the Company's document retention directives to its employees. Chairman Ryan kept abreast of the litigation on a regular basis. In 1995, Chairman Ryan held monthly meetings on the litigation and investigation. Ryan 19. In 1996, William Yelverton, head of individual insurance, took over the monthly meetings, but he and Gillen kept Ryan regularly informed. *Id.* Chairman Ryan stated that with respect to document retention he had:

> a pretty good understanding of what is required to insure that people understand what they are supposed to do. The management did communicate through certain written vehicles, but equally important, in all *communications, it's the obligation of management to insure that people understand* that laws are to be followed, regulations are to be followed, and doing the right thing is to be followed.
>
> Ryan 27-28 (emphasis added).

According to Chairman Ryan, he fulfilled his own personal obligation in this regard by referring the preservation of documents issue to the Prudential Legal Department and felt comfortable that the proper policy would be implemented. *See* Ryan 35-36. Ryan stated that:

> The interpretation of what is required by the law, the regulation is the responsibility of the law department. It is also their responsibility to communicate it to line management. The business unit is then responsible for understanding what goes on in their operations, and would be the ones responsible as they learned it, to communicate it immediately.
>
> Ryan 50.

When Chairman Ryan was informed that virtually every Prudential agent who was interviewed or deposed in connection with the Cambridge incident denied having knowledge of communications concerning document retention, he indicated that if this were true he "would be extremely dissatisfied." Ryan 28.

Marc Grier, Prudential's Chief Financial Officer, had very little knowledge or understanding about document preservation requirements. He testified that he had never seen "something in writing" which "demonstrated what the clear policy of the Company was." *See, e.g.*, Grier 54. Grier did not recall ever seeing the Audit Blueprint. *Id.* 56. Grier acknowledged that management has a responsibility to make important things clear to people within the organization, and also agreed that when it comes to observing court orders, an organization not only must advise the organization of any court- ordered responsibility, but also must audit its compliance. *See id.* 92-94.

Grier never inquired into whether the Mahoney PROFS note communication of August 15, 1995 was part of a printed manual that was in the libraries of offices around the country for people to access easily. *Id.* 91. Moreover, Grier admitted his concern that information about this Court's September 15, 1995 document preservation order was never disseminated to Prudential employees:

> Q. Do you believe today that the employees of Pru were made aware of Judge Wolin's document preservation order?
>
> A. No, I don't believe that.
>
> Q. Does that concern you?
>
> A. Yes, it does.
>
> Grier 97-98.

Rodger Lawson, Prudential's Executive Vice President in charge of planning and marketing, joined the company in June 1996. Lawson 7-8. Lawson testified that he was sure that the company had an adequate policy, but that he was not directly involved in implementing or communicating it:

> I am quite certain that the insurance company has clear instructions as to the preservation of documents. I am quite certain that they exist in some volume. Precisely what is in each of those documents, I cannot attest to. I have seen some of them and I have not read them in detail, and I believe the insurance company is ***606** responsible for issuing those instructions and maintaining them.
>
> Lawson 14.

Senior Vice President in charge of auditing, Priscilla A. Myers, was personally aware of the preservation order, but did not know whether compliance review employees were made aware of it. Myers 42-43.

James Gillen, Prudential's Senior Vice President and General Counsel, relied heavily on Richard Meade

and Deborah Bello-Monaco, two attorneys for the individual insurance division of Prudential, to see that proper document retention procedures were developed and implemented. Gillen had little personal involvement in this issue. Gillen 25.

Gillen testified that over the past two years Prudential has issued a variety of communications on document retention, primarily in the form of PROFS notes. Gillen 21. Gillen testified that with respect to messages sent by PROFS notes:

> Anybody who has a terminal on their desk would have received this. And they're in offices where typically these kinds of instructions provide that people are--that the people in offices that have terminals should share the documents with others that don't.

Gillen 86.

Thus, Gillen testified that Prudential relies upon associates being apprised of PROFS notes by those who have the equipment to receive them. *Id.* 87. When asked whether he had taken any steps to notify Prudential employees and agents that the Court had entered a document preservation order, Gillen replied that he "felt that our [Prudential's] existing policies of communications were adequate to meet the requirements of the order." *Id.* 93.

While Gillen did not believe that a separate communication concerning the September 15, 1995 Order was necessary, Gillen did notify Prudential employees of this Court's subsequent entry of an Order dealing with plaintiffs' communication with Prudential employees. Thus, on April 2, 1996, Gillen personally sent a PROFS note to all Prudential associates. This PROFS note, which was found in the Cambridge Office, stands in stark contrast to the absence of any such communication from Gillen regarding the September 15, 1995 order. It describes this Court's order concerning employee interviews and explains the implications for Prudential employees:

> As you know, Prudential has been sued in certain state and federal courts concerning allegedly improper practices in the sale of life insurance products. The federal actions have been consolidated for pre-trial purposes before Judge Wolin of the federal court in New Jersey under the caption 'In re: The Prudential Insurance Company of America Sales Practices Litigation,' Master Docket No. 95-4704 (AMW). We are vigorously defending these actions.
>
> Several current Prudential employees have expressed their concern to us that plaintiffs' counsel in the federal action have been calling them trying to set up interviews to discuss their knowledge of the company's policies and procedures. You, too, may receive such a call. Judge Wolin has ruled that plaintiffs' counsel may contact you. However, he has also ruled that you need not talk to plaintiffs' counsel. In addition, Judge Wolin has ruled that you can discuss any contacts from plaintiffs' counsel with a member of Prudential's Law Department or with your own attorney. I have instructed all the attorneys in the Prudential Law Department to make themselves available to assist you in these matters.

Breedlove Cambridge Ex. 106. It should be noted that e-mail rather than hard copy distribution was used in this instance as well.

C. How Communications Worked in the Cambridge Office

John Breedlove, Managing Director of the Cambridge Office, testified that either his assistant, Mary McHugh, or business manager, Bette Komanski, was responsible for reviewing incoming PROFS notes and bringing important notes to his attention. Breedlove 126, 195. Breedlove would then direct McHugh to distribute those PROFS notes that he felt were worthy of distribution.

Several PROFS notes relating to document retention were found in binders on McHugh's desk marked "PROFS Notes Sent ***607** and PROFS Distributed to Associates." Breedlove Cambridge Ex. 106-111. Additionally, many PROFS notes were marked by either Breedlove or McHugh as "distributed," with a specific date of distribution. However, neither the August 15, 1995 Mahoney, nor the March 14, 1996 Thierren PROFS notes were marked for distribution, and most of the Cambridge Office agents who have been deposed or answered plaintiffs' questionnaires have denied ever seeing any of the PROFS notes relating to document retention. Rider 34; McGloughlin 48, 59; Sayan 30-32.

In addition, hard-copy memoranda were not sent to each individual agent. Rather, they were sent to Komanski for office-wide distribution. Akers 70. As of the beginning of December 1996, Komanski had not yet distributed the November 1996 Frawley memorandum to agents within the Cambridge office. Akers 70-71.

Many agents in Prudential's Cambridge Office were questioned by Prudential after the disclosure of the Breedlove incident about their awareness of the three document retention PROFS notes circulated within their division, PPFS. Mahoney 8/95, Hahn 9/95,

Ryan 8/96. These agents uniformly were not aware that these memos even existed. At most, out of fifty-seven agents interviewed by Prudential and its counsel, [FN5] seven agents were aware of the Mahoney document retention e-mail; four were aware of Ryan's document retention e- mail; and eight were aware of Hahn's document retention e-mail. *See* Cambridge Ex. 12-33; Questionnaires completed during Prudential Interviews of Agents From Boston FSO, CAM 000567-CAM 000902.

FN5. Prudential produced its notes from these interviews to plaintiffs' counsel.

Similarly, many agents testified when deposed that they never received Prudential's document preservation notices. For example, Thomas F. Rider, an agent in the Cambridge Office, testified that he does not use the Computer Communication System at Prudential. *See* Rider 25. Accordingly, Rider testified he had never seen the Mahoney August 15, 1995 e-mail. Rider 34.

Similarly, William G. McGloughlin, III, an agent in the Cambridge Office, testified that he had never received documentation in a memo form that directed him to preserve documents because such documents could be evidence in a court proceeding. *See* McGloughlin 40. When asked if he accessed the electronic mail system at Prudential, McGloughlin testified that:

> I am on it but I don't access it, if that makes any sense. I am signed on but there are over 700 messages waiting there because I don't know how to use it and I don't have time to learn how to use it.

McGloughlin 43.

3. The Cambridge Document Destruction Incident

A. Background

Like all PPFS offices, the Cambridge office is subject to both routine and unannounced compliance inspections. Gonzalez 53.

On January 27, 1995, prior to any 1995 compliance inspections, John Breedlove, Managing Director of PPFS' Cambridge Office, advised the associates in that office:

> It is *critical* that all *unapproved sales material* in your possession be destroyed. Use of unauthorized material is a very serious *violation* and we have just completed destruction of all outdated materials in our supply area.

Gonzalez Ex. 7 (emphasis in original).

On April 5, 1995, members of Prudential's compliance review team, Bill Clark and Dean Schroeder, arrived at the Cambridge office unannounced, to perform a surprise compliance review. Tignanelli Ex. 28 at CAM 000966. The review team asked to check sales literature and all other items available to assist agents during the sales process. *Id.* During the inspection, the review team reviewed the supply areas, agent work spaces, and client files. *Id.* The Cambridge Office was cited for failure to adequately regulate the materials in the supply room, the agents' cabinet, and the training room. *Id.* at CAM 000968. Specifically, many of the sales materials that the review team found in these ***608** areas were not listed in the March 1995 Marketing Resources Guide ("MRG") and, thus, were unapproved. *Id.* Therefore, the auditors themselves discarded these outdated materials in accordance with Prudential's document destruction policy:

> We reviewed the materials in the supply room and the materials available to agents.... If the materials that we found on the shelves were not listed in the MRG, we *discarded* them. A listing of these materials can be found in Attachment I.... An old *CONCEPTS* manual was also destroyed by Jim Kenealy [BOSX Computer Specialist] when it was pointed out that it had a visual presentation of what was previously known as the 'Private Pension Plan.'...
>
> The training room contained many tapes and books. It also included old ACPP books (ORD 88672 & 88612) which we *discarded*.... We also *discarded* some office stationery and blank business cards that did not comply with the guidelines....

Tignanelli Ex. 28 at CAM 000968, 975, and 977 (some emphasis added and some in original).

During the April 5, 1995 investigation, the compliance review team also discovered that agent Zhen-Jing Sun was sending out unapproved correspondence. The unauthorized correspondence located in agent Sun's files was a letter in Chinese that when translated to English used terms such as "retirement Plan" and "Estate Planning." Pearson Ex. 5 at CAM 000463. On June 22, 1995, Michael Cataldo, Executive Director for the northeast marketing territory, sent a sanctions letter to agent Sun assessing him a fine of $250 for using a piece of unauthorized correspondence. *Id.* at CAM 000481.

On May 25, 1995, Bette Komanski, the office

Business Manager, sent a letter to Breedlove advising him that she had discarded some outdated sales material:

> Reference was also made to the Silver Dollars Kit. To tell you the truth, I had no idea what was in this because they are shrink wrapped. So while most of the kit is good, there were brochures inside which were outdated. I *discarded* these.

Breedlove Cambridge Ex. 104 at CAM 000982 (emphasis added).

Thereafter, a routine annual compliance review for the Cambridge office was scheduled for mid-August 1995. Tignanelli Ex. 28 at CAM 000994. In anticipation of this review and upset about the fine levied against agent Sun, Breedlove issued a memorandum dated August 7, 1995, directing all associates to "*please review your files during this week and discard any unapproved sales materials.*" Gonzalez Ex. 6 at CAM 000948 (emphasis in original).

