

# THE SEDONA CONFERENCE JOURNAL

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(post-public comment version)** *The Sedona Conference*

**Overview of Changes to *The Sedona Principles* in 2004** *The Sedona Conference*

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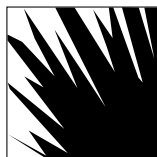
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*The Sedona Conference<sup>SM</sup> Journal* (ISSN 1530-4981) is published on an annual basis, containing approximately 15 selections from the preceding year's Conferences and Working Groups.

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*The Sedona Conference<sup>SM</sup> Journal* designed by  
Margo Braman of Studio D: [mbraman@sedona.net](mailto:mbraman@sedona.net).

Cite items in this volume to "5 Sedona Conf. J. \_\_\_\_ (2004)."

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## PUBLISHER'S NOTE

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Welcome to Volume Five of *The Sedona Conference<sup>SM</sup> Journal* (ISSN 1530-4981), an annual collection of approximately 15 articles originally presented at our conferences or prepared by our Working Groups over the past year. The Sedona Conference<sup>SM</sup> was founded in 1997 to provide a forum for advanced discussion by the nation's leading attorneys, academics and jurists of cutting-edge issues of law and policy in the areas of antitrust, intellectual property rights, and complex litigation. We host Regular Season Conferences and several Working Groups each year, providing unique and rewarding opportunities to seriously explore the boundaries of various areas of the law with those who are creating them. This volume of the *Journal* contains articles selected from our most recent Conferences on antitrust law and litigation (November 2003), patent litigation (November 2003), complex litigation (March 2004), and our Working Group on Electronic Document Retention and Production (October 2003).

We hope that you will find that the papers in this Journal reflect the same mix of theory and experience found at our Conferences and Meetings, including the bit of irreverence required to challenge traditional thinking. The views expressed herein are those of the authors', and we encourage the submission of counterpoint pieces. Submissions can be sent to us electronically at [tsc@sedona.net](mailto:tsc@sedona.net), or by mail to The Sedona Conference, 180 Broken Arrow Way South, Sedona, AZ 86351-8998, USA. If you are interested in participating in one of our Conferences (limited to 45 participants in addition to the 15-person faculty, to encourage the dialogue that is our hallmark), please visit our website for information on upcoming Conferences, as well as information on our Working Group Series: [www.thesedonaconference.org](http://www.thesedonaconference.org).

*Richard G. Braman  
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The Sedona Conference<sup>SM</sup> gratefully acknowledges the substantial contributions of its Conference faculty, Working Group participants, members and observers, and our Advisory Board members, whose volunteer efforts make The Sedona Conference<sup>SM</sup> a "thought-provoking and inspiring" experience providing content of immediate benefit to the Bench and Bar.

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# CASE MANAGEMENT ISSUES IN PATENT LITIGATION

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“Management is not an end in itself.  
It must be conducted to serve its purpose of bringing about  
‘the just, speedy, and inexpensive determination’ of the litigation,  
avoiding unnecessary and unproductive activity.”

MANUAL FOR COMPLEX LITIGATION  
Section 10.1, at 3 (West Pub. 3d. 1995) (quoting FED. R. CIV. P. 1).

## INTRODUCTION

From fast-tracking to bifurcation to special verdicts, judges and lawyers must decide an insurmountable number of procedures and considerations in a relatively short period of time. Such decisions may often dictate a winning or losing result in patent litigation cases. While judges may adopt special procedures for managing potentially difficult actions involving complex issues and difficult legal questions, *see* FED. R. CIV. P. 16 (c)(12), lawyers are often depended upon to provide practical guidance in the management of litigation. This paper examines the various procedures that judges and attorneys confront, and offers a practical guide in effectuating better case management. Part I discusses pretrial procedures and considerations, including claim limitations, Markman hearings, and discovery limitations. Part II explores trial procedures and considerations, including bifurcated trials.

### I. PRETRIAL PROCEDURES AND CONSIDERATIONS

#### A. Limitation on Claims

In presenting a patent case to the jury, counsel will normally address which claims of a patent that are being infringed upon. In a few cases, courts have restricted the number of claims that counsel may actually present. The Federal Circuit, while not squarely addressing this issue, has acknowledged the use of the court limiting claims so long as the party opposing the limitation is not prejudiced.

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In *ReRoof America, Inc. et al. v. United Structures of America, Inc.*, Nos. 98-1378, -1430, 1999 U.S. App. LEXIS 20788 (Fed. Cir. Aug. 30, 1999), the district court directed to the parties that the case be “made manageable for presentation to a jury”. *Id.* at \*2. Prior to trial, the plaintiff selected eighteen “illustrative” claims of five patents to present in its case. *Id.* Unsatisfied with this approach, the court struck thirteen of the eighteen claims, and ordered that plaintiff select a total of five claims—one from each patent—on which to go to trial. *Id.* at \*2, 10. The plaintiff lost at trial, and subsequently requested a new trial alleging prejudice because the court required the presentation of only five of its asserted claims. *Id.* at \*3. The trial court denied the motion. *Id.* On appeal to the Federal Circuit, the plaintiff renewed its objections and argued that the court’s limitation on allowing only five claims “disabled it from proving the full range of [defendant’s] infringing activities.” *Id.* at \*10. Instead of directly confronting the legitimacy of the issue, the Federal Circuit opined that “[n]ot having the opportunity to ‘impress’ a jury by presenting a large number of claims, however, does not constitute legally cognizable prejudice.” *Id.* at 15. The Circuit also noted that “there [was] no reasonable likelihood that a trial that included the 13 untried claims would have resulted in a verdict affording [plaintiff] any relief”, *id.* at \*11, and that “the trial court’s order [did not affect plaintiff’s] substantial rights” under 28 U.S.C. Section 2111 regarding harmless error. *Id.* at 15-16. *See also Kearns v. General Motors Corp.*, No. 93-1535, 1994 U.S. App. LEXIS 19568, at \*6-7 (Fed. Cir. Jul. 26, 1994) (since there were “51 claims in the five patents listed in the complaint and 232 total claims in all of [the plaintiff’s] patents”, the district court ordered to limit the “case to one representative claim per patent”).

Whether courts may properly limit the number of claims a party may present to a jury has yet to be decided. Proponents of claim limitation may argue that the tactic helps to expedite the case and effectuate case management. Opponents may counter such Court directives by (1) providing a clear set of guidelines as to the relevance and appropriate timing of presenting the claims;<sup>3</sup> (2) contending that such order runs afoul of the patent statutes’ intent that each patent claim’s validity is separated and independent from the validity of other claims of the patent; and (3) preserving the record for appeal, and making offers of proof pursuant to FED. R. EVID. 103 (a)(2).

## B. Markman Proceedings

Markman briefs and hearings are a critical part of patent litigation proceedings because the court’s rulings on claim construction and interpretation often determine the outcome of the case. *See Markman v. Westview Instruments, Inc.*, 52 F.3d 967, 989 (Fed. Cir. 1995) (en banc) (Mayer, J., concurring) (“to decide what the claims mean is nearly always to decide the case”), *aff’d*, 517 U.S. 370 (1996).

### *Procedural Timing*

From the outset, there is no uniform rule on when parties should file Markman briefs, or when judges should order Markman hearings. *See Vivid Techs., Inc. v. American Science & Engineering, Inc.*, 200 F.3d 795, 803 (Fed. Cir. 1999) (refusing to adopt uniform rule that claim construction be done no earlier than end of discovery—“We see no need for such a rule, for the state at which the claims are construed may vary with the issues, their complexity, the potentially dispositive nature of the construction, and other considerations of the particular case.”).

<sup>3</sup> In *St. Clair Intellectual Property Consultants, Inc. v. Sony Corp. et al.*, No. 01-557-JJF (D. Del. Feb. 21 2003), St. Clair’s lawsuit focused on a manageable set of claims and was directed to a defined class of multiple-format digital cameras. Relying on *ReRoof America* and *Kearns*, *supra*, defendants argued that a Court order for a limited number of claims was necessary for efficient case management. The Court denied defendants’ request. The parties were able to efficiently address fifteen claims in their expert reports and depositions. The entire infringement and damages case was tried, allocating just fourteen hours to each party. The jury found infringement of the claims in less than two days of deliberation.



Determining when to conduct Markman proceedings, however, can be of utmost importance. See *Control Resources, Inc. v. Delta Electronics, Inc.*, 133 F.3d 2d 121, 126 (D. Mass. 2001) (“Timing [of Markman] is everything.”). Generally, there are four phases of conducting Markman proceedings: (1) early in the case, before discovery; (2) near end of discovery, in conjunction with summary judgment; (3) in conjunction with summary judgment; and (4) late in the case, during or after trial.

### 1. Early in the Case, Before Discovery

Conducting Markman proceedings early in the case is preferable if it is “known with reasonable certainty which claim terms [are] at issue with respect to infringement [and] discovery [is] not needed for [that] purpose.” *Vivid Techs., Inc., supra*, 200 F.3d at 803; see *Aspex Eyeware, Inc. v. Elite Optik, Inc.*, No. 3:98-CV-2996-D, 2001 U.S. Dist. LEXIS 2088 (N.D. Tex. Feb. 27, 2001) (construing claims despite fact that discovery was not complete because defendant had admitted previously that scope of claim was clear). They may also be combined with hearings relating to preliminary injunctions. See *Int'l Communication Materials, Inc. v. Ricoh Co.*, 108 F.3d 316, 318 (Fed. Cir. 1997). The rationale for conducting Markman proceedings earlier is that it promotes various efficiencies, such as early settlement between the parties, or discovery use of pinpointed, pertinent facts.

Otherwise, most courts have discredited use of Markman proceedings at an early stage. See *Thomson Consumer Electronics, Inc. v. Innovatron, S.A.*, 43 F. Supp. 2d 26, 29 (D.D.C. 1999) (court had “some misgivings” of writing an opinion at such an early stage because no “information concerning how a certain construction might influence either the infringement or validity analysis”); *Toter Inc. City of Visalia*, 44 U.S.P.Q.2d 1312, No. CV-F-96-6234, 1997 U.S. Dist. LEXIS 18898, at \*10 (E.D. Cal. Jul. 11, 1997) (sympathizing with plaintiff’s concern that terms in dispute were not known, “the court agrees that some discovery at the very least is necessary prior to the *Markman* hearing. Accordingly the court today finds that an early *Markman* hearing would not promote the interest of judicial economy and refuses to schedule one”); *Certillion Data Systems, Inc. v. American Management Systems, Inc.*, 138 F. Supp. 2d 1117, 1120 (S.D. Ind. 2001) (“before a *Markman* issue is ripe, discovery or case management should have progressed to the point whether the parties and the court can be reasonably certain which claim terms are at issue, in other words, which claims and elements the plaintiff alleges were infringed”).

### 2. Near End of Discovery

The normal practice of most courts is to schedule a Markman hearing near the end of discovery. Constance S. Huttner et al., *Markman Practice, Procedures and Tactics*, 531 PLI/Pat 535, at 538 (Sept. 1998); see, e.g., *Mantech Envtl. Corp. v. Hudson Envtl. Servs., Inc.*, 152 F.2d 1368, 1370 (Fed. Cir. 1998) (Markman hearing held immediately before trial). Practical reasons advising this approach include (1) discovery may be taken as to the level of one skilled in the art—the standard by which the claims must ultimately be construed, (2) courts and litigants will have a better understanding of how claim construction fits into the case, and (3) as noted below, claim construction can be combined with, or at least be close to, summary judgments of non-infringement or invalidity.

### 3. In Conjunction with Summary Judgment

Several courts, including the Federal Circuit, prefer combining Markman briefs and hearings with summary judgment motions. See, e.g., *Athletic Alternatives, Inc. v. Prince Mfg., Inc.*, 73 F.3d 1573, 1578 (Fed. Cir. 1996) (“Where, as here, the parties do not dispute

any relevant facts regarding the accused product but disagree over claim construction, the question of literal infringement collapses to one of [claim interpretation] and is thus amenable to summary judgment.”); *MediaCom Corp. v. Rates Tech.*, 4 F. Supp. 2d 17, 22 (D. Mass. 1998) (“[L]ike any other determination of a legal rule, such a [Markman] hearing should take place in the context of conventional motion practice.”); *Mannington Mills, Inc. v. Armstrong World Industries, Inc.*, 218 F. Supp. 2d 594, 596 (D. Del. 2002) (arguments on claim construction and pretrial case-dispositive motions consolidated into a single Markman hearing); *V-Formation, Inc. v. Bennetton Group*, No. 01-610, 2002 U.S. Dist. LEXIS 22394 (S.D.N.Y. Nov. 19, 2002) (upon defendant’s motion for summary judgment, court held joint Markman hearing and oral argument on summary judgment motion); *but see Thomson Consumer Electronics, Inc. v. Innovatron, S.A.*, 43 F. Supp. 2d 26, 28 (D.D.C. 1999) (expressing concern with claim construction in non-dispositive sense).

#### 4. Late in the Case, Near the End of Trial

Other courts will not construe Markman briefs until after discovery is completed or near the end of trial. *See, e.g., Vitronics Corp. v. Conceptoronic, Inc.*, 90 F.3d 1576 (Fed. Cir. 1996) (claim construction delayed until close of trial testimony); *Medtronic, Inc. v. Advanced Cardiovascular Sys., Inc.*, 248 F.3d 1303, 1305 (Fed. Cir. 2001) (affirming construction of claims and entry of directed verdict prior to closing argument at trial). Indeed, the Markman case resulted from a post-trial claim construction that apparently differed from the claim construction that was presented to the jury.

A late claim construction ruling, however, can present enormous difficulties to the parties since it may trigger the need for more factual findings after discovery has already closed, or require the revision of written expert reports. *See Cybor Corporation v. FAS Techs.*, 138 F.3d 1448, 1474 n.2 (Fed. Cir. 1998) (Rader, J., dissenting).

