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First Department Adopts 'Zubulake'

Two First Department Decisions Adopt 'Zubulake'

'Voom' and 'GreenPoint' bring clarity and guidance to state e-discovery.

BY DANIEL L. BROWN AND VALENTINA SHENDEROVICH

ANY REASONABLE ANALYSIS of the development of electronic discovery case law includes a discussion of Southern District of New York Judge Shira Scheindlin's *Zubulake* decisions[1] and, more recently, her decision in *Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec.*,[2] self-titled "Zubulake Revisited," in which Judge Sheindlin further elaborated on the scope of a party's discovery obligations to preserve and produce electronically stored information (ESI). The precedents established in the *Zubulake* cases and its progeny remain as guiding principles concerning the scope of a party's preservation obligations with respect to ESI, the implementation of and compliance

BIGSTOCK

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with litigation holds, the ability of a party to shift the costs of discovery to the other party, and sanctions for a party's, or his or her counsel's, failure to comply with the foregoing discovery obligations.

Until earlier this year, however, it remained uncertain whether some or all of the rules established in *Zubulake*, which applied the Federal Rules of Civil Procedure, would apply to litigants in New York state courts. Since no state appellate court had adopted *Zubulake* in whole or in part, its applicability remained unclear until two decisions by the Appellate Division, First Department, in early 2012. In January's *VOOM HD Holdings v. EchoStar Satellite*, 2012 N.Y. Slip Op. 00658, 2012 WL 265833 (1st Dept. Jan. 31, 2012), the First Department explicitly adopted the *Zubulake* standards to a party's obligation to implement a litigation hold. And, in February's *U.S. Bank National Association v. GreenPoint Mortgage Funding Inc.*, 2012 NY Slip Op 1515, 2012 N.Y. App. Div. LEXIS 1487, at *1 (1st Dept. Feb. 28, 2012), the First Department, "persuaded that *Zubulake* should be the rule in this Department," applied *Zubulake* to hold that the cost of production of ESI and other discovery must generally be borne by the producing party, thus resolving an important unsettled issue among New York state courts.

'VOOM'

VOOM arose from a 2005 affiliation agreement between VOOM and EchoStar whereby EchoStar agreed to distribute VOOM's television programming on its high-definition television channels. VOOM alleged that, upon determining that the deal was unprofitable in mid 2007, EchoStar began to explore ways to wrongfully terminate the agreement, threatening VOOM with termination throughout the fall of 2007, and formally terminating the agreement on Jan. 30, 2008. The following day, VOOM filed its complaint in New York State Supreme Court.

At issue in the trial court was VOOM's motion for sanctions based on EchoStar's alleged failure to comply with its discovery obligations. Specifically, VOOM alleged that EchoStar failed to implement a litigation hold prior to VOOM filing its lawsuit even though it should have reasonably anticipated litigation with VOOM. The trial court determined that: (1) EchoStar failed to issue a litigation hold until after VOOM commenced suit despite numerous indications that EchoStar foresaw VOOM's lawsuit well in advance of January 2008, and (2) EchoStar failed to take any steps to prevent the automatic deletion of e-mails. *VOOM*, 2012 WL 265833, at *4-5. In particular, the court found that:

> EchoStar's concession that termination would lead to litigation, together with the evidence establishing EchoStar's intent to terminate, its various breach notices sent to VOOM HD, its demands and express reservation of rights, all support the conclusion that EchoStar must have reasonably anticipated litigation prior to the commencement of this action.

Id. at *4. The court concluded that EchoStar reasonably anticipated litigation no later than June 20, 2007, the date its corporate counsel sent VOOM a letter containing a notice of breach, a demand, and an explicit reservation of rights.

Based on the foregoing, the trial court granted VOOM's motion for spoliation sanctions, relying heavily on the principles set forth in *Zubulake*. The court determined that an adverse inference sanction was appropriate based on EchoStar's grossly negligent conduct and because EchoStar was already on notice of its "substandard document practices" based on a ruling in an earlier decision.

The First Department affirmed and, in doing so, explicitly adopted the *Zubulake* (and *Pension Comm.*) standards concerning a party's preservation obligations, holding that such standard "is harmonious with New York precedent." *VOOM*, 2012 WL 265833, at *1. Thus, "[o]nce a party reasonably anticipates litigation, it must suspend its routine document retention/destruction policy and put in place a litigation hold." Id. at 5. The court rejected EchoStar's argument that litigation was not reasonably anticipated because the parties were seeking an "amicable business resolution," stating that the argument "ignores the practical reality that parties often engage in settlement discussions before and during litigation, but this does not vitiate the duty to preserve." Id. at *5.