On August 17 and August 18, 1995, auditors Jeff Soderstrom and Marty Lewis inspected the Cambridge Office. Tignanelli Ex. 28. Their report, dated October 10, 1995, does not discuss the existence of Komanski's May 25, 1995 letter to Breedlove or Breedlove's August 7, 1996 document destruction memorandum, nor does it mention any evidence of document destruction at the Cambridge Office *Id.* at CAM 000994-1007. Rather, the report commends Breedlove for doing a fine job of establishing an "In Control" operation and for instituting procedures to monitor sales material. *Id.* The report, however, did address other areas in which the auditors expressed specific concern. The auditors concluded that other areas of liability exposure existed at the FSO, and that the implementation of management controls was necessary. *Id.* The report specifically suggested that Breedlove implement individual agent marketing material audits. *Id.* The auditors also suggested that Breedlove implement a system to spot-check agent correspondence. *Id.*

Thereafter, in a written memorandum to his associates on February 1, 1996, Breedlove declared that his office would conduct a client file review. Grier Ex. 1. Breedlove's directive stressed the need to "immediately" make sure that client files are "in compliance." He advised all associates that he had designated Cheryl Rizzo to assist with the audit of the client files and that this would reduce "exposure" and "liability":

> One area that we need to work on immediately is making sure that client files are in Compliance. To assist you in your efforts ***609** in this area, I am going to have Cheryl Rizzo visit with each agent and do an audit of your client files to make sure that they are in Compliance and to reduce your exposure and liability relative to this issue.

Id. The intention was to cleanse all the agent files prior to the next regular audit scheduled for November 1996. Komanski 31.

Hence, from February 1996 to November 1996, at Breedlove's direction, Rizzo reviewed every client's file from every active agent in the office, including the district office in Westborough. [FN6] Rizzo 30. Rizzo discarded all undated, handwritten notes, as well as any unapproved sales material that appeared to have been used following the 1994 moratorium on the use of such material. Gillen Ex. 3 at CAM 001033-34 (memo from David Greenbaum to Reid Ashinoff dated December 11, 1996). Rizzo's audit involved the cleansing of approximately 9,000 client files, and the destruction of approximately eighty "folders of documents." Rizzo 31; Gillen Ex. 3. In addition, Rizzo testified that she believed that some agents cleansed their files before her audit, and that additional documents may have been discarded. *Id.* at 73.

> FN6. Rizzo continuously worked on this project. Just before the November 20, 1996 compliance review, she worked overtime to ensure completion prior to the compliance inspection. Rizzo 30.

B. Discovery of Destruction

On November 20, 1996, Prudential compliance auditors Russ Spaulding and Melissa Gonzalez commenced the routine annual field office compliance review of the Cambridge Office. Spaulding 34, 40-41. At the start of this review, Breedlove reported his personal document destruction policy, Spaulding 36, and a short time later, Gonzalez discovered Breedlove's February 1, 1996 memo. Gonzalez 49-50. Breedlove also asked Rizzo to describe her actions for the auditors. Spaulding 68-71.

It appears that Russ Spaulding, the auditor in charge of the November 1996 Cambridge audit, did not consider the document destruction as a matter of urgency. Spaulding was informed of the Cambridge incident by Breedlove on Wednesday, November 20, 1996, but did not report the incident to his supervisor, William Reynolds, until a phone call on Tuesday,

November 26, 1996. Spaulding 40-41. Spaulding completed the audit before further investigating the document destruction. *Id.* 55-56. He did not substantively discuss the incident with Reynolds until December 2, 1996. Reynolds 44-45. Spaulding did not include document destruction in his initial memo of significant issues that arose during the audit. Spaulding 48-49. On December 4, 1996, Spaulding prepared his first full written report on the Cambridge incident. He prepared a "Compliance Memo" to the Development Unit regarding the document destruction incident. Spaulding 52-53. This memo stated that Breedlove had brought the document destruction incident to Spaulding's attention during the compliance review. *Id.* Spaulding recommended that Breedlove be punished for the document destruction incident by issuance of a warning letter rather than suspension or termination. Spaulding 63.

On Thursday, December 5, 1996, Jeff Soderstrom learned about the incident in a conversation with Spaulding. Soderstrom 67. Soderstrom then instructed Spaulding to contact James A. Tignanelli and apprise him of the destruction. Soderstrom 76-77. Spaulding sent an e-mail to Tignanelli and to Tignanelli's superior, Kevin Frawley. Soderstrom and Tignanelli established that Corporate Compliance should take the lead in further investigating the incident. Soderstrom 79-80, 82-83. Tignanelli sent a copy of Spaulding's e-mail to in-house counsel, Francine Boucher. Tignanelli 326, 337, 343.

On Friday, December 6, 1996, after discussing the matter with Tignanelli, Richard Mariani, Director of Development, called Spaulding and advised him that the Development Unit of the Compliance Department would take over the handling of the investigation. Spaulding 50. Tignanelli "was basically trying to cut off whatever activity Spaulding was trying to generate and then [turn] it over to Fran Boucher [of the law department]." Tignanelli 334-35. Tignanelli told Mariani to get copies of the compliance ***610** memo to him and the law department, "and then sit back and wait for them to tell us what to do, and I told him I would meet with Fran the next day [December 6]." Tignanelli 345.

Tignanelli met with Boucher at approximately eleven o'clock on December 6. Tignanelli 350. Boucher told Tignanelli that the law department would handle the situation. "They would be getting in touch with outside counsel. They would get in touch with whoever, and that we weren't to do anything until they told us what we were going to do. I said fine. Just let us know whatever you want us to do and we'll do it." Tignanelli 353. Tignanelli was "pretty sure" Boucher had read the memos because "she acted like she did." *Id.* 355- 56. Tignanelli told Boucher that Tignanelli's department had contacted the PPFS people and communicated to them not to do anything because the Law Department was now going to handle the situation. *Id.* 357. Assistant general counsel Richard Meade also learned of the incident in a brief conversation on December 6, 1996. (He didn't recall how he learned about it.) Meade 6.

On Monday, December 9, 1996, Prudential's lead outside attorney, Reid Ashinoff, was told of the document destruction. Ashinoff Affidavit at 5; December 18, 1996 Tr. at 33. Ashinoff asked one of his partners, David Greenbaum, to go to Cambridge to investigate. Ashinoff Affidavit at 5.

On either December 9 or December 10, 1996, Meade, the in-house lawyer in charge of these litigations, discussed the incident in brief conversations with another in-house attorney Deborah Bello-Monaco and Gillen. Meade 9. Greenbaum, Rochelle Barstow (another attorney with Sonnenschein), and Sherry Akers (a Prudential compliance manager), interviewed Breedlove, Rizzo, and Komanski in Cambridge on December 10, 1996. CAM 001027-001032. After these interviews, Greenbaum gave Boucher an oral report about the Breedlove document destruction and Boucher relayed the information to her colleague Bello-Monaco. Boucher 38-39. Barstow prepared a memorandum to Greenbaum outlining the chronology of events and provided a summary of the employee interviews. CAM 001027-1032. Greenbaum received a facsimile transmission from Rizzo containing her "best guess" that 9,125 client files were reviewed. CAM 000903-906.

Senior Vice President and Auditor Priscilla Myers, to whom Tignanelli and Frawley reported, learned from Gillen on "Monday or Tuesday, December 10 or 11" that documents were discarded. Myers 88-89.

Late in the afternoon on December 11, 1996, Ashinoff met with Prudential senior management, Arthur Ryan, James Gillen, and Marc Grier, and apprised them for the first time of the Cambridge incident. Ashinoff Affidavit ß 1a. According to Ryan and Grier, they had no prior knowledge of the incident. Ryan 45; Grier 63-64.

On Friday, December 13, 1996 there were meetings at Prudential's corporate office the entire day. Bello-Monaco 27-28. During the morning meeting, Ashinoff met with Prudential senior management Gillen and Bello-Monaco. Bello- Monaco 24-25.

Later, Ashinoff left the meeting to attend the hearing in this Court on the motion for recusal brought by counsel for Kittle and Krell.

After the Court hearing on December 13, Ashinoff returned to Prudential's corporate office and met with Ryan, Grier, and others. Bello-Monaco 26-28. They made a tentative decision to terminate Breedlove, and public relations executives Robert DeFillippo and Richard Riley began to prepare a public relations statement. Bello-Monaco 46; DeFillippo 45-46.

Thus, by Wednesday, December 11, 1996, the essential facts about the Cambridge incident were known to senior management. Sonnenschein attorney David Greenbaum had completed his preliminary investigation. According to CFO Grier, it was apparent by that time that Breedlove would be fired. Grier 79. Prudential management acknowledged that they needed to notify the Court, plaintiffs' counsel, and the New Jersey Department of Insurance about the Cambridge incident, preferably simultaneously. Gillen 121 ("Our intent was to inform plaintiff's counsel, [the] regulator and the Court, as soon as possible andat the same time"). Prudential management continued to discuss ***611** the matter on Friday, December 13, 1996, Saturday, December 14, 1996, and Sunday, December 15, 1996. Ryan 76-77; Gillen 129-130; Grier 87-88. Plaintiffs' counsel was notified on December 14, 1996, and the New Jersey and Massachusetts regulators, and the Court, were notified on Monday, December 16, 1996. Also, Breedlove was notified of his firing on December 16, 1996.

4. The Syracuse Office

Several different allegations of improper treatment of documents have recently surfaced in connection with Prudential's Syracuse office.

A number of the incidents involved Paul J. Berrafato, the General Manager of the Syracuse office, who has served as General Manager in Syracuse for twenty years. [FN7] Berrafato 7. First, Berrafato removed approximately ten/fifteen tapes from that office immediately prior to a visit from Prudential's compliance personnel in the late summer or fall of 1996. *Id.* at 62-63, 84-87. Prudential learned of that incident as a result of allegations made by the ABC television program *Prime Time Live.* Tignanelli 281-82; Bello-Monaco 70-75.

FN7. During the investigation, plaintiffs' counsel learned of an allegation that documents were removed from the Syracuse office and placed in the trunk of the office manager's car in advance of a compliance check by state regulators. Other than as described herein, Berrafato denied that this or any similar incident of document removal ever took place. Berrafato 89-91.

Berrafato testified that he needed to review the tapes to see whether they were still approved for use. Berrafato 63, 85-86. Because he did not have time to do that before the visit from Compliance, *id.* at 85, he put the tapes into the trunk of his car, allegedly intending to review them at home. *Id.* at 62-63. Berrafato admitted that, in doing so, he "may have used poor judgment." *Id.* at 63.

In fact, it is a fair inference that Berrafato attempted to conceal the tapes until the compliance review was over. He testified that he was concerned that if Compliance had found the tapes, they would have criticized him because he had not gone through them. *Id.* at 85-86. Berrafato did not reveal to Compliance that he had secreted the tapes and that they therefore were not available for Compliance to review. *Id.* at 86. Ultimately, in fact, despite his stated intention, Berrafato never did go through the tapes Instead, he admitted that they ended up "back in [his] office and in the same box, and [he] still did not have a chance, [he] never used them, and [he] just [has] not gone through them to see which is approved and which isn't." *Id.* at 63-64.

Berrafato admitted to instances in which he or the Syracuse office manager directed that documents be discarded, destroyed or thrown away. *See* Berrafato Ex. 5. Although Berrafato initially testified that he had done so in only one memorandum, Berrafato 66-67, the documents that he produced thereafter showed memoranda dated March 20, 1995, September 1, 1995 (discussed above), May 2, 1996, and May 9, 1996, all of which contained such directions. *See* Berrafato 73-84 (summarizing and quoting relevant portions of memoranda). A memorandum form the Syracuse Office Manager, Arlene Shore (also included in Berrafato Ex. 5), dated August 28, 1995, also ordered the disposal of documents. *Id.* Berrafato testified that Shore was in charge of the Syracuse office's document retention function, and that he had never known her to deviate from Prudential company policy on that subject. Berrafato 69-70.

Two of Berrafato's memoranda (dated May 2 and May 9, 1996) that ordered sales people to "throw

away" or "discard" documents, post-dated this Court's September 15, 1995 Order requiring the document preservation. Berrafato testified that he had never seen either the September 15, 1995 Order or its "Preservation of Documents" provision. *Id.* at 35-36, 37. He could not recall whether Prudential had issued any communication that advised that documents were to be preserved pursuant to a judge's order. *Id.* at 38-39. He testified that he might not have sent those memoranda if he had known of the existence of the Court's September 15, 1995 Order with the "Preservation of Documents" provision. *Id.* at 113.