Claim construction issues are also a typical subject of post-trial motions for a new trial or judgment as a matter of law. *See Markman*, 52 F.3d at 973.

#### *Local Procedural Rules*

A few district courts have adopted local rules requiring a number of early special pleadings intended to refine claim construction issues for Markman hearings, typically well before trial and the close of discovery. The Northern District of California is the seminal court that districts have adopted. *See, e.g., Digimarc Corp. v. Signum Technologies Ltd.*, No. CV-00-394-ST, 2001 U.S. Dist. LEXIS 7783, at \*3-4 (D. Ore. May 25, 2001) (adopting Northern District of California Local Rules for patent cases); *Precision Shooting Equipment, Inc. v. High Country Archery*, 1 F. Supp. 2d 1041, 1042 (D. Ariz. 1998) (using Northern District’s rules as guide for order on motion for Markman hearing).

Under the rules of the Northern District of California, there are very specific requirements for scheduling. For example, within 10 days after the Initial Case Management Conference the plaintiff must serve a disclosure of infringed claims and accused products for each claim. The disclosure must include a chart identifying where each claim limitation is found within each accused product and whether infringement is literal or under the doctrine of equivalents. Pat. L. R. 3-1 (N.D. Cal. 2001). In conjunction with this disclosure, the patentee must produce a copy of the patent file histories and all documents evidencing conception, reduction to practice, and first sale if it predates the patent application date.

Forty-five days after the patentee's disclosure, the parties opposing infringement must serve preliminary invalidity contentions including a full disclosure of the prior art, how the prior art invalidates the claims, and any motivation to combine references. See Pat. L. R. 3-3 (N.D. Cal. 2001). These disclosures must be accompanied by all prior art so identified, and documentation sufficient to show the operation of the accused products.

Within ten days of the service of preliminary invalidity contentions, the parties must simultaneously exchange a list of claim terms that should be construed by the court. Pat. L. R. 4-1 (N.D. Cal. 2001). The parties are instructed to meet and confer to narrow this list, but not later than 20 days later the parties must simultaneously exchange a preliminary proposed construction. Pat. L. R. 4-2 (N.D. Cal. 2001).

Before 60 days after service of the preliminary invalidity contentions, the parties must file a Joint Claim Construction and Prehearing Statement that covers, among other items, agreed-upon constructions, disputed terms and proposed constructions, and the required length of the Claim Construction Hearing. Pat. L. R. 4-3(a)-(e) (N.D. Cal. 2001).

### *Forms of Markman Proceedings*

The Markman hearing can take as many forms as there are district court judges. Probably the most common technique for conducting a Markman hearing is strictly on the basis of attorney argument during a short (half day) hearing. See, e.g., *Aspex*, 2001 U.S. Dist. LEXIS at \*6 (denying request for Markman hearing and deciding claim construction on briefs and argument because "technology is accessible to the court and the claims are relatively straightforward"). The use of demonstrative exhibits in such hearings is generally limited to those that emphasize the particular intrinsic evidence most helpful to the attorney's position, such as large exhibit boards, Trial Director software, or PowerPoint presentations.

Since the Federal Circuit has recognized that expert testimony can be relevant to the claim construction process, see *Pitney Bowes v. Hewlett-Packard Co.*, 182 F.3d 1298, 1308 (Fed. Cir. 1999), it is not uncommon for some Markman hearings to resemble mini-trials where testimony or affidavits from technical experts describes the underlying technology and informs the Court's claim construction. See *Pall Corp. v. Cuno, Inc.*, No. 97-CV-7599, 2001 U.S. Dist. LEXIS 16778 (E.D.N.Y. Sept. 7, 2001). In fact, one court has recently stated a strong desire that technical experts be called in Markman hearings with a relatively high degree of complexity. See *Borgwarner, Inc. v. New Venture Gear, Inc.*, No. 00-C-7470, 2002 U.S. Dist. LEXIS 24736 (N.D. Ill. Dec. 26, 2002). In *Borgwarner*, a rather displeased court stated:

In this case, the parties inform us that one of "ordinary skill" in the art is a person with a Bachelor of Science Degree in engineering, with several years of experience in building and designing transfer cases. At the Markman hearing, the parties indicated, however, that expert testimony would not be necessary to their presentations, and neither had their expert attend the proceedings. Nevertheless, the parties referred throughout the proceedings to interpretations based on the understanding of one skilled in the art. While it is true that both sides included reports from their respective experts, those reports—obviously—simply supported the interpretations the parties advanced. In a situation where the parties call upon the court to interpret a dozen intricate claims, some of which are interrelated, in an area outside the court's expertise, live testimony, with opportunity for cross-examination and questions from the court, would have been of real value.

*Id.* at \*11-12.

Several courts have appointed neutral experts or technical advisors to assist, *see MediaCom Corp. v. Rates Tech., Inc.*, 4 F. Supp. 2d 17, 29-30 n.11 (D. Mass. 1998), and some courts have appointed special masters to make initial rulings on claim construction, subject to plenary review by the court. *See Rodime PLC v. Seagate Tech, Inc.*, 174 F.3d 1294, 1300-01, 50 U.S.P.Q.2d 1429, 1433 (Fed. Cir. 1999); *cf. Smith & Nephew, Inc. v. Ethicon, Inc.*, 276 F.3d 1304, 1307 (Fed. Cir. 2001) (referring claim construction to magistrate judge).

### *Appeals From Markman Proceedings*

On appeal, the Federal Circuit reviews claim construction *de novo*, including any factual determinations related to the question. *Cybor Corp.*, 138 F.3d at 1456. That standard of review had not so far prompted the Federal Circuit to consider any interlocutory appeals on certified questions from claim construction rulings, even though the Federal Circuit has freely acknowledged that claim construction rulings are often outcome-dispositive and have been ultimately overturning nearly half of those decisions. *See Schering Corporation v. Amgen, Inc.*, 35 F. Supp. 2d 375, 377 (D. Del. 1999) (“the Federal Circuit disfavors direct appeals from Markman decisions.”); *see also Omniglow Corporation v. Unique Industries, Inc.*, 2002 U.S. App. LEXIS 13078 (Fed. Cir. May 7, 2002) (unpublished denial of permission to appeal certified claims construction). As a result, some district courts have been forced to conduct two trials, one with and one without the Federal Circuit’s ultimate claim construction. In several cases now, patent holders have requested courts to enter judgments of noninfringement before trial, based on adverse claim construction rulings, in order to expedite appeal, and avoid meaningless trials. *See Interactive Gift Express, Inc. v. Compuserve Inc.*, 256 F.3d 1323, 1327 (Fed. Cir. 2001) (appeal followed stipulated order and judgment after claim construction ruling); *Schering Corp. v. Amgen, Inc.*, 222 F.3d 1347, 1349 (Fed. Cir. 2000); *Mantech Envtl. Corp. v. Hudson Envtl. Servs., Inc.*, 152 F.3d 1368, 47 U.S.P.Q.2d 1732 (Fed. Cir. 1998) (appeal from summary judgment based on patentee’s concession).

The Federal Circuit’s consistent refusal to hear interlocutory appeals of claim constructions may change in the relatively near future, as Federal Circuit judges have noted concerns, *see Cybor Corp.*, 138 F.3d at 1479 (additional views of Judges Newman and Meyer noting that unnecessary trials or second trials are consequences of failure to provide early finality to claim construction), and commentators have encouraged the Federal Circuit to accept such appeals. *See* Craig Allen Nord, *Intellectual Property Challenges in the Next Century: Process Considerations in the Age of Markman and Montros*, 2001 U. Ill. L. Rev. 355 (2001).

### C. Disclosure of Otherwise Privileged Communications

Often parties make a tactical decision to intentionally waive otherwise privileged communications in order to bolster their theory or claims in a case. A client may waive the privilege by disclosure of some privileged communication, or by asserting reliance upon the advice of counsel as an essential element of his or her defense. *In re ML-Lee Acquisition Fund*, 859 F. Supp. 765, 766 (D. Del. 1994). For example, a party may voluntarily disclose draft patent applications as evidence of a pre-filing date of invention.

Once a party discloses otherwise privileged communications, the scope of waiver of the attorney-client privilege as to other communications and documents varies depending on the jurisdiction, in part, because the application of the attorney-client privilege is a question

of fact, and made on a case-by-case basis. *In re Spalding*, 203 F.3d 800, 805 (Fed. Cir. 2000); *American Standard, Inc. v. Pfizer Inc.*, 828 F.2d 734, 744-45 (Fed. Cir. 1987) (“courts have not been clear and of one mind in applying the privilege to communications from attorney to client”).<sup>4</sup> Therefore, parties should look to regional circuit law on the waiver of attorney-client privilege. See *In re Vixx*, 18 Fed. Appx. 821, 823 (Fed. Cir. 2001). Regardless, the privilege holder has the burden of convincing the court that it has not waived the privilege. *Id.*

A party must make a pivot on deciding whether to disclose or refuse to disclose otherwise privileged communications before pre-trial discovery ends. See, e.g., *W.L. Gore & Assoc., Inc. v. Tetratec Corp.*, 15 U.S.P.Q.2d (BNA) 1048, 1051 (E.D. Pa. 1989). Otherwise, they may be precluded from introducing the privileged evidence at trial. Donald S. Chisum, CHISUM ON PATENTS Section 20.03[4][b][v][J], at 20-430 (2001).

#### D. Discovery Limitations

Discovery in complex litigation, characterized by multiple parties, difficult issues, voluminous evidence, and large numbers of witnesses, tends to proliferate and become excessively costly, time consuming, and burdensome. Judicial discretion and parties’ early involvement, therefore, is imperative for effective management. See COMPLEX LITIGATION Section 21.4, at 54. Several courts limit depositions, interrogatories, and document requests during the discovery period.<sup>5</sup> The limitations take a variety of forms, including time limits, restrictions on scope and quantity, and sequencing. See COMPLEX LITIGATION Section 21.421, at 57. Among other provisions, FED. R. CIV. P. 16 (b) directs the court to limit the time for discovery, and FED. R. CIV. P. 26 (b) directs the court to limit the “frequency or extent of use of the discovery methods[.]” Parties should address discovery issues in their proposed discovery plan. See FED. R. CIV. P. 26 (f)(3).

#### Depositions

The court has broad authority to limit depositions. There is a presumptive limit of ten depositions per side. See FED. R. CIV. P. 30 (a)(2)(A) and 31 (a)(2)(A) (imposing a presumptive limit of ten depositions each for plaintiffs, defendants, and third-party defendants; FED. R. CIV. P. 26 (b)(2) and 30 (d)(2) (authority to limit number and length of depositions)). Parties may also stipulate a reasonable limit, including the imposition of setting a discovery cutoff date and trial date. Parties may consider whether there is an appropriate or effect limit on the number of depositions allowed, and in some cases, the number of hours of depositions granted.

Pursuant to FED. R. CIV. P. 30 (b)(6), parties may depose an organization in which several persons may be deposed simultaneously, either in person or by telephone, in a conference setting. Questions may arise as to how these depositions are calculated in the court’s order for allocation of time.

When deposing persons in foreign countries, parties should look to FED. R. CIV. P. 28 (b). Parties may request depositions (1) pursuant to any applicable treaty or convention;

<sup>4</sup> However, most courts, including one case in the Federal Circuit, are increasingly adopting the view that disclosing privileged communications amounts to a limited waiver of only related communications “on the same subject matter.” *Vixx*, 18 Fed. Appx. at 824; *United States v. Jacobs*, 117 F.3d 82, 89 (2d Cir. 1997); *United States v. Mendelsohn*, 896 F.2d 1183, 1188-89 (9th Cir. 1990); *Weil v. Investment Indicators, Research and Management, Inc.*, 647 F.2d 18, 24-25 (9th Cir. 1981); *Katz et al. v. AT&T Corp.*, 191 F.R.D. 433, 440 (E.D. Pa. 2000) (“the scope of the waiver” is “narrowly construed” and “informed both by the purpose served by the disclosure and the content of the disclosure”).

<sup>5</sup> Discovery related to claim construction is limited under the Northern District of California’s rules. Following the filing of the Joint Statement, the parties have only 30 days to complete discovery relevant to claim construction. Pat. L. R. 4-4 (N.D. Cal. 2001). Indeed, the party claiming patent infringement must file its opening claim construction brief not later than 45 days after filing the Joint Statement. Pat. L. R. 4-5(a) (N.D. Cal. 2001). Given the rigorous schedule, it is critical that a plaintiff have the case well-prepared before filing.

(2) pursuant to a letter of request; (3) on notice before a person authorized to administer oaths in the place where the examination is held, either by the law thereof or by the law of the United States; or (4) before a person commissioned by the court, and a person so commissioned shall have the power by virtue of the commission to administer any necessary oath and take testimony. FED. R. CIV. P. 28 (b).

### *Interrogatories*

FED. R. CIV. P. 33 (a) imposes a presumptive limit of twenty-five interrogatories, including subparts or subsections. In complex patent litigation, the ranger of potentially relevant facts is great and much largely noncontroversial background information must be gathered. Thus, adhering to the limitation of twenty-five interrogatories may be counterproductive. Parties may seek leave to file additional interrogatories, or stipulate a limitation with opposing counsel. COMPLEX LITIGATION Section 21.46, at 91-92.

### E. Summary Judgment Limitations

Summary Judgment motions are often made in conjunction with Markman proceedings. See section B.3, page 5, *supra*. Summary judgment motions help clarify and define issues and the scope of further discovery if necessary. See COMPLEX LITIGATION Section 21.34 at 51. The plethora of summary judgment motions can be quite litigious in complex litigation. To avoid the filing of unproductive motions, the court may require a prefiling conference in order to ascertain whether issues are appropriate for summary judgment, whether there are disputed issues of fact, and whether the motion, if granted, is likely to expedite the termination of the litigation. *Id.* Parties may consider whether the court has preferences regarding the timing of the motions, or whether a trial is preferred otherwise. The courts should attempt to ruling on such motions promptly. Deferring until the final pretrial conference “tends to defeat [the party’s] purpose of expediting the disposition of issues.” *Id.* at 53.