The court also rejected the arguments of EchoStar and an amicus party urging the court not to adopt the *Zubulake* standard and, instead, to require actual litigation or notice of a specific claim to trigger the duty to preserve. Defendant and amicus argued that the vagueness of the term "reasonably anticipated" made

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the standard unworkable. The First Department disagreed, and, citing to the Sedona Conference guidelines, elaborated that a duty to preserve arises at "such time when a party is on notice of a credible probability that it will become involved in litigation." Id. at *7.

The court further explained that the duty to preserve "is not limited simply to avoiding affirmative acts of destruction…it is necessary for a party facing litigation to take active steps to halt that process." Id. at *5-6. To that end, the court set forth specific requirements for a proper and defensible litigation hold, which

> must direct appropriate employees to preserve all relevant records, electronic or otherwise, and create a mechanism for collecting the preserved records so they might be searched by someone other than the employee.

VOOM, 2012 WL 265833, at *6. The court emphasized that where the party is a large company, "it is insufficient…to vest total discretion in the employee…without the guidance and supervision of counsel." Id.

While the foregoing instructions from the *VOOM* court are familiar to those who practice in the federal courts, it is now also clear that, at least in the First Department, these principles apply to New York state court litigants. However, the *VOOM* case did not implicate the holding in *Zubulake* concerning the ability to shift the costs of discovery of ESI, leaving it a "confusing and unsettled" issue in New York state court.[3] However, that issue was resolved one month later in *U.S. Bank Nat'l Ass'n v. GreenPoint Mortgage Funding*, 2012 NY Slip Op 1515, 2012 N.Y. App. Div. LEXIS 1487 (1st Dept. Feb. 28, 2012).

'GreenPoint'

In *GreenPoint*, U.S. Bank sued GreenPoint Mortgage Funding, a now-defunct lender, for issuing mortgages to individuals with little or no documentation of income and assets and selling notes backed by those mortgages to investors. According to plaintiff, less than two years after the transaction at issue closed, approximately $530 million worth of the loans had been charged off as a total loss or were severely delinquent. U.S. Bank, the Indenture Trustee (after numerous assignments) to the holders of mortgage-backed notes issued by GreenPoint in 2005 and 2006, alleged "gross violations" by GreenPoint of the warranties it made when issuing the notes and a failure to honor its agreement to cure losses in the notes' value.

When U.S. Bank served GreenPoint with a request for discovery, GreenPoint asked the trial court to stay discovery and for a protective order conditioning the production of documents on the payment of production costs by the requesting party. In an order dated April 13, 2010, the trial court denied GreenPoint's request but agreed that "the well-settled rule in New York State" was that the party seeking discovery bears the cost of production. *GreenPoint*, 2012 N.Y. App. Div. LEXIS 1487, at *6.[4]

U.S. Bank appealed. The First Department disagreed with the trial court's endorsement of the "requester pays" rule, and held "it is the producing party that is to bear the cost of the searching for, retrieving, and producing documents, including electronically stored information." Id. at *4. The First Department noted that with respect to the issue of the allocation of costs among the requesting or producing party, the applicable authorities—the Civil Practice Law and Rules (CPLR) and the Rules of the Commercial Division for Supreme Court, Nassau County—are silent, and case law is inconsistent.[5] The First Department held that "*Zubulake* presents the most practical framework for allocating all costs in discovery, including document production and searching for, retrieving and producing ESI." Id. at *5.

As such, the First Department directed the trial courts to follow the seven factors set forth in *Zubulake* in deciding which party should bear the cost of production. These factors, which now guide the issue of whether or not the request constitutes an undue burden on the responding party such that costs should be shifted, are:

> (1) [t]he extent to which the request is specifically tailored to discover relevant information;
> (2) [t]he availability of such information from other sources;
> (3) [t]he total cost of production, compared to the amount in controversy;
> (4) [t]he total cost of production, compared to the resources available to each party;
> (5) [t]he relative ability of each party to control costs and its incentive to do so;
> (6) [t]he importance of the issues at stake in the litigation; and
> (7) [t]he relative benefits to the parties of obtaining the information.