Berrafato stated that he believed he was acting in accordance with Prudential corporate ***612** policy when he sent the 1995 and 1996 memoranda included in Berrafato Ex. 5. *Id.* at 114. Berrafato never saw either of the two e-mail messages (August 17 and September 14, 1995) that Prudential had sent regarding corporate document retention policy, and testified that those memoranda were not sent to PPFS offices such as Syracuse. *Id.* at 43-44. The first of the corporate communications on the subject that Berrafato saw was Ryan's memorandum of August 14, 1996. *Id.* at 44.

With Winston Churchill's admonition in mind that this is not the end; that this is not the beginning of the end; but this is the end of the beginning, the Court makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. The Court's Order of September 15, 1995 which required, *inter alia*, that all parties "preserve all documents and other records containing information potentially relevant to the subject matter of this litigation" was never disseminated to Prudential employees.

2. Senior management, inclusive of Arthur Ryan, Prudential's Chief Executive Officer, Marc Grier, Prudential's Chief Financial Officer, Priscilla A. Myers, Senior Vice President in charge of auditing, and James Gillen, Prudential's Senior Vice President and General Counsel, never directed that the Court's Order of September 15, 1995 to preserve documents be disseminated to Prudential employees. Gillen was satisfied that Prudential's existing communications policies were adequate to meet the requirements of the Court's Order. Thus, Gillen did not believe that a separate communication concerning the Court's Order was necessary.

3. Commencing in August 1995, Prudential issued several PROFS notes (e-mail) directed to document preservation. While they cautioned against the destruction of documents, these one-page memoranda failed to specifically mention the putative class action litigation then pending before this Court in the District of New Jersey. Moreover, the memoranda subsequent to September 15, 1995, failed to inform the recipients of the Court's document preservation Order. [FN8] In these notes, "litigation" is referenced in the most general sense as "litigation alleging improper sales practices." Not until November 6, 1996, does a PROFS note mention a class action. Even then, the only reference is to the settlement agreement.

> FN8. Some of the PROFS notes caution that any willful or deliberate violation of these guidelines will result in serious disciplinary action, up to and including termination. No mention is made of sanctions provided for by the Federal Rules of Civil Procedure, civil contempt for violation of an Order of the Court, or criminal contempt pursuant to 18 U.S.C. ß 401(3).

4. The record is devoid of any reference to a document that would encourage non-management employees to report evidence of document destruction, for example, through the use of a telephone hotline or otherwise.

5. PROFS notes provided the names and telephone numbers of individuals to contact in the event that questions arose about document retention. No specific individual was designated as the primary contact source for information about document preservation.

6. On August 14, 1996, Arthur F. Ryan, Chairman and Chief Executive Officer, issued a PROFS note addressed to Prudential associates. It was entitled "Announcement." The announcement centered on the destruction of documents that had occurred in the Greater Southern Regional Office located in Jacksonville, Florida. Ryan referenced three Prudential internal orders as the foundation of Prudential's policy to preserve documents. Ryan did not mention this Court's Order to preserve documents or the class action litigation pending before this Court. Finally, Ryan informed the recipients that Prudential had notified several regulatory authorities of the failure to preserve documents in Jacksonville. Notwithstanding the prior preservation Order issued

by this Court and the violation of that Order, both Ryan and Prudential *failed to notify this Court* of the Jacksonville occurrence.

7. The admonition to preserve documents and not to destroy documents set forth in the PROFS notes was styled in ordinary print. Neither of these admonitions were delineated in emboldened or enlarged font:

***613**

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

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8. Prudential's use of PROFS notes to preserve documents and to prevent their destruction was ineffective and failed to implement this Court's document preservation Order. The Report of Investigation demonstrably highlights the PROFS notes inefficacy. Witnesses testified that they ignored e-mails, some testified that they lacked access to e-mail (approximately 1100/2700 agents have e-mail), and others testified that PROFS notes were not always printed and made available for general review. [FN9] Prudential, in its response to plaintiffs' Report of Investigation, concedes that it could have done more to ensure compliance with its document preservation directives. [FN10]

FN9. Report of Investigation at 11.

FN10. Response of Prudential at 7.

9. Prudential's Managing Director Audit Blueprint is not a document preservation policy statement. It is a marketing document in the form of a written manual printed in a format that allows it to be retained by individual company employees and placed on company bookshelves. The Audit Blueprint was designed to provide a standardized procedure and checklist for Managing Directors to enable them to keep abreast of the on-going changes in marketing material so that they would know what was and was not approved material. [FN11] The Audit Blueprint is inconsistent in its posture towards document preservation. In at least two locations it counsels that "disapproved material" and "out-of-date marketing material" should be destroyed. As stated in the Report of Investigation at 6, the only reference in the Audit Blueprint to document preservation is found in footnote 15, which states that unapproved marketing material found in a client file should not be destroyed. The Audit Blueprint was dated and distributed to Managing Directors in May 1995, approximately four months prior to the issuance of this Court's document preservation Order.

FN11. *See* Soderstrom Ex. 1 and 5.

10. The Court has no record of any written manual that would evidence that Prudential possesses a clear and unequivocal document preservation policy capable of retention by Prudential employees and available for easy reference.

11. Although the PROFS notes specify the types of materials that should be preserved and counsel against document destruction, these PROFS notes do not constitute uniform guidelines and do not represent the systematic process necessary to preserve documents. Indeed, not until November 13, 1996, did Prudential prepare and distribute a document entitled "Interim Document Retention Guidelines."

12. As of the writing of this Opinion, document destruction has occurred on at least four occasions. Despite the PROFS notes, documents have been destroyed in Jacksonville, Florida, Cambridge, Massachusetts, Des Moines, Iowa, and in Syracuse, New York. Additionally, in Syracuse, materials were spirited out of the office and secreted to avoid detection by internal Prudential compliance review teams.

13. Prudential acknowledges that document destruction has occurred at all of the above locations.

14. The document destruction that occurred in Cambridge is particularly unfortunate because of its magnitude and the failure to prepare a document destruction index. Approximately 9000 client files were cleansed and eighty "folders of documents" were destroyed. [FN12] Thus, the Court and the litigants are currently unaware of the documents that were destroyed and the files from which these documents were taken. Without a document destruction index or some other procedure, all concerned are forever foreclosed from the receipt of this information.

FN12. Report of Investigation at 22.

15. The document destruction in Cambridge occurred between February 1996 and ***614** November 1996, a period subsequent to the entry of this Court's document preservation Order.

16. Document destruction at the Des Moines, Iowa office involved 150 documents which were removed and discarded from 200 policyholder files. The activity that occurred in Des Moines clearly violated the Order of this Court. Moreover, Prudential concedes in its response to the Report of Investigation that "the document retention directives ... were not sufficiently clear on their import. Prudential management again must take responsibility for this failing." Response at 13.

17. Prudential's procedures to identify and report document destruction to senior management are unduly cumbersome and slow.

(a) Destruction of documents at the Cambridge, Massachusetts office was ascertained by routine audit on November 20, 1996.

(b) The auditor's supervisor was notified of the document destruction on November 26, 1996.

(c) The auditor's report, termed a "Compliance Memo," that described the document destruction was submitted to the Prudential Development Unit on December 4, 1996.

(d) Other Prudential employees learned of the document destruction on December 5, 1996.

(e) The Prudential Law Department learned of the document destruction on December 6, 1996. Assistant General Counsel Richard Meade also learned of the Cambridge incident on December 6, 1996.

(f) Prudential's lead outside counsel was told of the document destruction on Monday, December 9, 1996.

(g) Prudential's General Counsel James Gillen learned of the Cambridge destruction incident on either December 9 or December 10, 1996.

(h) Senior Vice President and Auditor Priscilla Myers learned of the document destruction from Gillen on either December 10 or December 11, 1996.

(i) Arthur Ryan, Chief Executive Officer, learned of the document destruction late in the afternoon of December 11, 1996 during a conference with Reid Ashinoff, James Gillen, and Marc Grier. Until that meeting, Grier had no notice of the prior destruction incident.

(j) Insurance regulators and the Court were notified on December 16, 1996.

18. Approximately twenty-one days elapsed between discovery of the document destruction and its report to senior management Ryan, Grier and Myers. Twenty- six days elapsed between the discovery of document destruction and notification of insurance regulators and the Court.

19. Prudential's senior management has failed effectively to establish a comprehensive document retention policy. The PROFS messages, while reflective of Prudential's intentions, lack sufficient content and detail to constitute a "policy" on document preservation.

20. The insufficiency of the PROFS notes and the failure to prepare and distribute a written document preservation manual made document destruction inevitable.

21. The failure of senior management promptly to ascertain and notify the Court of the Cambridge document destruction episode in particular is inexcusable in light of the December 19, 1996 exclusion date that required Cambridge policyholders to decide whether to remain in the class action.

CONCLUSIONS OF LAW

[2] 1. The Federal Rules of Civil Procedure provide for sanctions when a party to a litigation fails to obey a pre-trial order. Fed.R.Civ.P. 16(f). Beyond the formal rules and legislative dictates, the Court possesses the inherent authority to punish those who abuse the judicial process. *Republic of the Philippines v. Westinghouse Electric Corporation*, 43 F.3d 65, 73 (3d Cir.1995). The reason for the rule and the warrant for its existence lies in the fact that a court, in order to achieve the orderly and expeditious disposition of cases, must have the control necessary to manage its own affairs. *Chambers v. NASCO*, 501 U.S. 32, 43, 111 S.Ct. 2123, 2132, 115 L.Ed.2d 27 (1991).

***615** [3] 2. 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. Because the destroyed records in Cambridge are permanently lost, the Court will draw the inference that the destroyed materials are relevant and if available would lead to the proof of a claim. *See National Association of Radiation Survivors v. Turnage*, 115 F.R.D. 543, 557 (N.D.Cal.1987).

[4] 3. When the September 15, 1995 Court Order to preserve documents was entered, it became the obligation of senior management to initiate a comprehensive document preservation plan and to distribute it to all employees. Moreover, it was incumbent on senior management to advise its employees of the pending multi-district litigation venued in New Jersey, to provide them with a copy of the Court's Order, and to acquaint its employees with the potential sanctions, both civil and criminal, that the Court could issue for noncompliance with this Court's Order.

[5] 4. When senior management fails to establish and distribute a comprehensive document retention policy, it cannot shield itself from responsibility because of field office actions. The obligation to preserve documents that are potentially discoverable materials is an affirmative one that rests squarely on the shoulders of senior corporate officers.

SANCTIONS

[6] Through its findings of fact and conclusions of law, the Court is satisfied that the conduct of Prudential explicitly violates the mandate to preserve documents. The gravity of Prudential's conduct is especially troublesome in a complex litigation, such as this, that encompasses 10.7 million policyholders. From the very inception of this litigation, the allegations of document destruction have been a recurring theme. The accusations of document destruction not only threaten the integrity of this Court and the proceedings before it, but further serve to undermine the foundations of our system of justice. Corporations, like Prudential, who seek access to the federal courts, have an obligation to comply with both the spirit and intent of the rules. Failure to fulfill this responsibility should be met with unwavering judicial disapproval.

A. Rationale

In the exercise of its discretion to sanction, whether under the Federal Rules of Civil Procedure or under the Court's inherent power, the Court must consider the range of sanctions available and choose only those that are necessary to achieve the Court's purposes. Restraint and discretion are integral to the process. The adage "let the punishment fit the crime" is as true here as it was in Gilbert & Sullivan's "Mikado." W.S. Gilbert & Arthur Sullivan, *The Mikado*, *in* The Complete Plays of Gilbert & Sullivan 343, 352 (1938).

In the *Republic of the Philippines*, the Third Circuit provides a two-part test with concomitant factors to determine whether and which sanctions are appropriate. 43 F.3d at 74.