### F. Use of Technology Tutorials

At times the court will request a general explanation of the substance and terminology of the science or technology involved in the subject matter of the patent before attempting to decide motions, discovery plans, and trial. See COMPLEX LITIGATION Section 33.61 at 359. At an early stage in the litigation, the court may request that parties provide a general overview of the technical information, such as the definition of key terms and concepts. This procedure may occur in a joint statement of uncontested and contested facts under FED. R. CIV. P. 16 (c)(1), or at an informal pretrial conference where parties’ present experts to opine on the patent technology. Some of the expert testimony during pretrial briefings and conferences may overlap with subsequent expert testimony during trial, the difference being that the former provides a “more nonadversarial setting to learn the fundamentals—the vocabulary and general intellectual framework of the subject matter—in order to deal more intelligently with issues arising during the trial.” *Id.* Tutorials to the jurors may be given at the beginning of the trial by parties’ experts or court-appointed experts. *Id.*

## II. TRIAL PROCEDURES AND CONSIDERATIONS

### A. Bifurcation of Trials

Pursuant to FED. R. CIV. P. 42 (b),<sup>6</sup> bifurcation for trial may be advisable to (1) avoid unnecessary time and expense of discovery and trial; (2) help clarify and simplify the otherwise complexity of issues before a jury; and (3) reduce potential prejudice of one party. *Ciena Corp. v. Corvis Corp.*, 210 F.R.D. 519, 520-21 (D. Del. 2002) (advocating bifurcation of patent cases to reduce prejudice and jury confusion and to simplify trial issues); *Cardinal Chem. Co. v. Morton Int'l, Inc.*, 113 S. Ct. 1967 (1993) (Supreme Court indicating that the district court should resolve invalidity issues even if no infringement is found); see COMPLEX LITIGATION Section 33.62, at 361. The party seeking bifurcation has the burden of demonstrating that judicial economy would be promoted and that no party would be prejudiced by separate trials. *Princeton Biochemicals, Inc. v. Beckman Instr., Inc.*, 180 F.R.D. 254, 256 (D. N.J. 1997) (citing *Spectra-Physics Lasers, Inc. v. Uniphase Corp.*, 144 F.R.D. 99, 101 (N.D. Cal. 1992)).

In most cases, damages should be severed from other issues to simplify the task of the fact finder. See COMPLEX LITIGATION Section 33.62, at 361. Sometimes trifurcation of the statutory issues, equitable defenses, and damages may be advisable. *Id.* A defendant facing a willful infringement charge should consider the possibility of separating the trial on the issues of liability from the trial on damages and willfulness. See *Nam Jin Yeu v. Kim*, Nos. 91-1034, 91-1035, 1991 U.S. App. LEXIS 17880, at \*1 (Fed. Cir. Jul. 31, 1991); see also *Rhone-Poulenc Agro v. Genetics*, Nos. 00-1218, -1350, 2003 U.S. App. LEXIS 19971, at \*4 (Fed. Cir. Sept. 29, 2003) (affirming the decision where the district court bifurcated the trial between two different juries, with the first jury deciding the licensing and technology transfer issues and the second jury deciding the trade secret and patent infringement claims). Bifurcating the trials on liability from willfulness defers discovery of evidence of willfulness until the patentee prevails on the issue of liability.

In *Quantum Corp. v. Tandon Corp.*, 940 F.2d 642 (Fed. Cir. 1991), the Federal Circuit discussed bifurcation of willfulness from liability. Given the large number of patents, claims, and accused products at in some cases, an order of bifurcation will streamline discovery and simplify the parties' presentations at trial. A separate trial on liability is also very likely to eliminate the need for an inquiry into willfulness with respect to all, or at least some, of the patents in suit, while at the same time causing no prejudice to either party. A balancing of the risks and benefits of bifurcation reveals that ordering bifurcation of discovery and trial simplifies the trial and leads to the least amount of prejudice for either party.

In addition, the choice between waiving or maintaining the attorney-client privilege raises a dilemma for the accused party if bifurcation occurs, or if the defendant asserts the advice of counsel defense. In *Quantum Corp.*, the Federal Circuit addressed the dilemma an accused party faces when deciding whether to "choose between waiving the privilege in order to protect itself from a willfulness finding, in which case it may risk prejudicing itself on the question of liability, and maintaining the privilege, in which case it may risk being found to be a willful infringer if liability is found." *Id.* at 644. In order to minimize this dilemma, the Federal Circuit has encouraged trial courts to "give serious

<sup>6</sup> Rule 42 (b) reads:

The court, in furtherance of convenience or to avoid prejudice, or when separate trials will be conducive to expedition and economy, may order a separate trial of any claim, . . . or of any separate issues . . . , always preserving inviolate the right of trial by jury as declared by the Seventh Amendment to the Constitution or as given by a statute of the United States.  
FED. R. CIV. P. 42 (b).

consideration to a separate trial on willfulness whenever the particular attorney-client communications, once inspected by the court, *in camera*, reveal that the defendant is indeed confronted with this dilemma.” *Id.* And by relying on any advice of counsel in defense to a charge of infringement, the accused party must produce any opinions of counsel to opposing counsel. This presents what has become known as the “Quantum dilemma.” The “Quantum dilemma” is likely one reason why “[b]ifurcation, while perhaps not routine, is nonetheless common in patent litigation.” *Yamaha Hatsudoki Kabushiki Kaisha v. Bombardier Inc.*, 59 U.S.P.Q.2d 1088, 1090 (C.D. Cal. 2001);

Holding separate trials also raises an issue of when discovery of willfulness should be conducted—before or after a finding of infringement. The court must also decide whether to recall the jury or impanel a new jury. And the parties must decide on when is the appropriate time to file an appeal, either interlocutory, or after all of the trials.

### B. Time Limitations

Ordinarily limits on time and on evidence will be set at the pretrial conference in order that counsel can plan accordingly before the trial begins. *See* COMPLEX LITIGATION Section 22.35, at 144. The court may authorize the parties to “exercise reasonable control over the mode and order of interrogating witnesses and presenting evidence so as to (1) make [it] effective for the ascertainment of the truth, (2) avoid needless consumption of time, and (3) protect witnesses from harassment or undue embarrassment.” FED. R. EVID. 611 (a). While courts should be reluctant to interfere with counsel’s control over the presentation of their case and should ensure that each side has the opportunity to present its case fully and fairly, judicial intervention may become necessary if evidence exceeds reasonable bounds and does not contribute to the resolution of the issues presented. *See* COMPLEX LITIGATION Section 22.35, at 144.

Courts may limit the number of witnesses; the number of exhibits to be offered on a particular issue; the length of direct and cross-examination of witnesses; and the total time for direct and cross examinations. *See* COMPLEX LITIGATION Section 21.643, at 124. The courts’ authority arises from FED. R. CIV. R. 16 (c)(4), FED. R. EVID. 403, and 611.

### C. Experts

Experts are key witnesses in a patent case. Experts explain the invention, guide juries through the patent language, and construct damage models. The meaning of technical publications can be made clear through expert testimony. Expert testimony provides a useful way of explaining the novelty of an invention and either the beneficial aspects, or lack thereof, of a particular apparatus or method. Further, experts often state opinions on infringement and validity. A good expert must be a good teacher, and clearly articulate otherwise complex issues and facts to the jury. As the Federal Circuit plainly stated, “[i]t is well recognized that the persuasiveness of the presentation of complex technology based issues to lay persons depends heavily on the relative skill of the experts.” *Mitsubishi Elec. Corp. v. Ampex Corp.*, 190 F.3d 1300, 1313 (Fed. Cir. 1999), *cert. denied*, 529 U.S. 1054 (2000). Parties should always be mindful of the Federal Rules pertaining to expert testimony. *See* FED. R. EVID. 702, 703, 704, and 705.

#### *Technical Experts*

An effective technical expert can provide information on issues, including but not limited to: (1) tutorials on technology; (2) technical differences or similarities between the



patented invention and the prior art; (3) the level of knowledge of a person of ordinary skill in the art at the time the invention was made; (4) reasons why the claimed invention would or would not have been obvious from the prior art; (5) reasons why certain prior art does or does not anticipate the claimed invention; and (6) an analysis of why the accused product or process does or does not infringe the asserted claims of the patent.

A court may consider technical expert testimony to gain an understanding of the true meaning of the patent. *Markman*, 52 F.3d at 979-80. A court should consider a technical expert's testimony in *Markman* proceedings, particularly "to ensure that his or her understanding of the technical aspects of the patent is not entirely at variance with the understanding of one skilled in the art." *Pitney Bowes, Inc. v. Hewlett-Packard Co.*, 182 F.3d 1298, 1309 (Fed. Cir. 1999); *Eolas Techs., Inc. v. Microsoft Corp.*, No. 99-C-0626, 2000 U.S. Dist. LEXIS 18886, at \*13 (N.D. Ill. Dec. 28, 2000) (considering opinion of expert at *Markman* hearing to understand technology and construe claims). As a caveat, the Federal Circuit has counseled that consulting expert testimony during a *Markman* hearing should be considered particularly when the claim language of a patent is ambiguous. *Phillips Petroleum Co. v. Huntsman Polymers Corp.*, 157 F.3d 866, 870 (Fed. Cir. 1998) ("When the intrinsic evidence unambiguously delineates the scope of the patent, resort to extrinsic evidence, including expert testimony, is unnecessary.").

Technical experts are often critical on issues of validity and infringement. *Mitsubishi Elec. Corp.*, 190 F.3d 1300, 1313 (Fed. Cir. 1999) (ruling that when there are competing views regarding obviousness, a jury may hear the expert witnesses from both sides and decide based on the evidence and the explanations of the expert witnesses).

#### *Damages Experts*

The calculation of damages in patent infringement suits can be complex. The statutory rules governing damages are vague. Thus, an expert witness is needed to present or refute the types of damages available and the factors relevant to proving those damages. There are generally four types—(1) accounting experts; (2) licensing experts; (3) industry experts; and (4) economists. See Edward G. Poplawski, *Selection and Use of Experts in Patent Cases*, 9 Fed. Cir. B.J. 145, 147 (1999).

An accounting expert may be used to support or rebut the methodology of damages calculations based on lost profits and/or reasonable royalty. Accounting experts also may be used for proving a reasonable royalty. Industry experts may be used to establish or refute a claim that the plaintiff is entitled to lost profits based upon its ability to have made sales taken by the infringer. Industry experts also may provide evidence about conventional licensing rates in the industry. Economists might construct demand curves for the product at issue, or testify about price erosion suffered by the patentee.

#### *Court-Appointed Experts*

Courts have the authority to appoint a technical adviser "to inform and support the judicial process to settle disputes." *Techsearch v. Intel Corp.*, 286 F.3d 1360, 1377 (Fed. Cir. 2002). The Federal Circuit has set guidelines and procedural safeguards for appointing experts:

[T]he district court must use a 'fair and open procedure for appointing a neutral technical advisor . . . addressing any allegations of bias, partiality or lack of qualifications' in the candidates; clearly define and limit the

technical advisor's duties presumably in a writing disclosed to all parties; guard against extra-record information; and make explicit, perhaps through a report or record, the nature and content of the technical advisor's tutelage concerning the technology.

*Id.* at 1379.

Court-appointed experts are beneficial in that: (1) they have “a great tranquilizing effect” in the parties’ experts, reducing adversariness and potentially clarifying and narrowing disputed issues; (2) they facilitate stipulations or settlements; and (3) they may help the court and jury comprehend the issues and the evidence. COMPLEX LITIGATION Section 21.51, at 110.

The disadvantages of court-appointed experts are:

- Cost. The parties bear the burden of the expert’s compensation. See Fed. R. Evid. 706 (b).
- Neutrality. It may be difficult to find an expert that is truly neutral, and not favorable to either side.
- Delay. The testimony of a court-appointed expert may lengthen the trial.

*Id.*

#### D. High Reversal Rates

According to one study, the Federal Circuit overturned more than forty percent of district court judgments through 1996, a rate which is the highest of any appellate court in the country. See Ted D. Lee & Michele Evans, *The Charade: Trying a Patent Case to All “Three” Juries*, 8 TEX. INTELL. PROP. L.J. 1 (1999). Some statistics have indicated that the reversal rate is as high as forty-seven percent, and as low as thirty-three percent. Mark T. Banner, “Keeping Current with the Chair”, *IPL Newsletter*, Vol. 31, No. 4, at 1 (sum. 2003). The reversal rate for the first six months of 2003 alone is forty-eight percent. Banner, *supra*, at 2. The Honorable Samuel Kent of the Eastern District of Texas provided a colorful commentary on this dilemma: “Frankly, I don’t know why I’m so excited about trying to bring this [patent case] to closure. It goes to the Federal Circuit afterwards. You know, it’s hard to deal with things that are ultimately resolved by people wearing propeller hats.” Banner, *supra*.

A number of factors have contributed to the high reversal rate, including district court judges’ unfamiliarity with patent cases and the high number of unresolved questions of patent law that remain since the Federal Circuit’s inception in 1983. The uncertainty surrounding a judgment at the District Court level makes a win at trial only a first step, and can lead to litigation which can last for up to five years. Some critics argue that the Federal Circuit is to blame, creating a “morass of confused and contradictory claim construction canons.” Banner, *supra*, at 2. See *Interactive Gif Express, Inc. v. Compuserve Inc.*, 31 F.3d 859, 866 (Fed. Cir. 2000) (the blackletter law of patent analysis presents a clear hierarchy of authority—the court should consider first the claim language, intrinsic evidence, and then extrinsic evidence); cf. *Texas Digital Systems, Inc. v. Telegenix, Inc.*, 308 F.3d 1193 (Fed. Cir. 2002) (beginning claim construction by looking to the dictionary).