GreenPoint, 2012 N.Y. App. Div. LEXIS 1487, at *10, citing *Zubulake*, 217 F.R.D. at 322.

GreenPoint argued that requiring the requesting party to pay for the costs of production is "sounder judicial practice and policy" because it encourages parties to self-regulate the scope of their discovery demands and discourages litigants from imposing

excessive costs upon an adversary. It further argued that a "requestor pays" rule promotes judicial efficiency by alleviating the court's inquiry into whether the information sought is worth the cost of the search. Citing *Zubulake*, the First Department rejected these arguments in favor of the strong public policy favoring resolution of disputes on their merits, noting that defendant's proposed rule could deter the filing of potentially meritorious claims, particularly where the plaintiff is an individual. *GreenPoint*, 2012 N.Y. App. Div. LEXIS 1487, at *12. The First Department also noted that commentators and courts have already called into question the underpinning of the requestor pays rule and observed that the long-standing rule in New York is that disclosure expenses are to be paid by the respective producing parties. Id. at *6.

Based on the foregoing, the First Department denied the defendant's fee shifting proposal. The court noted that the proper course of action would have been for the defendant to make a motion to limit or strike the discovery requests it found overbroad, irrelevant, or unduly burdensome prior to filing a motion seeking to shift the costs to the requesting party.

Conclusion

The *VOOM* decision was significant because it was the first New York Appellate Division court to adopt *Zubulake* in the context of a party's ESI preservation obligations. However, after *VOOM*, questions remained as to whether other aspects of the *Zubulake* decisions would apply in state court. The *GreenPoint* court clarified that the *Zubulake* standard regarding cost shifting also applies, and noted that "the courts adopting the *Zubulake* standard are moving discovery, in all contexts, in the proper direction." *GreenPoint*, 2012 N.Y. App. Div. LEXIS 1487, at *5. The adoption of *Zubulake* by New York state courts will not, of course, suddenly bring crystal clarity to a party's obligations and potential liabilities arising from its preservation and production duties. Indeed, courts will still need to apply a case-by-case approach to the issue of when a party should be deemed to "reasonably anticipate" litigation. However, the adoption of *Zubulake* by the *VOOM* and *GreenPoint* decisions provides valuable guidance concerning a party's obligations to implement a litigation hold and the obligation to pay for the costs of discovery. Moreover, while neither decision explicitly decreed that all aspects of *Zubulake* will be applied in New York state courts, it is now incumbent upon state court litigants to fully understand and implement each of the additional teachings of *Zubulake* and its progeny.

1. See *Zubulake v. UBS Warburg*, 217 F.R.D. 309 (S.D.N.Y. 2003); *Zubulake v. UBS Warburg*, 216 F.R.D. 280 (S.D.N.Y. 2003); Z*ubulake v. UBS Warburg*, 220 F.R.D. 212 (S.D.N.Y. 2003); *Zubulake v. UBS Warburg*, 229 F.R.D. 422 (S.D.N.Y. 2004) (collectively, *Zubulake*).

2. 685 F. Supp. 2d 456 (S.D.N.Y. 2010).

3. Joseph Capobianco & Gabrielle R. Schaich-Fardella, "Electronic Age Changes in Legal Practice, Which No Attorney Can Ignore," New York State Bar Association Journal, March/April 2012, at 31.

4. Under *Zubulake*, the producing party must initially bear the cost of production of ESI but may ask the court to shift the cost to the requesting party under certain circumstances. In sharp contrast, some New York state courts followed the "requestor pays" rule. Joint E-Discovery Subcommittee of the New York City Bar, *Manual for State Trial Courts Regarding Electronic Discovery Cost-Allocation*, Spring 2009, at 19 ("New York case law establishes that the requesting party bears the costs of producing discovery").

5. The court compared *Lipco Elec. v. ASG Consulting*, 4 Misc. 3d 1019(A), 2004 WL 1949062, at *9 (N.Y. Sup. Aug. 18, 2004), which held that "under the CPLR, the party seeking discovery should incur the costs incurred in production of discovery material," with other decisions, such as *MBIA Ins. v. Countrywide Home Loans*, 27 Misc. 3d 1061, 1075-76, 895 N.Y.S.2d 643 (2010), which pushed instead for adoption of the *Zubalake* standard, placing, at least initially, the cost of discovery on the producing party.