First, the Court must consider the conduct at issue and must explain why the conduct warrants sanctions. *Id.* A pattern of wrongdoing may require stiffer sanctions than an isolated incident. *Id.* A grave wrongdoing may compel more severe sanctions than a minor infraction. *Id.* And wrongdoing that prejudices the wrongdoer's opponent or hinders the administration of justice may demand a heftier response than wrongdoing that fails to achieve its "untoward object." *Id.* Mitigating factors, if any, must shape the Court's response also. *Id.*

Second, after evaluating the conduct at issue, the Court must consider the range of permissible sanctions and must explain why less severe sanctions are inadequate or inappropriate. *Id.*

1. Actual Factual Predicate

[7] Here, Prudential violated the Order of the Court to preserve documents and failed to advise its field offices (334 field ***616** offices) of the pendency of the litigation and the Court-ordered requirement to preserve documents. While e-mail is an appropriate means for a corporation to disseminate its policy, the internal orders directed to the field by Prudential lacked coordination and represented a haphazard response to a serious problem of judicial administration. Moreover, because documents have been destroyed, they can never be retrieved and the resultant harm is incalculable. It is inexcusable that reports of document destruction were unduly delayed at a time when urgency of notification was particularly relevant. [FN13] Thus, the Court concludes that there exists a more than adequate factual predicate to sanction.

FN13. The Court-ordered notice to policyholders required them to opt out by December 19, 1996.

(a) Pattern of Wrongdoing

The Court finds that Prudential's consistent pattern of failing to prevent unauthorized document destruction warrants the imposition of substantial sanctions. Four field offices have reported document destruction. One of those field offices has engaged in deceptive removal of documents to avoid audit. Prudential has acknowledged that its PROFS notes failed to achieve document retention and prevent document destruction. Yet, Prudential still has not sent the Order of this Court to the field, nor fully explained the need for document retention. Accordingly, the Court finds a repetitive circumstance that requires correction and that merits the imposition of sanctions.

(b) Willful Misconduct

The Court finds no willful misconduct to have occurred.

(c) Prejudice to a Party Opponent

The Court finds that the document destruction, particularly in the Cambridge, Massachusetts office, caused harm to party opponents. Over 9,000 files were cleansed. Prudential is unable to specify what documents were taken from files, nor is it able to identify the files from which the documents were taken. [FN14] Because the prejudice to affected party opponents is so substantial, Prudential's consistent pattern of failing to curb document destruction, which at the very least was grossly negligent conduct, merits sanctions, despite the Court's finding that Prudential's conduct was not willful.

FN14. Although the Alternative Dispute Process set forth in the settlement agreement contemplated that documents would be inadvertently destroyed, the Court is unable to ascertain whether the remedial aspects of that agreement will fully address the harm incurred.

(d) Whether the Conduct Hindered the Administration of Justice

Document destruction inevitably hinders the administration of justice. The record is replete with references to document destruction and Prudential was repeatedly admonished by the Court that if Prudential engaged in document destruction, they would do so at their peril. By virtue of the time devoted to document destruction, both in and out of court, and the public frenzy it created, the Court is satisfied that the destruction of document issue has hindered and burdened the administration of justice.

(e) Mitigating Factors

The Court finds no mitigating factors for Prudential's senior management failure to comply with the Order of the Court.

2. Less Severe Alternatives

The Court has considered the range of sanctions available and has determined that each of the sanctions imposed below befits Prudential's conduct and is absolutely necessary to remedy the waste of judicial resources that Prudential has caused and to protect the authority of the Court.

C. Specific Sanctions

Although the considerations under Federal Rule of Civil Procedure 16(f) and under the inherent power of the Court are comparable, the Court will impose Federal Rule of Civil Procedure 16(f) sanctions as follows:

1. Within ten (10) days after the receipt of this Opinion, Prudential shall mail to every employee a copy of the Court's September 15, 1995 Order, together with a full explanation ***617** of the pending litigation and the civil and criminal sanctions that apply to the failure to follow an Order of the Court.

2. Within thirty (30) days, Prudential shall submit to the Court a written manual that embodies Prudential's document preservation policy. Such manual shall clearly and unequivocally establish guidelines for document retention, as well as the circumstances when a document may be discarded and the procedures to be employed when that event occurs. The plan shall include means to distribute the plan to each employee.

3. During the pendency of this litigation, Prudential shall dedicate a telephone "hotline" to facilitate reports of document destruction, if any. This hotline number shall be communicated to all employees and any caller's request for anonymity shall be respected. Each such call shall be recorded in a log to be monitored by a member of the Law Department. The date, the time of the call, and the field office involved are relevant matters that must be recorded. Reports of document destruction shall be promptly reported to the General Counsel and appropriate

action taken.

4. During the pendency of this litigation, Prudential shall establish a certification process wherein each field manager shall certify that his/her office is in compliance with the document retention manual and has not engaged in document destruction contrary to Prudential's established policy.

5. Within ten (10) days after the issuance of this Opinion, Prudential shall pay to the Clerk of the United States District Court for the District of New Jersey, the sum of One Million Dollars ($1,000,000). This sanction recognizes the unnecessary consumption of the Court's time and resources in regard to the issue of document destruction. Moreover, this sanction informs Prudential and the public of the gravity of repeated incidents of document destruction and the need of the Court to preserve and protect its jurisdiction and the integrity of the proceedings before it. In the assessment of this monetary sanction, the Court has considered the financial worth of Prudential and the minimal financial impact this sanction will have on Prudential's financial stability. [FN15]

> FN15. It is not uncommon for large corporations with vast resources to impede the discovery process through methods and processes that frustrate the production of relevant and unprivileged documents. Courts must be vigilant to prevent that type of conduct when it occurs and must impose meaningful sanctions to protect the integrity of the proceedings before it.

6. Prudential shall promptly reimburse plaintiffs' counsel for all fees and costs associated with the motion for sanctions, the order to show cause, the depositions and discovery in preparation for the depositions, and the preparation and distribution of the Report of Investigation to the Court and counsel.

7. The sanctions contained herein are without prejudice to the subsequent imposition of additional sanctions as may be fair and appropriate to remedy unknown harm to individual party opponents caused by document destruction.

CONCLUSION

Prudential has violated the Order of the Court on at least four occasions. It has no comprehensive document retention policy with informative guidelines and lacks a protocol that promptly notifies senior management of document destruction. These systemic failures impede the litigation process and merit the imposition of sanctions.

The sanctions imposed fall within the permissible range of sanctions. The imposition of any lesser sanctions would serve to diminish the harm that occurred, as well as the integrity of the proceedings before this Court.

END OF DOCUMENT

National Archives and Records Administration
General Records Schedules

NOTE: The GRS 20 Page has information about the Electronic Records Work Group, and the Records Management Page has additional information about Federal electronic records management initiatives.

Transmittal No. 7 General Records Schedule 20
August 1995

Electronic Records

This schedule provides disposal authorization for certain electronic records and specified hard-copy (paper) or microform records that are integrally related to the electronic records. This schedule applies to disposable electronic records created or received by Federal agencies including those managed for agencies by contractors. It covers records created by computer operators, programmers, analysts, systems administrators, and all personnel with access to a computer. Disposition authority is provided for certain master files, including some tables that are components of data base management systems, and certain files created from master files for specific purposes. In addition, this schedule covers certain disposable electronic records produced by end users in office automation applications. These disposition authorities apply to the categories of electronic records described in GRS 20, regardless of the type of computer used to create or store these records. GRS 20 does not cover all electronic records. Electronic records not covered by GRS 20 may not be destroyed unless authorized by a Standard Form 115 that has been approved by the National Archives and Records Administration (NARA). The records covered by several items in this schedule are authorized for erasure or deletion when the agency determines that they are no longer needed for administrative, legal, audit, or other operational purposes. NARA cannot establish a more specific retention that would be appropriate in all applications. Each agency should, when appropriate, determine a more specific disposition instruction, such as "Delete after X update cycles" or "Delete when X years old," for inclusion in its records disposition directives or manual. NARA approval is not needed to set retention periods for records in the GRS that are authorized for destruction when no longer needed. Items 2a and 1a (in part) of this schedule apply to hard-copy or microform records used in conjunction with electronic files. Item 1 also covers printouts produced to test, use, and maintain master files. Items 10 and 11 of this schedule should be applied to special purpose programs and documentation for disposable electronic records whatever the medium in which such documentation and programs exist. This schedule has been revised to include electronically-generated records previously covered in General Records Schedule 23, Records Common to Most Offices. The original numbering of the items in GRS 20 has been preserved. The items moved from GRS 23 have been added at the end, except the item covering administrative data bases that has been incorporated into item 3.

Electronic versions of records authorized for disposal elsewhere in the GRS may be deleted under the provisions of item 3 of GRS 20. See also 36 CFR Part 1234 for NARA regulations on electronic records management.

1. Files/Records Relating to the Creation, Use, and Maintenance of Computer Systems, Applications, or Electronic Records.

   a. Electronic files or records created solely to test system performance, as well as hard-copy printouts and related documentation for the electronic files/records. Delete/destroy when the agency determines that they are no longer needed for administrative, legal, audit, or other operational purposes.

   b. Electronic files or records used to create or update a master file, including, but not limited to, work files, valid transaction files, and intermediate input/output records. Delete after information has been transferred to the master file and verified.

   c. Electronic files and hard-copy printouts created to monitor system usage, including, but not limited to, log-in files, password files, audit trail files, system usage files, and cost-back files used to assess charges for system use.

   Delete/destroy when the agency determines they are no longer needed for administrative, legal, audit, or other operational purposes.

2. Input/Source Records.

   a. Non-electronic documents or forms designed and used solely to create, update, or modify the records in an electronic medium and not required for audit or legal purposes (such as need for signatures) and not previously scheduled for permanent retention in a NARA-approved agency records schedule.

      Destroy after the information has been converted to an electronic medium and verified, or when no longer needed to support the reconstruction of, or serve as the backup to, the master file, whichever is later.

   b. Electronic records, except as noted in item 2c, entered into the system during an update process, and not required for audit and legal purposes.

      Delete when data have been entered into the master file or database and verified, or when no longer required to support reconstruction of, or serve as back-up to, a master file or database, whichever is later.

   c. Electronic records received from another agency and used as input/ source records by the receiving agency, EXCLUDING records produced by another agency under the terms of an interagency agreement, or records created by another agency in response to the specific information needs of the receiving agency.

Delete when data have been entered into the master file or database and verified, or when no longer needed to support reconstruction of, or serve as back up to, the master file or database, whichever is later.

d. Computer files or records containing uncalibrated and unvalidated digital or analog data collected during observation or measurement activities or research and development programs and used as input for a digital master file or database.

Delete after the necessary data have been incorporated into a master file.

3. Electronic Versions of Records Scheduled for Disposal. a. Electronic versions of records that are scheduled for disposal under one or more items in GRS 1-16, 18, 22, or 23; EXCLUDING those that replace or duplicate the following GRS items: GRS 1, items 21, 22, 25f; GRS 12, item 3; and GRS 18, item 5. Delete after the expiration of the retention period authorized by the GRS or when no longer needed, whichever is later.

b. Electronic records that support administrative housekeeping functions when the records are derived from or replace hard copy records authorized by NARA for destruction in an agency-specific records schedule.

(1) When hard copy records are retained to meet recordkeeping requirements.

Delete electronic version when the agency determines that it is no longer needed for administrative, legal, audit, or other operational purposes.

(2) When the electronic record replaces hard copy records that support administrative housekeeping functions.

Delete after the expiration of the retention period authorized for the hard copy file, or when no longer needed, whichever is later.

(3) Hard copy printouts created for short-term administrative purposes.

Destroy when the agency determines that they are no longer needed for administrative, legal, audit, or other operational purposes.

4. Data Files Consisting of Summarized Information.

Records that contain summarized or aggregated information created by combining data elements or individual observations from a single master file or data base that is disposable under a GRS item or is authorized for deletion by a disposition job approved by NARA after January 1, 1988, EXCLUDING data files that are created as disclosure-free files to allow public access to the data which may not be destroyed before securing NARA approval.

Delete when the agency determines that they are no longer needed for administrative, legal, audit, or other operational purposes.