### E. Technology in the Courtroom

Technology in the courtroom is a useful resource because it promotes economy, aids in the analysis and interpretation of complex facts, and most importantly, fosters visual perception. Proponents of technology contend that visual displays convey more information than audio recordings or writings read aloud. Technology also increases jury attention, comprehension, and retention. The most common technologies used in the courtroom are:

- Video
- Computer Animation
- Laser Discs
- CD-ROM
- Electronic or Digitized Still Photographs
- Photogrammetry (e.g., aerial and space photographs)
- Personal Computers
- Computer-Aided Transcription (CAT) (translates a court reporter's keystroke patterns)
- Simultaneous Distributed Translation (SDT) (translating a number of foreign languages)

COMPLEX LITIGATION Section 34.3, at 394.



# EXPERT WITNESSES AND *DAUBERT* MOTIONS

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## I. INTRODUCTION

Expert witnesses are critical in patent litigation, given the complexity of the technical and damages issues involved. While expert testimony in patent trials may not be as likely to involve “junk science” as some other areas of litigation, the requirements of Rule 702 F. R. Evid. must still be met and guidelines provided by *Daubert*<sup>2</sup>, *Kumho*<sup>3</sup> and other authorities followed. Whether technical expert, damages expert or patent expert, counsel should consider how well his or her experts and proposed testimony will stand up to a *Daubert* motion challenge and whether the opposing party’s experts may be subject to such a challenge and excluded. Whether to make a *Daubert* motion requires careful consideration of the proposed testimony, of the guiding authorities and of the tactical consequences of winning or losing such a motion.

## II. RULE 702 FED. R. EVID.

Rule 702 F. R. Evid. provides:

If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.

The Rule appears straightforward. The proposed testimony must “assist the trier of fact,” the witness must be qualified as an expert and the testimony must be appropriately based, the product of reliable principles and methods reliably applied. Some courts have summarized these criteria as “reliable and relevant” or as “reliability and fit.” *Daubert*, 509 U.S. at 589-90; *KW Plastics v. United States Can Co.*, 131 F. Supp. 2d 1289, 1291 (M.D. Ala. 2001); *Aspex Eyewear, Inc. v. E’Lite Optik, Inc.*, No. 3:98-CV-2996-D, 2002 U.S. Dist. LEXIS 14834, at \*90 (N.D. Tex. April 4, 2002). Rule 702 is not intended to make it difficult to admit expert testimony. Rather, courts have pointed out that expert testimony is best challenged through vigorous cross-examination. *Daubert*, 509 U.S. at 596; *Micro Chem. v. Lextron, Inc.*, 317 F.3d 1387, 1392 (Fed. Cir. 2003).

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<sup>2</sup> *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579 (1993).

<sup>3</sup> *Kumho Tire Co. v. Carmichael*, 526 U.S. 137 (1999).

*Daubert* assigns to the trial court the gatekeeper role of determining whether proposed expert testimony meets the Rule 702 requirements, and *Kumho* establishes that the rule applies to testimony “of engineers and other experts who are not scientists.” *Kumho*, 526 U.S. at 141. *Kumho* also establishes that various factors discussed in *Daubert* and *Kumho* for carrying out this gatekeeper role may or may not be pertinent to any particular case. If challenged, the proponent of the expert testimony must show that it meets the requirements of Rule 702 by a preponderance of the evidence. Fed. R. Evid. 702 Advisory Committee’s note (2000) (citing *Bourjaily v. United States*, 483 U.S. 171 (1987)). Within these confines, the details of determining whether expert testimony meets the requirements of Rule 702 have been left to the discretion of the trial courts. *Gen. Elec. Co. v. Joiner*, 522 U.S. 136, 142 (1997).

The decisions concerning proffering one’s own experts, as well as whether and how to challenge the other party’s expert, are important trial strategy decisions.

### III. THE PROPOSED EXPERT TESTIMONY MUST ASSIST THE TRIER OF FACT

The requirement that the “scientific, technical, or other specialized knowledge” of the expert witness “will assist the trier of fact” would seem to encompass all of the other Rule 702 criteria. *Daubert*, however, explained that this requirement “goes primarily to relevance.” *Daubert*, 509 U.S. at 591.

#### A. A Witness Must Be Qualified As An Expert By Knowledge, Skill, Experience Or Education

The qualification requirement can be related to the requirement that expert testimony should be relevant, and thereby “assist the trier of fact.” The witness should be qualified in the “scientific, technical, or other specialized knowledge” relevant to the issues to be determined by the trier of fact. It may be an easy matter in some cases to determine that the witness is not qualified. For example, a witness with education or experience only in mechanical devices should not be permitted to present expert opinion testimony where the issue is the operation of electronic circuitry. Such a witness is not qualified in scientific, technical, or other specialized knowledge which “will assist the trier of fact to understand the evidence or to determine a fact in issue.” Similarly, a witness experienced in one kind of automotive clutch, but without any experience or knowledge concerning the type of clutch at issue, is not qualified. His testimony will not assist the jury. *Eaton Corp. v. Rockwell Int’l Corp.*, No. 97-421-JJE, 2001 U.S. Dist. LEXIS 17054, at \*61-\*64 (D. Del. Oct. 10, 2001).

On the other hand, a witness with “substantial credentials as an electrical engineer” has been held qualified to testify concerning an ultrasonic device having electrical circuitry for measuring the level of material in a bin or tank. *Endress + Hauser, Inc. v. Hawk Measurement Sys. Pty. Ltd.*, 122 F.3d 1040, 1042 (Fed. Cir. 1997). Even if the witness’ expertise was not in ultrasonic measurement devices, issues to be determined related to electrical circuitry.<sup>4</sup>

Similarly, a witness may be qualified in one aspect of the facts to be decided, but not in others. So long as the witness has relevant, specialized knowledge and directs the expert testimony to that relevant specialized knowledge, the qualification requirement of Rule 702 and *Daubert* may be met. Testimony outside the area of expertise, even if directed to issues in

<sup>4</sup> The *Endress* court also noted that an expert need not be one of ordinary skill in the art to be qualified.

the case, will be excluded. *City of Tuscaloosa v. Harcross Chems., Inc.*, 158 F.3d 548, 565 (11th Cir. 1998); *Buckley v. Airshield Corp.*, 116 F. Supp. 2d 658, 662 (D. Md. 2000).

### B. The Weight To Be Given To Expert Testimony Based On Qualifications Can Be Determined By The Trier Of Fact

Because many disputes concerning qualifications are not clear cut, courts often resolve challenges to an expert's qualifications by noting that the fact finder can assess the witness' qualifications and weigh the expert's testimony accordingly. *Laser Indus., Ltd. v. Reliant Techs., Inc.* No. C96-00390 CW, 1998 U.S. Dist. LEXIS 23494, at \*17-18 (N.D. Cal. Sept. 3, 1998). The purpose of Rule 702 and *Daubert* is to be sure the testimony will assist, not that the witness must have perfect qualifications. *Daubert*, 509 U.S. at 592-93; *Colon ex rel. Molina v. BIC USA, Inc.*, 199 F. Supp. 2d 53, 73 (S.D.N.Y. 2001). In defending against a *Daubert* challenge to qualifications, counsel would do well to focus on the ability of the expert to "assist the trier of fact," and the ability of the court or jury to assess the expert's qualifications, rather than engage in argument about narrow issues of specialization.

### C. Patent Expert Testimony May Be Challenged For Not Assisting The Trier Of Fact

Some patent expert testimony may be subject to challenge as not assisting the trier of fact. Indeed, more and more courts are excluding the type of patent expert testimony that instructs in substantive patent law, and then tells the fact finder how to decide an issue based on the facts as the patent expert sees them.<sup>5</sup>

This type of patent expert testimony may seem relevant in that it bears on the issues the court or jury is to decide. But will it really "assist the trier of fact?" In a bench trial the court certainly knows the law, and in a jury trial the court will instruct the jury concerning the law. Instruction in the law by the patent expert is unnecessary in either event and, in a jury trial, can be confusing and misleading. In addition, on many issues as to which patent experts are proposed to testify, once the jury is instructed in the law by the court, the expert is in no better position to determine the issue than are the jurors. The patent expert's "specialized knowledge" about the practice of patent law or Patent Office procedures does not make him or her any more qualified than the court or jurors to assess the evidence and to determine, for example, whether a claim is infringed, or whether a party has committed inequitable conduct. *Buckley*, 116 F. Supp. 2d at 662.<sup>6</sup> The specialized patent knowledge of such a witness does not assist the jury.

There are areas where an experienced patent practitioner's specialized knowledge, or that of a former Patent and Trademark Office official, may assist the trier of fact. Explanation of Patent and Trademark Office rules and procedures may be helpful, although that role may be filled by preliminary jury instructions or the FJC video. Patent expert testimony has been provided in recent non-jury cases involving prosecution laches estoppel, where the reasonableness of delays in prosecution of an application in view of Patent and Trademark Office rules and procedures is at issue. A patent expert's proposed testimony should be carefully scrutinized, however, to ensure that it is testimony in which the witness' specialized knowledge will assist the trier of fact, and not simply be a way for trial counsel to present his or her view of the law and the facts in the form of expert testimony.

<sup>5</sup> *Bausch & Lomb, Inc. v. Alcon Labs., Inc.*, 79 F. Supp. 2d 252, 254-59 (W.D.N.Y. 2000); *Aspex Eyewear*, 2002 U.S. Dist. LEXIS 14834, at \*102-\*03. See also *Revlon Consumer Prods. Corp. v. L'Oréal S.A.*, No. 96-192 MMS, 1997 WL 158281, at \*3 (D. Del. March 26, 1997) (finding that expert "may not testify as to substantive issues of patent law, including inequitable conduct"). Courts also have excluded expert testimony in non-patent cases where the jury was as capable as the expert to determine an issue. *Schwartz v. Fortune Magazine*, 193 F.R.D. 144, 147 (S.D.N.Y. 2000) (finding that expert's testimony was not based on any specialized knowledge, but rather involved basic calculations and therefore should be excluded under Rule 702 as unhelpful to the trier of fact).

#### D. Expert Testimony Based On Or Contrary To The Court's Claim Construction Rulings Should Be Excluded

Since *Markman*,<sup>7</sup> in nearly all patent cases the trial court provides its claim construction before trial. It should go without saying that expert testimony concerning validity or infringement which is based on a claim construction inconsistent with the court's construction should be excluded. Such testimony is not relevant to the issues to be decided by the trier of fact and cannot assist the trier of fact in determining those issues. Opposing experts' reports should be reviewed for this type of improper opinion and counsel should be ready to object if such an inconsistent opinion appears during trial testimony.

### IV. EXPERT TESTIMONY MUST BE RELIABLE

#### A. The Testimony Should Be Based On Sufficient Facts Or Data

The courts have indicated that exclusion is not to be used as a be-all or end-all. Vigorous cross-examination and countering evidence and testimony should enable the jury to deal with "shaky but admissible" expert testimony. *Daubert*, 509 U.S. at 596; *Heller v. Shaw Indus., Inc.*, 167 F.3d 146, 152 (3d Cir. 1999) (stating "[c]learly, the [Supreme] Court envisioned cases in which expert testimony meets the *Daubert* standard yet is 'shaky,' and cases in which admissible expert testimony provides only a 'scintilla' of support for a claim or defense"). That does not mean, however, that counsel should not try to exclude testimony which has no basis in supporting facts or data.

The testimony of damages experts may be particularly subject to challenge on the basis of insufficient supporting facts or data. Damages claims in patent cases sometimes seem limited only by the imagination of the expert. Inflated claims can be attacked on cross-examination, but it may be better to seek to prevent them from being presented to a jury at all. A review of the cases suggests that trial courts may feel more comfortable delving into the bases for opinions related to economic issues and making decisions to exclude them, than in more technical, less familiar areas. Testimony of a damages expert may therefore prove a more fruitful target for challenge than that of a technical expert.

In a variety of contexts, courts have analyzed economic/damages expert testimony where the underlying facts and data do not, in the view of the court, support the expert's conclusions. For example, in a non-patent case, *Target Mkt. Publ'g, Inc. v. ADVO, Inc.*, 136 F.3d 1139, 1142-45 (7th Cir. 1998), the court reviewed the facts upon which an expert based a conclusion of lost profits. The expert testified that problems with the business would have been remedied and that the company could have penetrated certain marketing zones, with resulting revenues and profits. This sounds like the kind of lost profits testimony often proffered in patent cases. The court, however, had no trouble concluding that the remedying of problems was only an "assumption," as was the penetration into the marketing zones, and excluded the testimony. In *Boucher v. U.S. Suzuki Motor Corp.*, 73 F.3d 18, 21-22 (2d Cir. 1996), the appellate court determined that the trial court should have excluded damages testimony because the facts relied on by the expert did not support conclusions, rendering them "speculative assumptions." Likewise, in *Otis v. Doctor's Assocs., Inc.*, No. 94 C 4227, 1998 U.S. Dist. LEXIS 15414, at \*18-19 (N.D. Ill. Sept. 10, 1998), the court excluded the testimony of the damages expert on the ground that, like the expert in *Target Mkt. Publ'g v. ADVO*, the expert based future lost profits damages on marketing plans and profit estimates generated by speculation and mere assumptions.<sup>8</sup>

<sup>7</sup> *Markman v. Westview Instruments, Inc.*, 52 F.3d 967 (Fed. Cir. 1995) (*en banc*), *aff'd*, 517 U.S. 370 (1996).

<sup>8</sup> In each of these cases, "vigorous cross-examination and competing evidence" could have been used to point out the lack of support for the expert's opinion. In *Boucher v. U.S. Suzuki Motor Corp.*, cross-examination, if used, was not successful at the trial court level but may have provided the record for the appellate court's decision.



Similarly, a trial court excluded reasonable royalty expert testimony in a cellular communications equipment case. The expert used the total minutes of customer cellular telephone use (a huge number) as the royalty base. There were no facts to support that analysis. Every license agreement in the field turned up by either side used the cost of the equipment as the base. No one had ever agreed to pay royalties based on minutes of customer use. *MLMC, Ltd. v. Airtouch Communications, Inc.*, No. 99-781-SLR, slip op. at 3 (D. Del. Nov. 9, 2001) (mem.).

The Federal Circuit, on the other hand, has approved reasonable royalty testimony where the plaintiff's expert based his *Georgia-Pacific*<sup>9</sup> hypothetical royalty negotiation testimony on contested facts. *Micro Chem.*, 317 F.3d at 1392. The court quoted the advisory committee's note (2000) to Rule 702, which states that "[t]he emphasis in the amendment on 'sufficient facts or data' is not intended to authorize a trial court to exclude an expert's testimony on the ground that the court believes one version of the facts and not the other." The court further recognized that defendants had ample opportunity to rebut the plaintiff's expert damages theory during cross-examination.<sup>10</sup>

To avoid a successful *Daubert* challenge on this basis, counsel should be careful to include in an expert witness statement the supporting facts for each of the expert's conclusions and opinions. The facts may be contested, but they should be sufficient to support a jury's verdict or trial court's findings.

#### B. The Expert Testimony Must Be The Product Of Reliable Principles And Methods

In *Daubert*, the Supreme Court was primarily concerned with evaluating the reliability of the principles and methodology employed by the experts, cautioning against "junk science." The court established as a precondition for admissibility a flexible list of guidelines for trial judges to consider ("*Daubert* factors"). *Daubert*, 509 U.S. at 592-93.

When applied in *Kumho*, the Supreme Court affirmed the trial court's decision to exclude the expert's testimony on the basis that the methodology employed by the petitioner's expert was unreliable. Although the expert was qualified to testify and his testimony concerning the failed automobile tire was based on sufficient facts and data, the methodology employed in determining the cause of the tire failure was suspect and grounds for exclusion. *Kumho*, 526 U.S. at 152-57.

In *Domingo v. T.K.*, 289 F.3d 600, 605-06 (9th Cir. 2002), the appellate court held that the trial court properly excluded the expert's testimony on the ground that the methodology employed was unreliable. In this medical malpractice case, the expert claimed that the medical procedure performed by the defendant caused the plaintiff to suffer brain damage. The appellate court affirmed the trial court's decision to exclude the testimony because it lacked "any objective source, peer review, clinical tests, establishment of an error rate or other evidence to show that [the expert] followed a valid, scientific method in developing his theory."

The question of methodology is less often at issue in patent cases, but cannot be ignored. The courts have not hesitated to exclude testimony where the methodology can be tested against the practice or views of the scientific community and found wanting. In

<sup>9</sup> *Georgia-Pac. Corp. v. United States Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970), *modified and aff'd*, 446 F.2d 295 (2d Cir. 1971).

<sup>10</sup> In *Bio-Tech. Gen. Corp. v. Genentech, Inc.*, 267 F.3d 1325, 1330-31 (Fed. Cir. 2001), the court stated that "[w]hen scientific certainty is not available, and the scientific theories and evidence are within a reasonable range of difference of scientific opinion, resolution of such difference based on weight and credibility of evidence is the province of the trier of fact."

*Carnegie Mellon Univ. v. Hoffmann-LaRoche*, 55 F. Supp. 2d 1024, 1030-41 (N.D. Cal. 1999), the court excluded the testimony of the plaintiff's expert on the grounds that the methodology employed in determining the expression of an enzymatic activity (1) rested on unsound scientific standards within the scientific community; (2) was not subjected to peer review and publication; and (3) was not followed by at least a recognized minority of scientists in his field. In *SmithKline Beecham Corp. v. Apotex Corp.*, 247 F. Supp. 2d 1011, 1036-42 (N.D. Ill. 2003), although the court did not exclude the testimony in a non-jury trial, the court did apply a "sharp discount factor" to the testimony of two of the plaintiff's expert witnesses because their methodology was not in keeping with the methodology the experts used in their regular work.

Counsel should be very careful before creating restrictions on the methodology the expert may use. If those restrictions result in the expert doing a less thorough analysis than would be done in the normal course of his or her work, the result may be excluded testimony. *SmithKline Beecham*, 247 F. Supp. 2d at 1038-42 (discounting the testimony of the expert due, in part, to the lawyers' limitations placed on the expert's analysis).

The expert's methodology may also be tested against legal precedent. The entire patent damages analysis is by necessity hypothetical, whether a reasonable royalty determination or a "but for" lost profits analysis. If the methodology of reaching that hypothetical result is consistent with legal precedent, the testimony may be admitted. *Micro Chem.*, 317 F.3d at 1393.

When preparing an expert report and expert testimony, counsel should become familiar with the accepted methodologies in the relevant field and be sure that the expert's methodology is consistent. This may require independent study by counsel or consultation with other, non-testifying experts in the field. Counsel should also be familiar with the legal precedents in the field so that the expert may adopt, where possible, a methodology previously accepted by the courts.

#### V. WHICH IS BETTER? *DAUBERT* MOTION OR VIGOROUS CROSS-EXAMINATION

A tactical question for counsel is whether to seek to exclude questionable expert testimony by *Daubert* motion or to deal with it by "vigorous cross-examination." With the Rule 26, Fed. R. Civ. P. requirement for expert witness statements and expert depositions, the expert's proposed testimony is known before trial. Accordingly, some courts are requiring that *Daubert* motions be filed before trial with other pretrial motions such as motions *in limine*. Whether made before or during trial, if the *Daubert* motion fails, attack by cross-examination is still available. The witness and opposing counsel, of course, are then forewarned of the cross-examination to come. This would suggest that *Daubert* motions be used only where there is a significant chance of success.

Successful exclusion of the expert's entire proposed testimony is always preferable to running the risk that cross-examination will not persuade the jury of the expert's errors. The more difficult tactical question is when some, but not all, of the expert's testimony is questionable and could be excluded on motion. In that case, counsel should consider whether it may be more helpful to establish the lack of credibility of the expert through cross-examination of the questionable portion, than to preclude that portion by motion. Partial exclusion may result in an opposing expert appearing to the jury more reasonable and credible than would be the case if the questionable testimony were presented and effectively cross-examined.

Whether the case is tried to the court or to the jury is an important factor to consider. Cases suggest that in trial to the court, questionable expert testimony is more likely to be admitted, with the court assessing its weight and discounting it where appropriate. Except in the most clear cut case of inadmissibility, cross-examination and trial briefing may make *Daubert* motions an unnecessary expenditure of the client's funds and of the court's time.

## VI. IN SUM, BE MINDFUL OF THE GATE

The trial court is the gatekeeper for expert testimony. Ensuring that one's own experts get through that gate and determining whether, and if so how, to try to have that gate closed on the opposing party's experts should be important considerations in every trial strategy. Counsel should be knowledgeable concerning Rule 702 and the technical and economic fields about which the parties' experts are to testify. Counsel can then ensure that their own experts will be properly qualified and that their testimony will be admissible and effective, while determining the best challenge to the opposing party's experts.



# EXAMINING REEXAMINATION: NOT YET AN ANTIDOTE TO LITIGATION

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## INTRODUCTION

While the Sedona Conference is dedicated to the advancement of law and policy in the area of patent *litigation*, it is no secret that most litigants are displeased (or worse) with the cost, pace and unpredictability of lawsuits seeking to enforce or challenge U.S. patents. This paper addresses one alternative to litigation—*inter partes* reexamination, presenting the latest evidence regarding experiences with that alternative and asking whether it offers a real option to patentees or challengers alike.

### I. *INTER PARTES* REEXAMINATION: PROCEDURAL REVIEW

Congress attempted to enact a substantial and beneficial change in U.S. reexamination law when it passed Subtitle F of the American Inventors Protection Act of 1999, entitled “Optional *Inter Partes* Reexamination Procedures.” See Subtitle F of the American Inventors Protection Act of 1999, 35 U.S.C. Chapter 31 (hereafter “Chapter 31 proceeding”). As indicated by the title, the new procedure did not repeal or even amend prior provisions regarding *ex parte* reexamination. Rather, the new procedure was created to give patent challengers the option of participating after reexamination is ordered by the Patent and Trademark Office (“PTO”).<sup>1</sup> The stated goal of the legislation was to improve “the quality and reliability of United States patents.” 65 Fed. Reg. 18154. In addition, proponents hoped to make patent reexamination a more viable alternative to litigation in the federal district courts. Regrettably, however, as we predicted several years ago, practitioners continue to be wary of this new administrative proceeding.

An *inter partes* reexamination begins with the submission of a request for reexamination. 35 U.S.C. Section 311(a).<sup>2</sup> The only ground for seeking reexamination under either chapter is prior art consisting of patents or printed publications.<sup>3</sup> *Id.* The PTO has three months from the filing of a request for reexamination in which to determine whether the request raises a substantial new question of patentability affecting any claim of the patent. *Id.* Section 312(a). The scope of the claims cannot be enlarged as a result of reexamination.<sup>4</sup>

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<sup>1</sup> The Intellectual Property Technical Amendments Act of 2000 (H.R. 4870) adopted a few, minor changes in the wording of Chapter 31 to clarify the fact that patent owners cannot request reexamination under this chapter. Rather, it was enacted to allow third parties to challenge the validity of patent claims.

<sup>2</sup> The new procedure can be invoked only for patents issuing on applications filed on or after November 29, 1999.

<sup>3</sup> Thus, a request for reexamination on any other basis (lack of enablement, prior use or sale, inequitable conduct, etc.) will fail. If a request for reexamination is based on several issues, including prior art issues, a reexamination may result but non-prior art issues will be ignored. 37 C.F.R. Section 1.906.

On the other hand, while the grounds for the initial request for *inter partes* reexamination are limited to prior art, appeals may raise issues under 35 U.S.C. Section 112, first paragraph as well. 37 C.F.R. Section 1.965 (c)(8)(i). Unlike the *inter partes* reexamination itself, in an appeal of the reexamination to the Board of Patent Appeals and Interferences there is the possibility of an oral hearing. 37 C.F.R. Section 1.973. A decision by the Board may include a new ground of rejection, but such a rejection “shall not be considered final for purposes of judicial review.” *Id.* Section 1.977.

<sup>4</sup> See 35 U.S.C. Section 314(a). Likewise, any proposed amended or new claim determined to be patentable and incorporated into a patent has the same effect as that specified in section 252 for reissued patents. *Id.* Section 316(b).

If the PTO determines that there is a substantial new question of patentability, an *inter partes* reexamination is ordered. *Id.* Section 313. It is the PTO's stated intention that each *inter partes* reexamination will be assigned to an examiner who was not actually involved in the examination and issuance of the patent in question. This will be done as a matter of policy, and not by a change in the rules (*see* 65 Fed. Reg. 76756, 76757 – 58, Response to General Comment 1, Rules to Implement Optional Inter Partes Reexamination Proceedings, December 7, 2000). Similarly, where the *inter partes* reexamination was refused but then ordered following a petition to review the refusal (a petition under 37 C.F.R. Section 1.927), “the *inter partes* reexamination will ordinarily be conducted by an examiner other than the examiner responsible for the initial determination under Section 1.923.” 65 Fed. Reg. 76780. Recently, for *inter partes* reexaminations, the PTO has promised that it “will have the reexamination performed by specially-assigned senior staff, and will use this (as) a pilot for the possibility of an expert panel or board to handle all *ex parte* reexaminations, as well” (remarks by Todd Dickenson, reported in U.S.P.T.O. Today Vol. 1 p. 9 June-July, 2000). Still further, “prior art submitted pursuant to 35 U.S.C Section 301 and 37 CFR Section 1.501 will be reviewed at the Group Director level, with an eye towards serving as a possible basis for Director Ordered Reexaminations.” *Id.*

After the grant of reexamination, procedures change dramatically from prior, *ex parte* practice. Most significantly, any document filed by the patent owner or requester has to be served on the other party.<sup>5</sup> *Id.* Section 314(b). Any time the patent owner files a response to an Office Action, the requester also has an opportunity to file written comments within thirty days of service. Likewise, either the patent owner or the requester may appeal an adverse finding by an examiner to the Board of Patent Appeals and Interferences, after paying a fee. 35 U.S.C. Section 315(a) and (b). And, both the challenger and the patent owner may appeal to the Federal Circuit from an adverse determination by the Board of Patent Appeals and Interferences. *Id.* Section 315(a)(1).

The effect of an *inter partes* proceeding on pending litigation is also different from *ex parte* reexamination. The patent owner may obtain a stay of any pending litigation involving an issue of patentability of any patent claims which are the subject of an *inter partes* reexamination. 35 U.S.C. Section 318. A stay may be denied only if the district court “determines that a stay would not serve the interests of justice.” *Id.* Even more important, a requester whose reexamination request is granted must include in that request all grounds available to him at the time. If the reexamination request is granted, the requester will be estopped, in subsequent litigation in the district court or a subsequent Chapter 31 proceeding, to assert the invalidity of any claim finally determined to be valid on any ground which he raised or *could have raised* in the *inter partes* reexamination. *Id.* Section 315(c).<sup>6</sup> Thus, while the new procedure offers the advantage of third-party participation in the reexamination of a patent, it also embodies the significant penalty that failure to convince the PTO of the invalidity of the relevant claims can be overcome only by successful appeal to the Federal Circuit (a feat for which we have no precedent as of yet), making *inter partes* reexamination something of a double-or-nothing gamble.<sup>7</sup>

There also is an estoppel with respect to *inter partes* reexamination requests submitted after the conclusion of a prior *inter partes* reexamination or civil court action. That is, the requester *and* its privies may not request an *inter partes* reexamination of any

5 Unlike a court proceeding, there are no face-to-face exchanges (37 C.F.R. Section 1.955); all communications are in writing (37 C.F.R. Section 1.937(c)).