[NOTE: Data files consisting of summarized information which were created from a master file or data base that is unscheduled, or that was scheduled as permanent but no longer exists or can no longer be accessed, may not be destroyed before securing NARA approval.]

5. Records Consisting of Extracted Information.

Electronic files consisting solely of records extracted from a single master file or data base that is disposable under GRS 20 or approved for deletion by a NARA-approved disposition schedule, EXCLUDING extracts that are:

a) produced as disclosure-free files to allow public access to the data; or

b) produced by an extraction process which changes the informational content of the source master file or data base; which may not be destroyed before securing NARA approval. For print and technical reformat files see items 6 and 7 of this schedule respectively.

Delete when the agency determines that they are no longer needed for administrative, legal, audit, or other operational purposes.

[NOTES: (1) Records consisting of extracted information that was created from a master file or data base that is unscheduled, or that was scheduled as permanent but no longer exists or can no longer be accessed may not be destroyed before securing NARA approval. (2) See item 12 of this schedule for other extracted data.]

6. Print File.

Electronic file extracted from a master file or data base without changing it and used solely to produce hard-copy publications and/or printouts of tabulations, ledgers, registers, and statistical reports.

Delete when the agency determines that they are no longer needed for administrative, legal, audit, or other operational purposes.

7. Technical Reformat File.

Electronic file consisting of data copied from a complete or partial master file or data base made for the specific purpose of information interchange and written with varying technical specifications, EXCLUDING files created for transfer to the National Archives.

Delete when the agency determines that they are no longer needed for administrative, legal, audit, or other operational purposes.

8. Backups of Files.

Electronic copy, considered by the agency to be a Federal record, of the master copy of an electronic record or file and retained in case the master file or database is damaged or inadvertently erased.

a. File identical to records scheduled for transfer to the National Archives.

Delete when the identical records have been captured in a subsequent backup file or when the identical records have been transferred to the National Archives and successfully copied.

b. File identical to records authorized for disposal in a NARA-approved records schedule.

Delete when the identical records have been deleted, or when replaced by a subsequent backup file.

9. Finding Aids (or Indexes).

Electronic indexes, lists, registers, and other finding aids used only to provide access to records authorized for destruction by the GRS or a NARA-approved SF 115, EXCLUDING records containing abstracts or other information that can be used as an information source apart from the related records.

Delete with related records or when the agency determines that they are no longer needed for administrative, legal, audit, or other operational purposes, whichever is later.

10. Special Purpose Programs.

Application software necessary solely to use or maintain a master file or database authorized for disposal in a GRS item or a NARA-approved records schedule, EXCLUDING special purpose software necessary to use or maintain any unscheduled master file or database or any master file or database scheduled for transfer to the National Archives.

Delete when related master file or database has been deleted.

11. Documentation.

a. Data systems specifications, file specifications, codebooks, record layouts, user guides, output specifications, and final reports (regardless of medium) relating to a master file or data base that has been authorized for destruction by the GRS or a NARA-approved disposition schedule.

Destroy or delete when superseded or obsolete, or upon authorized deletion of the related master file or data base, or upon the destruction of the output of the system if the output is needed to protect legal rights, whichever is latest.

b. Copies of records relating to system security, including records documenting periodic audits or review and recertification of sensitive applications, disaster and continuity plans, and risk analysis, as described in OMB Circular No. A-130.

Destroy or delete when superseded or obsolete.

[NOTES: (1) Documentation that relates to permanent or unscheduled master files and data bases is not authorized for destruction by the GRS. (2) See item 1a of this schedule for documentation relating to system testing.]

12. Downloaded and Copied Data.

Derived data and data files that are copied, extracted, merged, and/or calculated from other data generated within the agency, when the original data is retained.

a. Derived data used for ad hoc or one-time inspection, analysis or review, if the derived data is not needed to support the results of the inspection, analysis or review.

Delete when the agency determines that they are no longer needed for administrative, legal, audit, or other operational purposes.

b. Derived data that provide user access in lieu of hard copy reports that are authorized for disposal.

Delete when the agency determines that they are no longer needed for administrative, legal, audit, or other operational purposes.

c. Metadata or reference data, such as format, range, or domain specifications, which is transferred from a host computer or server to another computer for input, updating, or transaction processing operations.

Delete from the receiving system or device when no longer needed for processing.

[NOTE: See item 5 of this schedule for other extracted data.]

13. Word Processing Files.

Documents such as letters, memoranda, reports, handbooks, directives, and manuals recorded on electronic media such as hard disks or floppy diskettes after they have been copied to an electronic recordkeeping system, paper, or microform for recordkeeping purposes.

Delete from the word processing system when no longer needed for updating or revision.

14. Electronic Mail Records.

Senders' and recipients' versions of electronic mail messages that meet the definition of Federal records, and any attachments to the record messages after they have been copied to an electronic recordkeeping system, paper, or microform for recordkeeping purposes.

Delete from the e-mail system after copying to a recordkeeping system.

[NOTE: Along with the message text, the recordkeeping system must capture the names of sender and recipients and date (transmission data for recordkeeping purposes) and any receipt data when required.]

15. Electronic Spreadsheets.

Electronic spreadsheets generated to support administrative functions or generated by an individual as background materials or feeder reports.

a. When used to produce hard copy that is maintained in organized files.

Delete when no longer needed to update or produce hard copy.

b. When maintained only in electronic form.

Delete after the expiration of the retention period authorized for the hard copy by the GRS or a NARA-approved SF 115. If the electronic version replaces hard copy records with differing retention periods and agency software does not readily permit selective deletion, delete after the longest retention period has expired.

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PART 1234 -- ELECTRONIC RECORDS MANAGEMENT

Authority: 44 U.S.C. 2904, 3101, 3102, and 3105.

Subpart A -- General

§ 1234.1 Scope of part.

This part establishes the basic requirements related to the creation, maintenance, use, and disposition of electronic records. Electronic records include numeric, graphic, and text information, which may be recorded on any medium capable of being read by a computer and which satisfies the definition of a record. This includes, but is not limited to, magnetic media, such as tapes and disks, and optical disks. Unless otherwise noted, these requirements apply to all electronic information systems, whether on microcomputers, minicomputers, or main-frame computers, regardless of storage media, in network or stand-alone configurations. This part also covers creation, maintenance and use, and disposition of Federal records created by individuals using electronic mail applications.

§ 1234.2 Definitions.

Basic records management terms are defined in 36 CFR 1220.14. As used in part 1234 --

Data base means a set of data, consisting of at least one data file, that is sufficient for a given purpose.
Data base management system means a software system used to access and retrieve data stored in a data base.
Data file means related numeric, textual, or graphic information that is organized in a strictly prescribed form and format.
Electronic information system. A system that contains and provides access to computerized Federal records and other information.
Electronic mail system. A computer application used to create, receive, and transmit messages and other documents. Excluded from this definition are file transfer utilities (software that transmits files between users but does not retain any transmission data), data systems used to collect and process data that have been organized into data files or data bases on either personal computers or mainframe computers, and word processing documents not transmitted on an e-mail system.
Electronic mail message. A document created or received on an electronic mail system including brief notes, more formal or substantive narrative documents, and any attachments, such as word processing and other electronic documents, which may be transmitted with the message.
Electronic record means any information that is recorded in a form that only a computer can process and that satisfies the definition of a Federal record in 44 U.S.C. 3301.
Electronic recordkeeping system. An electronic system in which records are collected, organized, and categorized to facilitate their preservation, retrieval, use, and disposition.
Text documents means narrative or tabular documents, such as letters, memorandums, and reports, in loosely prescribed form and format.
Transmission and receipt data.
(1) *Transmission data.* Information in electronic mail systems regarding the identities of sender and addressee(s), and the date and time messages were sent.
(2) *Receipt data.* Information in electronic mail systems regarding date and time of receipt of a message, and/or acknowledgment of receipt or access by addressee(s).

Subpart B -- Program Requirements

§ 1234.10 Agency responsibilities.

The head of each Federal agency shall ensure that the management of electronic records incorporates the following elements:
(a) Assigning responsibility to develop and implement an agencywide program for the management of all records created, received, maintained, used, or stored on

electronic media; and notifying the National Archives and Records Administration, Modern Records Programs (NWM), 8601 Adelphi Rd., College Park, MD 20740-6001 and the General Services Administration, Office of Government Policy (MKB), Washington, DC 20505, of the name and title of the person assigned the responsibility.
(b) Integrating the management of electronic records with other records and information resources management programs of the agency.
(c) Incorporating electronic records management objectives, responsibilities, and authorities in pertinent agency directives and disseminating them throughout the agency as appropriate.
(d) Establishing procedures for addressing records management requirements, including recordkeeping requirements and disposition, before approving new electronic information systems or enhancements to existing systems.
(e) Ensuring that adequate training is provided for users of electronic mail systems on recordkeeping requirements, the distinction between Federal records and nonrecord materials, procedures for designating Federal records, and moving or copying records for inclusion in an agency recordkeeping system;
(f) Ensuring that adequate training is provided for users of electronic information systems in the operation, care, and handling of the equipment, software, and media used in the system.
(g) Developing and maintaining up-to-date documentation about all electronic information systems that is adequate to: Specify all technical characteristics necessary for reading or processing the records; identify all defined inputs and outputs of the system; define the contents of the files and records; determine restrictions on access and use; understand the purpose(s) and function(s) of the system; describe update cycles or conditions and rules for adding information to the system, changing information in it, or deleting information; and ensure the timely, authorized disposition of the records.
(h) Specifying the location, manner, and media in which electronic records will be maintained to meet operational and archival requirements, and maintaining inventories of electronic information systems to facilitate disposition.
(i) Developing and securing NARA approval of records disposition schedules, and ensuring implementation of their provisions.
(j) Specifying the methods of implementing controls over national security-classified, sensitive, proprietary, and Privacy Act records stored and used electronically.
(k) Establishing procedures to ensure that the requirements of this part are applied to those electronic records that are created or maintained by

contractors.
(l) Ensuring compliance with applicable Governmentwide policies, procedures, and standards such as those issued by the Office of Management and Budget, the General Accounting Office, the General Services Administration, the National Archives and Records Administration, and the National Institute of Standards and Technology.
(m) Reviewing electronic information systems periodically for conformance to established agency procedures, standards, and policies as part of the periodic reviews required by 44 U.S.C. 3506. The review should determine if the records have been properly identified and described, and whether the schedule descriptions and retention periods reflect the current informational content and use. If not, or if substantive changes have been made in the structure, design, codes, purposes, or uses of the system, submit an SF 115, Request for Records Disposition Authority, to NARA.

Subpart C -- Standards for the Creation, Use, Preservation, and Disposition of Electronic Records

§ 1234.20 Creation and use of data files.

(a) For electronic information systems that produce, use, or store data files, disposition instructions for the data shall be incorporated into the system's design.
(b) Agencies shall maintain adequate and up-to-date technical documentation for each electronic information system that produces, uses, or stores data files. Minimum documentation required is a narrative description of the system; physical and technical characteristics of the records, including a record layout that describes each field including its name, size, starting or relative position, and a description of the form of the data (such as alphabetic, zoned decimal, packed decimal, or numeric), or a data dictionary or the equivalent information associated with a data base management system including a description of the relationship between data elements in data bases; and any other technical information needed to read or process the records.

§ 1234.22 Creation and use of text documents.

(a) Electronic recordkeeping systems that maintain the official file copy of text documents on electronic media shall meet the following minimum requirements:
(1) Provide a method for all authorized users of the system to retrieve desired documents, such as an indexing or text search system;
(2) Provide an appropriate level of security to ensure integrity of the documents;
(3) Provide a standard interchange format when

necessary to permit the exchange of documents on electronic media between agency computers using different software/operating systems and the conversion or migration of documents on electronic media from one system to another; and
(4) Provide for the disposition of the documents including, when necessary, the requirements for transferring permanent records to NARA (see § 1228.270 of this chapter).
(b) Before a document is created electronically on electronic recordkeeping systems that will maintain the official file copy on electronic media, each document shall be identified sufficiently to enable authorized personnel to retrieve, protect, and carry out the disposition of documents in the system. Appropriate identifying information for each document maintained on the electronic media may include: office of origin, file code, key words for retrieval, addressee (if any), signator, author, date, authorized disposition (coded or otherwise), and security classification (if applicable). Agencies shall ensure that records maintained in such systems can be correlated with related records on paper, microform, or other media.