6 This provision does not literally apply to privies of the requester. The different treatment of privies depending on whether the reexamination or litigation is initiated first may have been a legislative oversight, but has not been altered in subsequent amendments.

7 If the first proceeding is a Chapter 31 proceeding, the estoppel provisions apply to subsequent litigation brought by the requester. However, “privies” of the requester apparently are *not* estopped in such a situation to relitigate the invalidity of the patent in district court. *Id.* Section 315.

patent claim, once a final decision has been entered against that party either in district court or the PTO with respect to the patentability of any claim of the patent, on grounds that were raised *or could have been raised* in the civil action or first *inter partes* reexamination proceeding. *Id.* Section 317(b).

Some limited relief from the estoppel provisions are found in the provisions allowing assertions of invalidity in subsequent civil proceedings (35 U.S.C. Section 315(c) and in subsequent *inter partes* reexamination requests (35 U.S.C. Section 317 (b)) “based on newly discovered prior art unavailable to the third-party requester and the Patent and Trademark Office at the time of the *inter partes* reexamination proceedings.” The legislation does not define the term “available.” Future case law will decide whether that term means “available” to any employee of a corporation, a managing officer, or an attorney. Litigation also will likely explore whether “available” means “able to be found,” “known to” or actually in the custody of the requester or the PTO at the time of the reexamination. Finally, it is not clear whether “available” means available any time during the reexamination, or merely at the time that reexamination is first sought.

## II. FACTS AND STATS REGARDING INTER PARTES REEXAMINATION

From 1999-2002, ten *inter partes* reexamination requests were filed at the PTO; in 2003, eighteen were filed through October. According to the USPTO, all reexamination requests have been accepted. So far, only one case has reached a final holding. In this case, all claims were cancelled because the patentee never responded. To the knowledge of the USPTO, only 5 of the requests were associated with litigation. Three of the proceedings have been vacated: one because the requester never managed to correct informalities within a three-month deadline, and two because the requester subsequently lost his invalidity arguments in a co-pending litigation (and so became estopped from proceeding at the USPTO). The average pendency was about 15 months.

Given the low numbers of cases filed, it is impossible to glean trends or report valid statistics. (By comparison, 272 *ex parte* reexamination requests were filed in 2002 and 9615 patent cases were filed in United States district courts between 1995 and 1999<sup>8</sup>.) Nonetheless, a few facts are worth noting. Six of the patents under reexamination pertain to chemistry (including one in genetic engineering), eight involve electronics and fourteen concern mechanical devices and/or methods. Surprisingly, none pertain to the fields of business methods or software. In two of the first seven cases, an *ex parte* reexamination also was started, either immediately after the filing of the reexamination request or within two months. However, the PTO has followed rule 37 C.F.R. Section 1.989(b) and has merged the proceedings. Accordingly rights of the third party requesters are not being adversely affected by the concurrent *ex parte* reexaminations.

Of the twenty eight total challenges over the three year period, seven were filed on behalf of foreign companies, eighteen for U.S. companies, one for a U.S. non-profit foundation, one for an individual, and one was reported as filed with an “unknown” real party in interest. No industry association was listed as a real party in interest. Four of the challenges over the three year period came from one company (Shimano, Inc.) against varied patents. Thus, industry associations have not begun use of this procedure but at least one foreign company may be taking advantage of this system to avoid litigation.

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<sup>8</sup> Our enumeration of *ex parte* reexaminations; the number of patent cases is from Kimberly Moore, “Forum Shopping in Patent Cases: Does Geographic Choice Affect Innovation?” 79 North Carolina Law Review 889, 901 (2001)

Of the first 7 cases studied in detail, none appear to be linked to pending litigation. The challenger asserted publications (generally U.S. patents) to support anticipation and obviousness arguments. In one case, a U.S. patent that had been considered previously by an examiner was asserted as invalidating art under Section 103 in combination with a newly discovered patent. In another instance, the challenger also argued invalidity on indefiniteness and written grounds. The PTO properly responded to the latter by refusing to consider non-prior art bases of patent invalidity, but advised the patentee to consider filing a reissue based on the arguments if they were persuasive. Thus, a third party may use *inter partes* reexamination to place non-prior art arguments for invalidity on the record and thereby provide formal notice to a patentee of possible defects in an issued patent.

In general, *inter partes* proceedings appear to have been “conducted with special dispatch” as specified in 37 C.F.R. Section 1.937—at least at the start<sup>9</sup>. The PTO issued all five of the first grants for reexamination within three months of the third party’s request and four of the five grants were accompanied by first Office Actions. However, it hardly can be said that reexaminations are concluding with dispatch. The first request for reexamination was filed on July 27, 2001 yet the proceedings had not progressed beyond an initial round of rejections and an amendment in the following 17 months. Indeed, the first two cases were significantly delayed by the patentee having to correct improper claim amendments, which differed in form from that used in regular patent application prosecution.

Finally, as a matter of policy and procedure, the PTO is assigning new examiners to *inter partes* reexamination and thus avoiding the situation where an examiner is asked to reconsider a patent already allowed.

### III. THE UNFULFILLED PROMISE OF *INTER PARTES* REEXAMINATION

Patent litigation is costly and lengthy, and the ultimate outcome is uncertain. In Texas (one of the more expeditious venues), going through trial may cost between \$1.5 and 2.5 million dollars<sup>10</sup>. The median cost, nationwide, for a patent suit taken through trial is reported to be \$1.2 million.<sup>11</sup> If a patent case gets to trial after several years of discovery and motion practice (only about 5% do<sup>12</sup>), the trial typically will be longer than other civil trials, with almost 10% requiring 20 or more days of trial (*vs.* less than 1% of all civil cases requiring 20 or more days of trial). Thus, the few patent cases that do reach trial are more complex, lengthy, and expensive than the average civil case.<sup>13</sup> Surprisingly, a patentee who has endured the time and expense has only a 58% chance of winning at trial.<sup>14</sup> Then, after two to four years of discovery requests, depositions, meetings with counsel, and trial (all of which distract senior engineers and management, disrupt company operations, and cost millions of dollars), it is time for the appeal. It is common knowledge that the Federal Circuit is very likely to overturn some if not all of what was decided in the trial court and then remand.

Given this rather bleak scenario, most putative defendants (and even some patentees) would welcome alternative ways to settle claim scope and validity of U.S. patents.

<sup>9</sup> However, at least one observer has noted that *inter partes* reexamination proceedings may be conducted with *too much* dispatch. As described by Peter DiMauro from “PatentWatch” in a letter to the Comment Box at the USPTO, dated June 27, 2003 commenting on the proposed changes noticed in the Federal Register, Vol. 68, No. 81, the USPTO issued an Order under 35 USC 313 declaring that a substantial new question of patentability existed, and, at the same time, issued an Office Action confirming the patentability of all claims; DiMauro suggested that such dispatch “eviscerates the prosecution stage altogether.”

<sup>10</sup> *Austin Business Journal* for January 17-23, 2003, Volume 22, number 44, at 18.

<sup>11</sup> Intellectual Property Insurance Services Corporation, Louisville Kentucky 40223. See <http://www.infringeins.com>

<sup>12</sup> Kimberly Moore, “Forum Shopping in Patent Cases: Does Geographic Choice Affect Innovation?” 79 *North Carolina Law Review* 889, 909 (2001), finding 49% of patent cases terminated from 1995 to 1999 terminated before any significant court action; 46% of patent cases terminated from 1995 to 1999 terminated after some court action but before trial; and only 5% of patent cases terminated from 1995 to 1999 terminated during or after a trial began.

<sup>13</sup> *Id.* at 931.

<sup>14</sup> “Judges, Juries and Patent Cases: An Empirical Peek Inside the Black Box,” 98 *Michigan Law Review* 98:365,381 (2000)



Prior to 1999, one avenue of attacking a patent (or rebutting a challenge to a patent) was *ex parte* reexamination. However, that alternative was attractive only to patentees because they tended to prevail 88% of the time.<sup>15</sup> *Inter partes* reexamination was intended to redress the perceived bias of the prior procedure. Yet, as a famous baseball player might have said, people are staying away from the *inter partes* reexamination procedure in droves. Why?

Our informal survey of patent attorneys determined that most were hesitant to use the new procedure because of potential estoppel and uncertainty as to how courts will interpret its scope. As discussed above, a party (and privies to that party) is estopped from raising an issue in subsequent litigation that was raised *or could have been raised* in a prior *inter partes* reexamination. Unfortunately, the courts have not interpreted the meaning of “or could have been raised.” At a minimum, a party likely would be obligated to assert all prior art encountered by the party at the time of filing a reexamination request, or be precluded from asserting that art in any district court or in a reexamination proceeding. This is particularly onerous when the meaning of a patent claim may not become clear until the Federal Circuit has reviewed a case on appeal.<sup>16</sup>

In addition, it is quite common for lawyers to assert in litigation multiple, alternative defenses — some prior art based, some based on Section 112, and some based on claim construction. This strategy is not effective in the reexamination context, where invalidity challenges are limited to printed publications and patents. Thus, where a great deal is at stake, this is a second, cogent reason for defendants to avoid the PTO.

On the other hand, where the amount at risk is relatively low (less than \$5 million), *inter partes* reexamination may make sense for the accused infringer that believes it has a very good invalidity defense. In that situation, *inter partes* reexamination can provide a cost effective alternative to patent litigation or to seeking a settlement with the patentee. Indeed, simply starting the reexamination process could reduce the settlement value of a dispute by threatening to tie up the patent for the years that the PTO might take to reach a conclusion. Where the value of the intellectual property involved is low, so that litigation is not worthwhile, the obvious disadvantage of *inter partes* reexamination — estoppel — is not so serious because the party is effectively “estopped” from pursuing litigation by financial considerations.

In addition, some types of patents will be more susceptible to successful attack by *inter partes* reexamination than others. For example, many business method patents and software patents are believed to be vulnerable to prior art challenge, due to the lack of prior art and search capability available to the Patent Office, and the lack of experience with these fields that have been only newly-recognized as patentable. In addition, the amounts at risk may be small, and many of the companies in these fields that are too small to absorb litigation costs could handle the costs of an *inter partes* challenge.

*Inter partes* reexamination also provides a second avenue for seeking a favorable claim interpretation from the Federal Circuit, possibly more quickly and certainly less expensively than going through a full trial in federal district court. Thus, a party who is relying on a technical, field-specific definition of a claim term to win an invalidity argument may do better to advance the argument to the PTO. Of course, the Federal Circuit has the

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15 Robert P. Merges, *As Many as Six Impossible Patents Before Breakfast: Property Rights for Business Concepts and Patent System Reform*, 14 Berkeley Tech. L. J. 577, 611-13 (1999)

16 Trade groups may comprise small company members with a shared interest in blocking patents that have been issued without consideration of important prior art. An important, unanswered question is whether the estoppel extends to all members of an organization that undertakes an *inter partes* reexamination request? If not, such an organization might undertake to initiate an *inter partes* reexamination procedure on its own, leaving its individual members free to pursue litigation on the same issues in the event of an unfavorable outcome.

final say on claim interpretation regardless of the source of appeal. It will be extremely interesting, in coming years, to see whether the Federal Circuit gives as little deference to the PTO's work product in reexamination as it has to district court claim construction.

Although most comments on the new procedure have considered *inter partes* reexamination merely as an alternative to litigation, *inter partes* reexamination also offers a possible alternative to licensing a patent. It is well-established that a licensee is *not* estopped from challenging the validity of a licensed patent<sup>17</sup>. Thus, a party may take a license and challenge the validity of the patent in the PTO at the same time. This alternative may also play a part in the license negotiations, since the availability of the low-cost *inter partes* reexamination may make a challenge to the patent more credible. Conversely, patentee may well consider adding a "shall use *inter partes* reexamination" contract clause in agreements with others, to limit future exposure of a patent to litigation challenge. Although this circumstance has not been reviewed by the Federal Circuit, an obligatory *inter partes* reexamination clause could be treated as an arbitration clause and force the use of reexamination. Courts strongly honor arbitration clauses in contracts and the Federal Circuit has demonstrated a willingness to go out of its way to uphold such agreements.

## CONCLUSION

*Inter partes* reexamination clearly has not fulfilled the promise of becoming a truly viable alternative to litigation. However, it would be error to disregard it entirely. It remains an interesting and potentially useful tool for certain types of disputes and in certain business settings. And, with more time, we will know whether it at least affords a more fair and informed setting for evaluation of issued patents.

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<sup>17</sup> *Lear, Inc. v. Adkins*, 395 U.S. 653, 671 (1969) finding that a licensee is not estopped from challenging the patent which has been licensed.

# EXEMPTION TO PATENT INFRINGEMENT UNDER 35 U.S.C. SECTION 271 (E)(1): SAFE HARBOR OR STORM A-BREWING?

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## I. INTRODUCTION

Frequently, scientists assume that their work does not expose them to claims of patent infringement because they are only performing “research.” Such a position reflects a fundamental misunderstanding of the patent laws which specifically provide that making and using a patented invention constitute infringement.<sup>3</sup> There are only two exceptions to patent infringement: the common-law “Experimental Use Exception” and the statutory “271(e) Exemption.” Both are circumscribed in their applicability, however, and recent case law has potentially limited their scope even further.

The Experimental Use Exception derives from a 19th century case in which Judge Story stated that “it could not have been the intention of the legislature to punish a man” who constructed a patented device “merely for philosophical experiments.”<sup>4</sup> In the recent case of *Madey v. Duke University* the Federal Circuit court held that the exception does not apply to work “when it is undertaken in the guise of scientific inquiry but has definite, cognizable, and not insubstantial commercial purposes.”<sup>5</sup> Considering that the commercial purposes at issue in *Madey* were the education of students and faculty research under government grants at a privately funded university, the Experimental Use Exception would appear to provide little, if any protection in today’s world.

The 271(e) Exemption, also referred to as the FDA Exemption, applies only to biomedical research undertaken to obtain governmental regulatory approval under the Federal Food, Drug and Cosmetic Act.<sup>6</sup> While the 271(e) Exemption was intended to rectify a specific inequity relating to generic and patented drugs, the language of the statute was not so limited and has been broadly construed by the courts. The 271(e) Exemption has been invoked by numerous defendants as a shield from claims of infringement. However, because the language of the statute is far from clear, courts have differed in their interpretations, leading to confusion and inconsistency. Despite almost 20 years of judicial construction, questions remain as to the appropriate application and scope of the exemption.

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<sup>3</sup> 35 U.S.C. Section 271(a) provides “whoever without authority makes, uses, offers to sell or sells any patented invention, within the United States or imports into the United States any patented invention during the term of the patent therefore, infringes the patent.”

<sup>4</sup> *Wittamore v. Cutter*, 29 F. Cas. 1120, 1121 (No 17,600) (C.C.D. Mass. 1813).

<sup>5</sup> *John M.J. Madey v. Duke University*, 307 F.3d 1351 (Fed. Cir. 2002).

<sup>6</sup> 21 U.S.C. Section 301 *et seq.*

## The 271(e) Exemption

The 271(e) Exemption was enacted as part of the *Drug Price Competition and Patent Term Restoration Act of 1984* (the 1984 Act),<sup>7</sup> also known as the Hatch-Waxman Act. The goals of the 1984 Act as a whole were two-fold: to provide an incentive for the development of patented drugs while promoting the availability of lower-cost generic alternatives. To this end, the 1984 Act contained provisions to promote the availability of low cost generic drugs, including expedited approval for generic drugs through Abbreviated New Drug Applications (ANDA).<sup>8</sup> At the same time, the 1984 Act included provisions designed to correct two patent term “distortions”<sup>9</sup> perceived by Congress, both of which result from the requirement that certain medical products obtain FDA approval prior to marketing.<sup>10</sup> The first distortion is the reduction in the patent term resulting from the inability of the patent holder to benefit from the early years of patent protection before the patented drug receives FDA approval. The second distortion is the effective patent term extension which results from delays in the entrance of generic products to the market if they cannot undertake the studies necessary for FDA approval prior to the expiration of the innovator’s patent.

As to the first distortion, obtaining FDA marketing approval for a new drug is both a lengthy and unpredictable process.<sup>11</sup> Considering that patent applications are normally filed early in the drug discovery process, by the time a patent issues only a few years of protection may remain. This patent term shortening has been exacerbated further by the GATT/TRIPS legislation which changed the patent term expiration in the United States from 17 years after the date of patent issuance to 20 years from the date of filing of the patent application.<sup>12</sup> For new drugs entering the market, the average remaining patent term is only seven years.<sup>13</sup> Section 201 of the 1984 Act (now codified as 35 U.S.C. Section 156) implemented a complex set of regulations designed to extend the term a patent up to a maximum of five years to compensate for delays in achieving regulatory approval. This patent term restoration directly benefits pharmaceutical companies by extending the term of exclusivity during which the enormous costs of drug development can be recouped.<sup>14</sup>

The second distortion relates to the time of generic drug entry to the market. At the time of the 1984 Act, generic drug manufacturers could not begin the studies required for FDA market approval during the term of patent protection on the innovator drug without the risk of being sued for infringement. In *Roche v. Bolar*<sup>15</sup> Roche held a patent on the anti-anxiety drug flurazepam. Intending to market a generic version, Bolar imported quantities of the drug to begin the testing required for FDA marketing approval prior to expiration of Roche’s patent. The Federal Circuit declined to apply the common law Experimental Use Exception to Bolar’s activities on the basis that they were being undertaken “solely for business reasons and not for amusement, to satisfy idle curiosity, or for strictly philosophical inquiry” and thus held that Bolar infringed Roche’s patent.<sup>16</sup>

<sup>7</sup> Pub. L. No. 98-417, 98 Stat. 1585 (1984).

<sup>8</sup> 21 C.F.R. Section 314, Subpart C.

<sup>9</sup> *Eli Lilly & Co. v. Medtronic, Inc.*, 496 U.S. 661, 669-670 (1990).

<sup>10</sup> 21 U.S.C. Section 301 *et seq.*

<sup>11</sup> *See, generally*, 21 C.F.R. Section 31258 *et seq.* for the regulations applicable to the filing of an Investigational New Drug Application (IND).

<sup>12</sup> 35 U.S.C. Section 154(a)(2).

<sup>13</sup> Competition in the Pharmaceutical Marketplace: Hearings before the Federal Trade Commission and the Department of Justice—Anti-Trust Division (March 19, 2002) (Gregory J. Glover, M.D., J.D. on behalf of the Pharmaceutical Research and Manufacturers Association).

<sup>14</sup> Tufts Center for the Study of Drug Development, news release of May 13, 2003, (“The fully capitalized cost to develop a new drug, including studies conducted after receiving regulatory approval, averages \$897 million.”)

<sup>15</sup> *Roche Products, Inc. v. Bolar Pharmaceutical Co.*, 733 F.2d 858 (Fed. Cir. 1984).

<sup>16</sup> *Id.* at 863.

If generic drug manufacturers are prevented from performing studies necessary to obtain FDA approval until the after expiration of the patent on the innovator drug, the patent holder in effect obtains an extension of its term of exclusivity. Negating the holding of *Roche*, Section 202 of the 1984 Act (codified as 35 U.S.C. Section 271(e)(1)) obviated this patent term distortion by providing a safe harbor for otherwise infringing studies undertaken on generic drugs in order to obtain regulatory approval.

While Section 271(e)(1) was enacted specifically to allow generic drugs to enter the market simultaneously with the expiration of the innovator's patent, the language of the statute was not so limited. The section reads as follows:

It shall not be an act of infringement to make, use, or sell a patented invention . . . solely for uses reasonably related to the development and submission of information under a Federal law which regulates the manufacture, use or sale of drugs or veterinary biological ducts.<sup>17</sup>

There is clearly a disparity between the limited purpose for which Congress enacted the 271(e) Exemption and the broad language of the exemption itself. It is not, for example, limited to generic drugs but rather includes all patented invention[s].<sup>18</sup> Because the language of 271(e)(1) is so broad, the courts have long struggled to determine the limits of its application. The uncertainties inherent in the statutory language have also led to sometimes-conflicting judicial interpretations of its scope and applicability.

The courts have repeatedly noted that the language of Section 271(e)(1) is not without ambiguity. "No interpretation we have been able to imagine can transform section 271(e)(1) into an elegant piece of statutory draftsmanship."<sup>18</sup> Nonetheless, in many of the cases in which the 271(e) Exemption has been considered, the parties have asked the courts to decide as a matter of law, and often in motions for summary judgment, whether entire classes of patents or activities fall outside the scope of the exemption. The case law that has developed increasingly indicates that application of the exemption will not be decided as a matter of law but as a question of fact. While some clear standards have emerged, many questions remain unanswered.

1. Should the exemption look to the "sole purpose" of the acts?

In the first case to construe the 271(e) Exemption, *Scripps v. Genentech*,<sup>19</sup> the court declined to grant defendant Genentech's motions for dismissal or summary judgment based on the 271(e) Exemption. The Scripps patent claimed a protein, the human blood clotting FactorVIII:C, which Genentech used to determine its amino acid sequence in order to clone the gene. In addition, Genentech prepared a European patent application, entered into an agreement to develop commercial scale-up manufacturing processes and contemplated sales outside the United States.

The District Court relied on the word "solely" in the statute and held that Genentech's activities were not shielded from infringement; although they might "eventually lead to the submission of data. . . that was not the *sole purpose*. . . . To apply 271(e)(1) in

<sup>17</sup> 35 USC Section 271(e)(1) as amended by the Uruguay Round Agreement Act, Pub. L. No. Section 533(a)(3)(A), 108 Stat. 4809 1994 (effective January 1, 1996) the acts of offering for sale or importing the invention into the United States were further included so as to conform to the amendments of 35 U.S.C. Section 271(a). The language of the statute as provided in the cases may therefore differ depending on the date of decision.

<sup>18</sup> *Eli Lilly & Co. v. Medtronic, Inc.*, 496 U.S. 661, 679 (1990).

<sup>19</sup> *Scripps Clinic & Res. Found. v. Genentech, Inc.*, 666 F. Supp. 1379 (N.D. Cal. 1987) *aff'd in part, rev'd in part on different grounds*, 927 F.2d 1565 (Fed. Cir. 1991).

those circumstance would be to permit the exception to swallow the rule.”<sup>20</sup> This was the first and last case to focus its analysis on the word “solely.”<sup>21</sup> Doubtless, it is also the only court to venture that “[t]he statute’s meaning is clear. . . .”<sup>22</sup>

## 2. What activities are “reasonably related” to regulatory approval?

Subsequent decisions declined to follow the “solely for the purpose” standard of *Scripps*, instead focusing on whether the acts were “reasonably related” to obtaining regulatory approval. In *Intermedics v. Ventritex*<sup>23</sup> the court articulated a more objective standard, not dependent on the defendant’s “purpose” as in *Scripps*.<sup>24</sup> The court looked to the plain language of the 271 (e) statute, noting that the words are “‘solely for *uses* reasonably related,’ not ‘solely for *purposes* reasonably related’ . . . [i]f Congress had wanted courts to focus on ‘purposes’ it probably would have selected that word. . . .”<sup>25</sup>

Ventritex had developed implantable cardiac defibrillators which fell within the scope of patents held by Intermedics. The district court articulated a two step test for determining whether Ventritex’s uses of the defibrillators were covered by the 271(e) Exemption. First, it determined which activities were in fact infringing under 35 U.S.C. 271(a).<sup>26</sup> Having determined that defendant Ventritex’s sales to hospitals in the United States, sales to international distributors, tests of the device in the United States and abroad and demonstrations of the device at trade shows infringed Intermedics patents, the court then asked:

Would it have been reasonable, objectively, for a party in defendant’s situation to believe that there was a decent prospect that the ‘use’ in question would contribute (relatively directly) to the generation of [the] kinds of information that was likely to be relevant in the process by which the FDA would decide whether to approve the product?<sup>27</sup>

Finding that each of defendant’s uses satisfied this latter test, the district court held the activities to be exempt from infringement under Section 271(e)(1).

The scope of exempt activities has been further expanded in later cases to include the personal use of a patented female condom by a physician, and its use in consumer focus groups, color tests and interviews,<sup>28</sup> and demonstrations of medical devices to non-physicians at medical conferences.<sup>29</sup>

In another case involving *Scripps Clinic’s Factor VIII:C*,<sup>30</sup> the court did not follow the “solely” reasoning in the earlier *Scripps v. Genentech* decision, and declined to dismiss certain of Baxter’s defenses. Instead the court invoked the “reasonably related” standard, indicating that the “scope of 271(e)(1) presents a question of law that has no clear answer. . . . This question must be more fully developed before the Court can decide it.”<sup>31</sup>

<sup>20</sup> *Id.* at 980, (emphasis added); see also, 666 F. Supp. at 1396.

<sup>21</sup> *See, Angen, Inc. v. Hoechst Marion Roussel, Inc.*, 3 F. Supp. 2d 104, 108 (D. Mass.1998) (“the use must be reasonably related to (albeit not for the exclusive purpose of) FDA approval.”)

<sup>22</sup> *Scripps Clinic & Res. Found. v. Genentech, Inc.*, 231 U.S.P.Q. 978, 980 (N.D. Cal. 1986).

<sup>23</sup> *Intermedics, Inc. v. Ventritex, Inc.*, 775 F. Supp. 1269 (N.D. Cal. 1991) *aff’d* 991 F.2d 808 (Fed. Cir. 1993).

<sup>24</sup> *Id.* at 1274 (“Plaintiff has urged that we put the ‘intent’ of the party that claims to be engaged in activity protected by the exemption at the center of the judicial inquiry. . . . We also fail to understand why the subjective state of mind of a party should be significant in this setting. Surely Congress was not concerned about clearing certain ‘unacceptable’ thoughts or hope or visions out of certain persons’ minds.”).

<sup>25</sup> *Id.* at 1278 (emphasis added).

<sup>26</sup> See note 1, *supra*.

<sup>27</sup> *Intermedics, supra*, at 1280.

<sup>28</sup> *Chartex Int’l PLC v. M.D. Personal Products Corp.*, 5 F.3d 1993 (Fed. Cir. 1993).

<sup>29</sup> *Teletronics Pacing Systems, Inc. v. Ventritex, Inc.*, 982 F.2d 1520 (Fed. Cir. 1992).

<sup>30</sup> *Scripps Clinic & Research Foundation v. Baxter Travenol Labs, Inc.*, 7 U.S.P.Q. 2d 1562 (D.Del. 1998).

<sup>31</sup> *Id.* at 1565.

An unusual approach to determining whether activities were “reasonably related” to FDA approval was employed by the District Court of Delaware.<sup>32</sup> The defendants acts included sending information to physicians and soliciting them through a website to participate in clinical trials, maintaining a booth at trade shows displaying the device, and advertising in medical journals. Rather than determine whether these acts were “reasonably related to FDA approval” test, the district court initially held that “the FDA is in a better position than the courts to determine what activities are reasonably related to obtaining regulatory approval. . . . The court will not resolve the issue of whether AmCell’s activities are protected by 271(e)(1). Rather, the court will defer to the FDA.”<sup>33</sup> The FDA declined to make the evaluation.<sup>34</sup>

While the *Intermedics* court may have expanded the five words of the phrase “solely for uses reasonably related” into some 56 words, it is not clear that the standard has been clarified. Although the test is ostensibly objective, the number of words with subjective connotations is likely to prevent consistent application. However, the *Intermedics* test has now become the prevailing standard for determining whether the 271(e) Exemption applies.