§ 1234.24 Standards for managing electronic mail records.

Agencies shall manage records created or received on electronic mail systems in accordance with the provisions of this chapter pertaining to adequacy of documentation, recordkeeping requirements, agency records management responsibilities, and records disposition (36 CFR parts 1220, 1222, and 1228).
(a) Agency instructions on identifying and preserving electronic mail messages will address the following unique aspects of electronic mail:
(1) Some transmission data (names of sender and addressee(s) and date the message was sent) must be preserved for each electronic mail record in order for the context of the message to be understood. Agencies shall determine if any other transmission data is needed for purposes of context.
(2) Agencies that use an electronic mail system that identifies users by codes or nicknames or identifies addressees only by the name of a distribution list shall instruct staff on how to retain names on directories or distributions lists to ensure identification of the sender and addressee(s) of messages that are records.
(3) Agencies that use an electronic mail system that allows users to request acknowledgments or receipts showing that a message reached the mailbox or inbox of each addressee, or that an addressee opened the message, shall issue instructions to e-mail users specifying when to request such receipts or acknowledgments for recordkeeping purposes and how to preserve them.
(4) Agencies with access to external electronic mail

systems shall ensure that Federal records sent or received on these systems are preserved in the appropriate recordkeeping system and that reasonable steps are taken to capture available transmission and receipt data needed by the agency for recordkeeping purposes.
(5) Some e-mail systems provide calendars and task lists for users. These may meet the definition of Federal record. Calendars that meet the definition of Federal records are to be managed in accordance with the provisions of General Records Schedule 23, Item 5.
(6) Draft documents that are circulated on electronic mail systems may be records if they meet the criteria specified in 36 CFR 1222.34.
(b) Agencies shall consider the following criteria when developing procedures for the maintenance of electronic mail records in appropriate recordkeeping systems, regardless of format.
(1) Recordkeeping systems that include electronic mail messages must:
(i) Provide for the grouping of related records into classifications according to the nature of the business purposes the records serve;
(ii) Permit easy and timely retrieval of both individual records and files or other groupings of related records;
(iii) Retain the records in a usable format for their required retention period as specified by a NARA-approved records schedule;
(iv) Be accessible by individuals who have a business need for information in the system;
(v) Preserve the transmission and receipt data specified in agency instructions; and
(vi) Permit transfer of permanent records to the National Archives and Records Administration (see 36 CFR 1228.270 and 36 CFR 1234.32(a)).
(2) Agencies shall not store the recordkeeping copy of electronic mail messages that are Federal records only on the electronic mail system, unless the system has all of the features specified in paragraph (b)(1) of this section. If the electronic mail system is not designed to be a recordkeeping system, agencies shall instruct staff on how to copy Federal records from the electronic mail system to a recordkeeping system.
(c) Agencies that maintain their electronic mail records electronically shall move or copy them to a separate electronic recordkeeping system unless their system has the features specified in paragraph (b)(1). Because they do not have the features specified in paragraph (b)(1) of this section, backup tapes should not be used for recordkeeping purposes. Agencies may retain records from electronic mail systems in an off-line electronic storage format (such as optical disk or magnetic tape) that meets the requirements described at 36 CFR 1234.30(a). Agencies that retain permanent electronic mail records scheduled for transfer to the

National Archives shall either store them in a format and on a medium that conforms to the requirements concerning transfer at 36 CFR 1228.270 or shall maintain the ability to convert the records to the required format and medium at the time transfer is scheduled.
(d) Agencies that maintain paper files as their recordkeeping systems shall print their electronic mail records and the related transmission and receipt data specified by the agency.

§ 1234.26 Judicial use of electronic records.

Electronic records may be admitted in evidence to Federal courts for use in court proceedings (Federal Rules of Evidence 803(8)) if trustworthiness is established by thoroughly documenting the recordkeeping system's operation and the controls imposed upon it. Agencies should implement the following procedures to enhance the legal admissibility of electronic records.
(a) Document that similar kinds of records generated and stored electronically are created by the same processes each time and have a standardized retrieval approach.
(b) Substantiate that security procedures prevent unauthorized addition, modification or deletion of a record and ensure system protection against such problems as power interruptions.
(c) Identify the electronic media on which records are stored throughout their life cycle, the maximum time span that records remain on each storage medium, and the NARA-approved disposition of all records.
(d) Coordinate all of the above with legal counsel and senior IRM and records management staff.

§ 1234.28 Security of electronic records.

Agencies shall implement and maintain an effective records security program that incorporates the following:
(a) Ensures that only authorized personnel have access to electronic records.
(b) Provides for backup and recovery of records to protect against information loss.
(c) Ensures that appropriate agency personnel are trained to safeguard sensitive or classified electronic records.
(d) Minimizes the risk of unauthorized alteration or erasure of electronic records.
(e) Ensures that electronic records security is included in computer systems security plans prepared pursuant to the Computer Security Act of 1987 (40 U.S.C. 759 note).

§ 1234.30 Selection and maintenance of electronic records storage media.

(a) Agencies shall select appropriate media and systems

for storing agency records throughout their life, which meet the following requirements:
(1) Permit easy retrieval in a timely fashion;
(2) Facilitate distinction between record and nonrecord material;
(3) Retain the records in a usable format until their authorized disposition date; and
(4) If the media contains permanent records and does not meet the requirements for transferring permanent records to NARA as outlined in 1228.270 of this chapter, permit the migration of the permanent records at the time of transfer to a medium which does meet the requirements.
(b) The following factors shall be considered before selecting a storage medium or converting from one medium to another:
(1) The authorized life of the records, as determined during the scheduling process;
(2) The maintenance necessary to retain the records;
(3) The cost of storing and retrieving the records;
(4) The records density;
(5) The access time to retrieve stored records;
(6) The portability of the medium (that is, selecting a medium that will run on equipment offered by multiple manufacturers) and the ability to transfer the information from one medium to another (such as from optical disk to magnetic tape); and
(7) Whether the medium meets current applicable Federal Information Processing Standards.
(c) Agencies should avoid the use of floppy disks for the exclusive long-term storage of permanent or unscheduled electronic records.
(d) Agencies shall ensure that all authorized users can identify and retrieve information stored on diskettes, removable disks, or tapes by establishing or adopting procedures for external labeling.
(e) Agencies shall ensure that information is not lost because of changing technology or deterioration by converting storage media to provide compatibility with the agency's current hardware and software. Before conversion to a different medium, agencies must determine that the authorized disposition of the electronic records can be implemented after conversion.
(f) Agencies shall back up electronic records on a regular basis to safeguard against the loss of information due to equipment malfunctions or human error. Duplicate copies of permanent or unscheduled records shall be maintained in storage areas separate from the location of the records that have been copied.
(g) Maintenance of magnetic computer tape. (1) Agencies shall test magnetic computer tapes no more than 6 months prior to using them to store electronic records that are unscheduled or scheduled for permanent retention. This test should verify that the tape is free of permanent errors and in compliance with National Institute of Standards and Technology or

industry standards.
(2) Agencies shall maintain the storage and test areas for computer magnetic tapes containing permanent and unscheduled records at the following temperatures and relative humidities:
Constant temperature -- 62 to 68oF.
Constant relative humidity -- 35% to 45%
(3) Agencies shall annually read a statistical sample of all reels of magnetic computer tape containing permanent and unscheduled records to identify any loss of data and to discover and correct the causes of data loss. In tape libraries with 1800 or fewer reels, a 20% sample or a sample size of 50 reels, whichever is larger, should be read. In tape libraries with more than 1800 reels, a sample of 384 reels should be read. Tapes with 10 or more errors should be replaced and, when possible, lost data shall be restored. All other tapes which might have been affected by the same cause (i.e., poor quality tape, high usage, poor environment, improper handling) shall be read and corrected as appropriate.
(4) Agencies shall copy permanent or unscheduled data on magnetic tapes before the tapes are 10 years old onto tested and verified new tapes.
(5) External labels (or the equivalent automated tape management system) for magnetic tapes used to store permanent or unscheduled electronic records shall provide unique identification for each reel, including the name of the organizational unit responsible for the data, system title, and security classification, if applicable. Additionally, the following information shall be maintained for (but not necessarily attached to) each reel used to store permanent or unscheduled electronic records: file title(s); dates of creation; dates of coverage; the recording density; type of internal labels; volume serial number, if applicable; number of tracks; character code/software dependency; information about block size; and reel sequence number, if the file is part of a multi-reel set. For numeric data files, include record format and logical record length, if applicable; data set name(s) and sequence, if applicable; and number of records for each data set.
(6) Agencies shall prohibit smoking and eating in magnetic computer tape storage libraries and test or evaluation areas that contain permanent or unscheduled records.
(h) *Maintenance of direct access storage media.* (1) Agencies shall issue written procedures for the care and handling of direct access storage media which draw upon the recommendations of the manufacturers.
(2) External labels for diskettes or removable disks used when processing or temporarily storing permanent or unscheduled records shall include the following information: name of the organizational unit responsible for the records, descriptive title of the contents, dates of creation, security classification,

if applicable, and identification of the software and hardware used.

§ 1234.32 Retention and disposition of electronic records.

Agencies shall establish policies and procedures to ensure that electronic records and their documentation are retained as long as needed by the Government. These retention procedures shall include provisions for:
(a) Scheduling the disposition of all electronic records, as well as related documentation and indexes, by applying General Records Schedules (particularly GRS 20 or GRS 23) as appropriate or submitting an SF 115, Request for Records Disposition Authority, to NARA (see part 1228 of this chapter). The information in electronic information systems, including those operated for the Government by a contractor, shall be scheduled as soon as possible but no later than one year after implementation of the system.
(b) Transferring a copy of the electronic records and any related documentation and indexes to the National Archives at the time specified in the records disposition schedule in accordance with instructions found in § 1228.270 of this chapter. Transfer may take place at an earlier date if convenient for both the agency and the National Archives and Records Administration.
(c) Establishing procedures for regular recopying, reformatting, and other necessary maintenance to ensure the retention and usability of electronic records throughout their authorized life cycle (see § 1234.28).
(d) Electronic mail records may not be deleted or otherwise disposed of without prior disposition authority from NARA (44 U.S.C. 3303a). This applies to the original version of the record that is sent or received on the electronic mail system and any copies that have been transferred to a recordkeeping system. See 36 CFR part 1228 for records disposition requirements.
(1) *Disposition of records on the electronic mail system.* When an agency has taken the necessary steps to retain the record in a recordkeeping system, the identical version that remains on the user's screen or in the user's mailbox has no continuing value. Therefore, NARA has authorized deletion of the version of the record on the electronic mail system under General Records Schedule 20, Item 14, after the record has been preserved in a recordkeeping system along with all appropriate transmission data.
(2) *Records in recordkeeping systems.* The disposition of electronic mail records that have been transferred to an appropriate recordkeeping system is governed by the records schedule or schedules that control the records in that system. If the records in the system are not scheduled, the agency shall follow the procedures at 36 CFR part 1228.

§ 1234.34 Destruction of electronic records.

Electronic records may be destroyed only in accordance with a records disposition schedule approved by the Archivist of the United States, including General Records Schedules. At a minimum each agency shall ensure that:

(a) Electronic records scheduled for destruction are disposed of in a manner that ensures protection of any sensitive, proprietary, or national security information.

(b) Magnetic recording media previously used for electronic records containing sensitive, proprietary, or national security information are not reused if the previously recorded information can be compromised by reuse in any way.

(c) Agencies shall establish and implement procedures that specifically address the destruction of electronic records generated by individuals employing electronic mail.

NARA Regulations

National Archives and Records Administration home page
URL: http://www.nara.gov/nara/cfr/cfr1234.html
webmaster@nara.gov
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National Archives and Records Administration
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Return to Subchapter B
Part 1234 was last amended on 5/16/2001

PART 1234 -- ELECTRONIC RECORDS MANAGEMENT

Authority: 44 U.S.C. 2904, 3101, 3102, and 3105.

Subpart A -- General

§ 1234.1 Scope of part.

This part establishes the basic requirements related to the creation, maintenance, use, and disposition of electronic records. Electronic records include numeric, graphic, and text information, which may be recorded on any medium capable of being read by a computer and which satisfies the definition of a record. This includes, but is not limited to, magnetic media, such as tapes and disks, and optical disks. Unless otherwise noted, these requirements apply to all electronic information systems, whether on microcomputers, minicomputers, or main-frame computers, regardless of storage media, in network or stand-alone configurations. This part also covers creation, maintenance and use, and disposition of Federal records created by individuals using electronic mail applications.

§ 1234.2 Definitions.

Basic records management terms are defined in 36 CFR

1220.14. As used in part 1234 --
Data base means a set of data, consisting of at least one data file, that is sufficient for a given purpose.
Data base management system means a software system used to access and retrieve data stored in a data base.
Data file means related numeric, textual, or graphic information that is organized in a strictly prescribed form and format.
Electronic information system. A system that contains and provides access to computerized Federal records and other information.
Electronic mail system. A computer application used to create, receive, and transmit messages and other documents. Excluded from this definition are file transfer utilities (software that transmits files between users but does not retain any transmission data), data systems used to collect and process data that have been organized into data files or data bases on either personal computers or mainframe computers, and word processing documents not transmitted on an e-mail system.
Electronic mail message. A document created or received on an electronic mail system including brief notes, more formal or substantive narrative documents, and any attachments, such as word processing and other electronic documents, which may be transmitted with the message.
Electronic record means any information that is recorded in a form that only a computer can process and that satisfies the definition of a Federal record in 44 U.S.C. 3301.
Electronic recordkeeping system. An electronic system in which records are collected, organized, and categorized to facilitate their preservation, retrieval, use, and disposition.
Text documents means narrative or tabular documents, such as letters, memorandums, and reports, in loosely prescribed form and format.
Transmission and receipt data.
(1) *Transmission data.* Information in electronic mail systems regarding the identities of sender and addressee(s), and the date and time messages were sent.
(2) *Receipt data.* Information in electronic mail systems regarding date and time of receipt of a message, and/or acknowledgment of receipt or access by addressee(s).

Subpart B -- Program Requirements

§ 1234.10 Agency responsibilities.

The head of each Federal agency shall ensure that the management of electronic records incorporates the following elements:
(a) Assigning responsibility to develop and implement an agencywide program for the management of all records

created, received, maintained, used, or stored on electronic media; and notifying the National Archives and Records Administration, Modern Records Programs (NWM), 8601 Adelphi Rd., College Park, MD 20740-6001 and the General Services Administration, Office of Government Policy (MKB), Washington, DC 20505, of the name and title of the person assigned the responsibility.
(b) Integrating the management of electronic records with other records and information resources management programs of the agency.
(c) Incorporating electronic records management objectives, responsibilities, and authorities in pertinent agency directives and disseminating them throughout the agency as appropriate.
(d) Establishing procedures for addressing records management requirements, including recordkeeping requirements and disposition, before approving new electronic information systems or enhancements to existing systems.
(e) Ensuring that adequate training is provided for users of electronic mail systems on recordkeeping requirements, the distinction between Federal records and nonrecord materials, procedures for designating Federal records, and moving or copying records for inclusion in an agency recordkeeping system;
(f) Ensuring that adequate training is provided for users of electronic information systems in the operation, care, and handling of the equipment, software, and media used in the system.
(g) Developing and maintaining up-to-date documentation about all electronic information systems that is adequate to: Specify all technical characteristics necessary for reading or processing the records; identify all defined inputs and outputs of the system; define the contents of the files and records; determine restrictions on access and use; understand the purpose(s) and function(s) of the system; describe update cycles or conditions and rules for adding information to the system, changing information in it, or deleting information; and ensure the timely, authorized disposition of the records.
(h) Specifying the location, manner, and media in which electronic records will be maintained to meet operational and archival requirements, and maintaining inventories of electronic information systems to facilitate disposition.
(i) Developing and securing NARA approval of records disposition schedules, and ensuring implementation of their provisions.
(j) Specifying the methods of implementing controls over national security-classified, sensitive, proprietary, and Privacy Act records stored and used electronically.
(k) Establishing procedures to ensure that the requirements of this part are applied to those

electronic records that are created or maintained by contractors.
(l) Ensuring compliance with applicable Governmentwide policies, procedures, and standards such as those issued by the Office of Management and Budget, the General Accounting Office, the General Services Administration, the National Archives and Records Administration, and the National Institute of Standards and Technology.
(m) Reviewing electronic information systems periodically for conformance to established agency procedures, standards, and policies as part of the periodic reviews required by 44 U.S.C. 3506. The review should determine if the records have been properly identified and described, and whether the schedule descriptions and retention periods reflect the current informational content and use. If not, or if substantive changes have been made in the structure, design, codes, purposes, or uses of the system, submit an SF 115, Request for Records Disposition Authority, to NARA.

Subpart C -- Standards for the Creation, Use, Preservation, and Disposition of Electronic Records

§ 1234.20 Creation and use of data files.

(a) For electronic information systems that produce, use, or store data files, disposition instructions for the data shall be incorporated into the system's design.
(b) Agencies shall maintain adequate and up-to-date technical documentation for each electronic information system that produces, uses, or stores data files. Minimum documentation required is a narrative description of the system; physical and technical characteristics of the records, including a record layout that describes each field including its name, size, starting or relative position, and a description of the form of the data (such as alphabetic, zoned decimal, packed decimal, or numeric), or a data dictionary or the equivalent information associated with a data base management system including a description of the relationship between data elements in data bases; and any other technical information needed to read or process the records.

§ 1234.22 Creation and use of text documents.

(a) Electronic recordkeeping systems that maintain the official file copy of text documents on electronic media shall meet the following minimum requirements:
(1) Provide a method for all authorized users of the system to retrieve desired documents, such as an indexing or text search system;
(2) Provide an appropriate level of security to ensure integrity of the documents;

(3) Provide a standard interchange format when necessary to permit the exchange of documents on electronic media between agency computers using different software/operating systems and the conversion or migration of documents on electronic media from one system to another; and
(4) Provide for the disposition of the documents including, when necessary, the requirements for transferring permanent records to NARA (see § 1228.270 of this chapter).
(b) Before a document is created electronically on electronic recordkeeping systems that will maintain the official file copy on electronic media, each document shall be identified sufficiently to enable authorized personnel to retrieve, protect, and carry out the disposition of documents in the system. Appropriate identifying information for each document maintained on the electronic media may include: office of origin, file code, key words for retrieval, addressee (if any), signator, author, date, authorized disposition (coded or otherwise), and security classification (if applicable). Agencies shall ensure that records maintained in such systems can be correlated with related records on paper, microform, or other media.

§ 1234.24 Standards for managing electronic mail records.

Agencies shall manage records created or received on electronic mail systems in accordance with the provisions of this chapter pertaining to adequacy of documentation, recordkeeping requirements, agency records management responsibilities, and records disposition (36 CFR parts 1220, 1222, and 1228).
(a) Agency instructions on identifying and preserving electronic mail messages will address the following unique aspects of electronic mail:
(1) Some transmission data (names of sender and addressee(s) and date the message was sent) must be preserved for each electronic mail record in order for the context of the message to be understood. Agencies shall determine if any other transmission data is needed for purposes of context.
(2) Agencies that use an electronic mail system that identifies users by codes or nicknames or identifies addressees only by the name of a distribution list shall instruct staff on how to retain names on directories or distributions lists to ensure identification of the sender and addressee(s) of messages that are records.
(3) Agencies that use an electronic mail system that allows users to request acknowledgments or receipts showing that a message reached the mailbox or inbox of each addressee, or that an addressee opened the message, shall issue instructions to e-mail users specifying when to request such receipts or acknowledgments for recordkeeping purposes and how to preserve them.

(4) Agencies with access to external electronic mail systems shall ensure that Federal records sent or received on these systems are preserved in the appropriate recordkeeping system and that reasonable steps are taken to capture available transmission and receipt data needed by the agency for recordkeeping purposes.
(5) Some e-mail systems provide calendars and task lists for users. These may meet the definition of Federal record. Calendars that meet the definition of Federal records are to be managed in accordance with the provisions of General Records Schedule 23, Item 5.
(6) Draft documents that are circulated on electronic mail systems may be records if they meet the criteria specified in 36 CFR 1222.34.
(b) Agencies shall consider the following criteria when developing procedures for the maintenance of electronic mail records in appropriate recordkeeping systems, regardless of format.
(1) Recordkeeping systems that include electronic mail messages must:
(i) Provide for the grouping of related records into classifications according to the nature of the business purposes the records serve;
(ii) Permit easy and timely retrieval of both individual records and files or other groupings of related records;
(iii) Retain the records in a usable format for their required retention period as specified by a NARA-approved records schedule;
(iv) Be accessible by individuals who have a business need for information in the system;
(v) Preserve the transmission and receipt data specified in agency instructions; and
(vi) Permit transfer of permanent records to the National Archives and Records Administration (see 36 CFR 1228.270 and 36 CFR 1234.32(a)).
(2) Agencies shall not store the recordkeeping copy of electronic mail messages that are Federal records only on the electronic mail system, unless the system has all of the features specified in paragraph (b)(1) of this section. If the electronic mail system is not designed to be a recordkeeping system, agencies shall instruct staff on how to copy Federal records from the electronic mail system to a recordkeeping system.
(c) Agencies that maintain their electronic mail records electronically shall move or copy them to a separate electronic recordkeeping system unless their system has the features specified in paragraph (b)(1). Because they do not have the features specified in paragraph (b)(1) of this section, backup tapes should not be used for recordkeeping purposes. Agencies may retain records from electronic mail systems in an off-line electronic storage format (such as optical disk or magnetic tape) that meets the requirements described at 36 CFR 1234.30(a). Agencies that retain permanent

electronic mail records scheduled for transfer to the National Archives shall either store them in a format and on a medium that conforms to the requirements concerning transfer at 36 CFR 1228.270 or shall maintain the ability to convert the records to the required format and medium at the time transfer is scheduled.
(d) Agencies that maintain paper files as their recordkeeping systems shall print their electronic mail records and the related transmission and receipt data specified by the agency.

§ 1234.26 Judicial use of electronic records.

Electronic records may be admitted in evidence to Federal courts for use in court proceedings (Federal Rules of Evidence 803(8)) if trustworthiness is established by thoroughly documenting the recordkeeping system's operation and the controls imposed upon it. Agencies should implement the following procedures to enhance the legal admissibility of electronic records.
(a) Document that similar kinds of records generated and stored electronically are created by the same processes each time and have a standardized retrieval approach.
(b) Substantiate that security procedures prevent unauthorized addition, modification or deletion of a record and ensure system protection against such problems as power interruptions.
(c) Identify the electronic media on which records are stored throughout their life cycle, the maximum time span that records remain on each storage medium, and the NARA-approved disposition of all records.
(d) Coordinate all of the above with legal counsel and senior IRM and records management staff.

§ 1234.28 Security of electronic records.

Agencies shall implement and maintain an effective records security program that incorporates the following:
(a) Ensures that only authorized personnel have access to electronic records.
(b) Provides for backup and recovery of records to protect against information loss.
(c) Ensures that appropriate agency personnel are trained to safeguard sensitive or classified electronic records.
(d) Minimizes the risk of unauthorized alteration or erasure of electronic records.
(e) Ensures that electronic records security is included in computer systems security plans prepared pursuant to the Computer Security Act of 1987 (40 U.S.C. 759 note).

§ 1234.30 Selection and maintenance of electronic records storage media.

(a) Agencies shall select appropriate media and systems for storing agency records throughout their life, which meet the following requirements:
(1) Permit easy retrieval in a timely fashion;
(2) Facilitate distinction between record and nonrecord material;
(3) Retain the records in a usable format until their authorized disposition date; and
(4) If the media contains permanent records and does not meet the requirements for transferring permanent records to NARA as outlined in 1228.270 of this chapter, permit the migration of the permanent records at the time of transfer to a medium which does meet the requirements.
(b) The following factors shall be considered before selecting a storage medium or converting from one medium to another:
(1) The authorized life of the records, as determined during the scheduling process;
(2) The maintenance necessary to retain the records;
(3) The cost of storing and retrieving the records;
(4) The records density;
(5) The access time to retrieve stored records;
(6) The portability of the medium (that is, selecting a medium that will run on equipment offered by multiple manufacturers) and the ability to transfer the information from one medium to another (such as from optical disk to magnetic tape); and
(7) Whether the medium meets current applicable Federal Information Processing Standards.
(c) Agencies should avoid the use of floppy disks for the exclusive long-term storage of permanent or unscheduled electronic records.
(d) Agencies shall ensure that all authorized users can identify and retrieve information stored on diskettes, removable disks, or tapes by establishing or adopting procedures for external labeling.
(e) Agencies shall ensure that information is not lost because of changing technology or deterioration by converting storage media to provide compatibility with the agency's current hardware and software. Before conversion to a different medium, agencies must determine that the authorized disposition of the electronic records can be implemented after conversion.
(f) Agencies shall back up electronic records on a regular basis to safeguard against the loss of information due to equipment malfunctions or human error. Duplicate copies of permanent or unscheduled records shall be maintained in storage areas separate from the location of the records that have been copied.
(g) Maintenance of magnetic computer tape. (1) Agencies shall test magnetic computer tapes no more than 6 months prior to using them to store electronic records that are unscheduled or scheduled for permanent retention. This test should verify that the tape is free of permanent errors and in compliance with

National Institute of Standards and Technology or industry standards.
(2) Agencies shall maintain the storage and test areas for computer magnetic tapes containing permanent and unscheduled records at the following temperatures and relative humidities:
Constant temperature -- 62 to 68oF.
Constant relative humidity -- 35% to 45%
(3) Agencies shall annually read a statistical sample of all reels of magnetic computer tape containing permanent and unscheduled records to identify any loss of data and to discover and correct the causes of data loss. In tape libraries with 1800 or fewer reels, a 20% sample or a sample size of 50 reels, whichever is larger, should be read. In tape libraries with more than 1800 reels, a sample of 384 reels should be read. Tapes with 10 or more errors should be replaced and, when possible, lost data shall be restored. All other tapes which might have been affected by the same cause (i.e., poor quality tape, high usage, poor environment, improper handling) shall be read and corrected as appropriate.
(4) Agencies shall copy permanent or unscheduled data on magnetic tapes before the tapes are 10 years old onto tested and verified new tapes.
(5) External labels (or the equivalent automated tape management system) for magnetic tapes used to store permanent or unscheduled electronic records shall provide unique identification for each reel, including the name of the organizational unit responsible for the data, system title, and security classification, if applicable. Additionally, the following information shall be maintained for (but not necessarily attached to) each reel used to store permanent or unscheduled electronic records: file title(s); dates of creation; dates of coverage; the recording density; type of internal labels; volume serial number, if applicable; number of tracks; character code/software dependency; information about block size; and reel sequence number, if the file is part of a multi-reel set. For numeric data files, include record format and logical record length, if applicable; data set name(s) and sequence, if applicable; and number of records for each data set.
(6) Agencies shall prohibit smoking and eating in magnetic computer tape storage libraries and test or evaluation areas that contain permanent or unscheduled records.
(h) *Maintenance of direct access storage media.* (1) Agencies shall issue written procedures for the care and handling of direct access storage media which draw upon the recommendations of the manufacturers.
(2) External labels for diskettes or removable disks used when processing or temporarily storing permanent or unscheduled records shall include the following information: name of the organizational unit responsible for the records, descriptive title of the

contents, dates of creation, security classification, if applicable, and identification of the software and hardware used.

§ 1234.32 Retention and disposition of electronic records.

Agencies shall establish policies and procedures to ensure that electronic records and their documentation are retained as long as needed by the Government. These retention procedures shall include provisions for:
(a) Scheduling the disposition of all electronic records, as well as related documentation and indexes, by applying General Records Schedules (particularly GRS 20 or GRS 23) as appropriate or submitting an SF 115, Request for Records Disposition Authority, to NARA (see part 1228 of this chapter). The information in electronic information systems, including those operated for the Government by a contractor, shall be scheduled as soon as possible but no later than one year after implementation of the system.
(b) Transferring a copy of the electronic records and any related documentation and indexes to the National Archives at the time specified in the records disposition schedule in accordance with instructions found in § 1228.270 of this chapter. Transfer may take place at an earlier date if convenient for both the agency and the National Archives and Records Administration.
(c) Establishing procedures for regular recopying, reformatting, and other necessary maintenance to ensure the retention and usability of electronic records throughout their authorized life cycle (see § 1234.28).
(d) Electronic mail records may not be deleted or otherwise disposed of without prior disposition authority from NARA (44 U.S.C. 3303a). This applies to the original version of the record that is sent or received on the electronic mail system and any copies that have been transferred to a recordkeeping system. See 36 CFR part 1228 for records disposition requirements.
(1) *Disposition of records on the electronic mail system.* When an agency has taken the necessary steps to retain the record in a recordkeeping system, the identical version that remains on the user's screen or in the user's mailbox has no continuing value. Therefore, NARA has authorized deletion of the version of the record on the electronic mail system under General Records Schedule 20, Item 14, after the record has been preserved in a recordkeeping system along with all appropriate transmission data.
(2) *Records in recordkeeping systems.* The disposition of electronic mail records that have been transferred to an appropriate recordkeeping system is governed by the records schedule or schedules that control the records in that system. If the records in the system are not scheduled, the agency shall follow the procedures at 36 CFR part 1228.

§ 1234.34 Destruction of electronic records.

Electronic records may be destroyed only in accordance with a records disposition schedule approved by the Archivist of the United States, including General Records Schedules. At a minimum each agency shall ensure that:

(a) Electronic records scheduled for destruction are disposed of in a manner that ensures protection of any sensitive, proprietary, or national security information.

(b) Magnetic recording media previously used for electronic records containing sensitive, proprietary, or national security information are not reused if the previously recorded information can be compromised by reuse in any way.

(c) Agencies shall establish and implement procedures that specifically address the destruction of electronic records generated by individuals employing electronic mail.

NARA Regulations

National Archives and Records Administration home page
URL: http://www.nara.gov/nara/cfr/cfr1234.html
webmaster@nara.gov
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Press Release

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For Immediate Release **November 16, 2001**

Monograph Provides Comprehensive Guide to Understanding and Managing Electronic Discovery

In the public's eye, the key battles of civil litigation are fought out between plaintiffs' and defendants' lawyers in court and in the pages of their hefty legal briefs. For those who practice law, the reality is that many lawsuits rise or fall on the unnoticed but intense battles over pre-trial gathering of information known as *discovery*. This process, which had become quite drawn out and contentious in the past two decades, is slowly becoming even more burdensome for litigants as an ever increasing amount of information is stored and produced in electronic form. With e-mail becoming more common than letters as a form of correspondence, and more corporations swearing off the accordion file and digitalizing their records and key documents, new opportunities are being created for plaintiffs' discovery requests, and in turn, unfamiliar challenges are arising for defendants and the judiciary.

In the latest edition of the Washington Legal Foundation's (WLF) educational Monograph series, four complex litigation specialists with the South Carolina law firm *Nelson Mullins Riley & Scarborough, LLP* provide a comprehensive overview of how electronically stored information has changed the landscape of document discovery. WLF is honored that the Monograph, ***A Corporate Counsel's Guide to Discovery in the Information Age***, features a foreword by one of the federal judiciary's leading voices on this issue, **Judge Shira A. Scheindlin** of the U.S. District Court for the Southern District of New York, and an introduction by the business community's foremost expert on electronic discovery, **Thomas Y. Allman**, Senior Vice President and General Counsel of BASF Corporation.

The authors provide a wealth of information in the Monograph's four main sections and fifty reader-friendly pages. The first section describes the types of electronically stored information that could be the target of discovery requests. This section shines an important spotlight on e-mail and the problems that its more casual nature have presented to corporate defendants when plaintiffs obtain such correspondence through discovery. The authors also focus on the unique discovery challenges that computers present, such as dealing with information hidden on back-up tapes and combating the often false notion that all electronic information can be more easily saved or retrieved than paper documents.

The next section provides a helpful historical overview of how federal rules governing discovery impact electronic documents, how such rules are now outdated in defining the scope of discovery, and what types of electronic documents are "discoverable." The discussion on the types of documents is particularly important, because it helps readers to grasp how broad plaintiffs' discovery requests can sweep. As the authors explain, even data which a computer user has consciously acted to delete from their hard drive can still be recovered by technicians.

The Monograph's third section is a short but instructive discussion of the need for reasonable limits on the extent of discovery and types of "documents" litigants can pursue. The authors advocate nation-wide rules which would dictate that requesting parties only have access to materials if they are "reasonably available to the producing party in the *normal course of business*." Such an approach has been adopted in the State of Texas and proposed by the American Bar Association to those who draft federal court rules. The authors also argue that courts should strictly enforce existing requirements that there be a balance between the burden of production and litigants' right to information.

The fourth and final section highlights some of the practical aspects of responding to requests for electronic documents. In this section, the authors touch upon nearly every major issue that should be of concern to litigants, courts, and the drafters of rules to govern electronic discovery. The topics addressed include: coping with preservation orders; assertion of attorney-client and work-product protections; objections to unreasonable requests; and production and preservation of data. The section ends with a sample "how to" approach for the typical business defendant facing protective orders requiring the preservation of all electronic data and the need to produce large volumes of electronic files.

Washington Legal Foundation is a national, non-profit public interest law and policy center. By utilizing a unique approach to forwarding its mission — publishing timely legal studies, engaging in innovative litigation, and communicating directly to the public — WLF has become the nation's most effective advocate of freedom and free enterprise. This Monograph is one of six free-standing formats in which WLF's Legal Studies Division produces legal policy papers and promotes free enterprise legal thought.

To obtain a copy of *A Corporate Counsel's Guide to Electronic Discovery,* forward a written request and a check for $10 per copy to: Publications Department, Washington Legal Foundation, 2009 Massachusetts Avenue, N.W., Washington, D.C. 20036.

WLF MONOGRAPH

"This Monograph ought to be required reading for every in-house counsel with litigation responsibility and part of every General Counsel's reference shelf for ongoing review of corporate policies and procedures."

Thomas Y. Allman
Senior Vice President and General Counsel
BASF Corporation

In this **Washington Legal Foundation** Monograph, four complex litigation specialists with the South Carolina law firm *Nelson Mullins Riley & Scarborough, LLP* provide a comprehensive overview of how electronically stored information has changed the landscape of document discovery prior to litigation. As the traditional "paper trail" of notes, correspondences, formal corporate records, and other data rapidly transforms to computer files, personal e-mail, and other electronic formats, litigants and the courts which referee their disputes face a litany of new, undefined challenges and controversies over the scope of discovery, its management, and many other issues.

This Monograph touches upon every major subject relating to electronic discovery, helping readers understand its historic development, the special compliance burdens it creates, and the way that courts have responded thus far on issues such as scope and privilege. In its final section, the guidebook offers an invaluable discussion of practical issues corporate counsels and their outside lawyers must face in responding to discovery requests, including preservation orders, objections to unreasonable requests, and the proper approach to producing electronic data.

A CORPORATE COUNSEL'S GUIDE TO DISCOVERY IN THE INFORMATION AGE

by
David E. Dukes
James K. Lehman
Michael W. Hogue
Jason Sprendle
Nelson Mullins Riley & Scarborough, LLP

Foreword
by
The Honorable Shira A. Scheindlin
U.S. District Court for the
Southern District of New York

Introduction
by
Thomas Y. Allman
Senior Vice President and General Counsel
BASF Corporation

Enclosed is my check for ____ copies of the Monograph "**A Corporate Counsel's Guide to Discovery in the Electronic Age**" at **$10 per copy**.

● Checks should be made payable to "Washington Legal Foundation" and sent to the attention of WLF's Publications Department.

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