### 3. To what “patented inventions” does the Exemption apply?

An early issue considered by the courts in construing the 271(e) Exemption was whether the term “patented invention” is limited to “drugs” or is to be given broader scope to include all FDA regulated products. The term was first considered in the *Eli Lilly v. Medtronic* line of cases.<sup>35</sup> Lilly’s predecessor-in-interest sued Medtronic for patent infringement based, in part, on Medtronic’s pre-market testing of implantable cardiac defibrillators. Medtronic defended on the basis that its activities were exempt under the safe harbor provision of 35 U.S.C. Section 271(e)(1). While the district court held that the exemption was not applicable to medical devices, the Federal Circuit reversed, and the Supreme Court affirmed and remanded for a determination of whether Medtronic’s activities were reasonably related to the development and submission of information for regulatory approval.<sup>36</sup>

Characterizing the language of the statute as “as imprecise and not plainly comprehensible”<sup>37</sup> the Supreme Court looked to the structural symmetry of the 1984 Act to discern its applicability to medical devices. The Court noted that the 1984 Act “[t]aken as a whole” was designed to remedy the two complementary patent term distortions: loss of patent term during the patent holder’s efforts to obtain regulatory approval and the extension of patent term pending approval for competitors to enter the market.<sup>38</sup>

The Court invoked a symmetry rationale, reasoning that it was implausible that the 1984 Act would seek to correct the dual distortions for some products subject to regulatory approval, while correcting only one aspect for other regulated products. Noting that, like pharmaceuticals, medical devices are eligible for patent term restoration to compensate for lengthy pre-market regulatory delays,<sup>39</sup> the court held that the 271(e) Exemption was applicable to medical devices. The court indicated that any other holding would “leave in place an anti-competitive restriction at the end of the monopoly term but simultaneously

<sup>32</sup> *Nexell Therapeutics, Inc. v. Amcell Corp.*, 143 F. Supp. 2d 407 (D. Del. 2001).

<sup>33</sup> *Id.* at 422, 423.

<sup>34</sup> *Nexell Therapeutics v. AmCell Corp.*, 199 F. Supp. 2d 197, 202 (D. Del.) (“It is not clear to the FDA what, if anything, the court expects the agency to do in this litigation”).

<sup>35</sup> *Eli Lilly & Co. v. Medtronic, Inc.*, 872 F.2d 402 (Fed. Cir. 1998); 496 U.S. 661 (1990).

<sup>36</sup> *Id.*

<sup>37</sup> *Id.* at 1123.

<sup>38</sup> *Id.* at 669.

<sup>39</sup> *Id.* Patent term restoration is available for “a drug product. . . any medical device, food additive, or color additive subject to regulation under the Federal Food, Drug, and Cosmetic Act. . . .” 35 U.S.C. Section 156 *et seq.* 2003.

expand the monopoly term itself, thereby not only failing to eliminate but positively aggravating distortion” of the patent term.<sup>40</sup>

In a subsequent decision, *AbTox v. Exitron*,<sup>41</sup> the Federal Circuit was confronted with the issue of whether a medical device which is not eligible for patent term restoration under 35 U.S.C. 156 is nonetheless subject to the 271(e) Exemption.<sup>42</sup> Devices, such as the plasma sterilizer at issue, are not subject to the rigorous pre-market approval process of the potentially more risky devices considered in *Lilly*. While noting that the Supreme Court’s reasoning in *Lilly* stressed the symmetry of the two provisions, the court in *AbTox* nonetheless held that under the broad holding of *Lilly*, the 271(e) Exemption is applicable to all classes of medical devices.<sup>43</sup>

#### 4. Does the exemption cover uses of tool technology?

Many of the inventions that underlie the biotechnology revolution of the late 20th century relate to basic platform technologies, new materials or methods for discovering new products. Such platform, or “tool,” technology has enormously increased the types of diagnostic and therapeutic products currently available. However, patents claiming the tools themselves, rather than the products obtained through the use of the tools, present novel issues. Among these is the question of whether otherwise infringing uses of tool patents can be shielded by the 271(e) Exemption.

In *Infigen v. ACT*,<sup>44</sup> the defendants conceded that in developing transgenic cows they infringed Infigen’s tool patents. The court looked to the patented products covered by the tool patents—methods and materials for producing and growing bovine embryos—and determined that these patents were not eligible for patent term restoration under 35 U.S.C. 156. Using the *Lilly* symmetry rationale requiring that products eligible for the 271(e) Exemption also be subject to patent term restoration, the court held the defendant’s acts not immune from infringement.<sup>45</sup> However, the holding was not well taken in view of the Federal Circuit’s directly inopposite prior decision in *Abtox* which dismissed the symmetry rationale relied on by *Infigen*. Under the reasoning of *Infigen*, it would be difficult to imagine any tool patents to which the 271(e) Exemption could apply.

A contrary result was reached in *Bristol-Myers v. Rhone-Poulenc*<sup>46</sup> which found that utilizing patented research tools could fall within the 271(e) Exemption. Bristol Myers was seeking new taxol analogs useful as cancer therapeutics. Using chemical intermediates patented by Rhone-Poulenc, Bristol-Myers created a structure/function database for analysis of thousands of compounds for activity. The District Court for the Southern District of New York looked to the *Abtox-Chartex* line of cases for the precedent that “patented invention” includes “all patented inventions or discoveries, and not merely those that are covered by section 156” to find that defendant’s work was exempted from infringing plaintiff’s tool patents.<sup>47</sup>

<sup>40</sup> *Lilly, supra*, at 672-73.

<sup>41</sup> *AbTox, Inc. v. Exitron Corp* 122 F.3d 1019 (Fed. Cir. 1997).

<sup>42</sup> Medical Device patents eligible for term restorations under 35 USC156(g)(B) are limited to those that require regulatory review under section 21 U.S.C. 360(e); these include the Class III medical devices at issue in *Lilly*, but not class II devices of *AbTox*.

<sup>43</sup> *AbTox, supra*, at 1029.

<sup>44</sup> *Infigen, Inc v. Advanced Cell Technology, Inc.* 65 F. Supp. 2d 967 (W. D. Wis.1999).

<sup>45</sup> *Id.* at 981.

<sup>46</sup> *Bristol-Myers Squibb Company v. Rhone-Poulenc Rorer, Inc.*, No. 95 Civ. 8833, 2001 WL 1512597 (S.D. N.Y. Nov. 28, 2001).

<sup>47</sup> *Id.* at 6.



## 5. How far back in the research process does the Exemption extend?

After many years of extending the scope of the 271(e) Exemption, the Federal Circuit has now issued a decision narrowing its scope. In its most recent consideration of the 271(e) Exemption, *Integra LifeSciences v. Merck KGaA*,<sup>48</sup> the court had to determine “whether the pre-clinical research . . . is exempt from liability for infringement.”<sup>49</sup> The issue before the Court was whether the 271(e) Exemption “reaches back down the chain of experimentation to embrace development and identification of new drugs that will, in turn, be subject to FDA approval.”<sup>50</sup>

The *Integra LifeSciences* case involved the use of peptides that contain the amino acid sequence Arg-Gly-Asp (otherwise abbreviated as RGD) which are involved in cell adhesion. The peptides have application where cells, appropriately or inappropriately, adhere to each other or to extracellular matrix proteins. Patents covering the RGD peptides themselves, their receptors and various methods of their use were exclusively licensed to Integra LifeSciences.

After their initial discovery, RGD peptides became the subject of much further research; a scientist working at The Scripps Research Institute discovered that they were involved in the growth of new blood vessels (a process known as angiogenesis) and thus had potential for treating cancer by starving solid tumors. Interested in the practical application of RGD peptides to inhibit angiogenesis, Merck KGaA entered into a sponsored research agreement with The Scripps Research Institute to test the activity of various RGD peptides. The research at issue with regard to the 271(e) Exemption involved *in vitro* screening of certain RGD peptides for anti-angiogenesis activity as well as testing the RGD peptides on fertilized chicken eggs to determine their effect on blood vessel development.<sup>51</sup>

Merck KGaA was offered, and declined to take, a sub-license. Integra LifeSciences brought suit alleging that Merck KGaA was directly infringing their patents by importing RGD peptides into the United States and inducing Scripps to infringe their patents by virtue of the sponsored research agreement. Merck KGaA defended the right to make and use the patented compositions and methods on the basis, *inter alia*, that the work fell under the 271(e) Exemption. After a 27-day trial, the jury was asked to determine whether the infringing acts were “reasonably related” to FDA approval so as to be exempt.<sup>52</sup> The district court concurred with the jury’s verdict, holding that the research was not exempt from infringement and awarded damages of \$15 million based on a hypothetical license negotiation.<sup>53</sup>

On appeal, defendant Merck KGaA argued that the 271(e) Exemption should be construed to exempt all experimentation that could serve as a “rational predicate” for subsequent experimentation leading to information directly pertinent to FDA review for safety and efficacy.<sup>54</sup> Rejecting this broad construction, the court stated that “271(e)(1) simply does not globally embrace all experimental activity that at some point, however attenuated, may lead to an FDA approval process.”<sup>55</sup> The Court pointed out that “the FDA

<sup>48</sup> *Integra LifeSciences I, Ltd. v. Merck KGaA* 331 F.3d 860 (Fed. Cir. 2003).

<sup>49</sup> *Id.* at 865.

<sup>50</sup> *Id.* at 865-66.

<sup>51</sup> *See Id.* at 863 and Opening Brief of Plaintiffs-Cross Appellants in Appeal to the United States Court of Appeals for the Federal Circuit, p. 21.

<sup>52</sup> The jury was instructed that for the 271(e) Exemption to apply, Merck must prove “that it would be objectively reasonable for a partying Merck’s and Scripps’ situation to believe that there was a decent prospect that the accused activities would contribute, relatively directly, to the generation of the kinds of information that are likely to be relevant in the process by which the FDA could decide whether to approve the product in question.” Jury Instructions, *Integra LifeSciences, I Ltd. v. Merck*, (S.D. Cal. 96-CV-1307).

<sup>53</sup> Because damages only attach in situations where the 271(e) Exemption does not apply, they will not be considered further.

<sup>54</sup> Opening Brief of Defendant-Appellant in Appeal to the United States Court of Appeals for the Federal Circuit, p. 45.

<sup>55</sup> *Integra LifeSciences, supra*, at 867.

does not require information about drugs other than the compound featured” in an IND.<sup>56</sup> Accordingly, the Court held that the Merck-sponsored Scripps research to select the best among several possible drug candidates does not fall within the 271(e)(1) Exemption. The damage award was remanded to the District Court for further consideration.<sup>57</sup>

The *Integra LifeSciences* decision cannot be taken to mean that all-preclinical research necessarily is outside the scope of the 271(e) Exemption. In fact, the court noted that some activities that do not themselves produce FDA information may nevertheless be exempted.<sup>58</sup> The decision holds only that application of the 271(e) Exemption requires a specific factual showing of relatively direct relevance to core FDA concerns of safety and efficacy. Merck KGaA failed to make a sufficient showing to convince a judge and jury that the exemption should apply. But in other cases the connection between infringing pre-clinical experiments and FDA review may well be direct enough to invoke the 271(e)(1) Exemption.

The *Integra LifeSciences* court also considered the effect of the “rational predicate” theory urged by Merck on “tool patents.” The court noted that extending the safe harbor of 271(e)(1) to cover the Scripps experiments “would effectively vitiate the exclusive rights of patentees owning biotechnology tool patents. . . . [and] would swallow the whole benefit of the Patent Act for some categories of biotechnological inventions.”<sup>59</sup> The *Integra LifeSciences* case was not simply a tool patent case. The Merck-sponsored research included using patented compositions and methods to search for non-peptide alternatives. However, the patent claims which were infringed included claims that had been construed to directly cover the peptides Merck had imported and Scripps had used in their experiments.<sup>60</sup> Thus, while the decision may be a bellwether of the Federal Circuit’s inclination to consider tool patents outside the scope of the 271(e) Exemption, the decision should not be read to so hold.

## II. WHERE ARE WE NOW?

In many of the cases leading up to *Integra LifeSciences*, the courts have been asked to hold that the 271(e) Exemption is applicable, or inapplicable, to entire categories of “uses” or “inventions.” No such bright lines can be drawn. *Lilly* demonstrated that the exemption is not limited to drugs, much less generic drugs. Further, *Abtox* dismissed the symmetry theory, by which the exemption would only be applied to patents which were also eligible for patent term restoration. While there remain apparently conflicting decisions between the district courts as to whether the 271(e) Exemption is properly applied to tool patents, ultimately they should be treated in the same manner as any other patents in asking: were the infringing uses of the patented invention “reasonably related” to obtaining FDA approval?

The decision in *Integra LifeSciences* reaffirms that application of the 271(e) Exemption will be determined under the *Intermedics* “reasonably related” standard. Exemption cannot be determined as a matter of law according to either the class of infringing product or the type of patent. Instead, the analysis will focus on the nature of the

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<sup>56</sup> *Id.*

<sup>57</sup> *Id.* at 872.

<sup>58</sup> *Id.* at 866 (“The term ‘reasonably’ permits some activities that are not themselves the experiments that produce FDA information to qualify as ‘solely for uses reasonably related’ to clinical tests for the FDA”).

<sup>59</sup> *Id.* at 867.

<sup>60</sup> U.S. Patent No. 4,792,525, entitled *Tetrapeptide*, issued December 20, 1998 (inventors: Ruoslahti and Pierschbacher), includes claim 8, which reads as follows: “A substantially pure peptide including as the cell-attachment-promoting constituent the amino acid sequence Arg-Gly-Asp-R wherein R is Ser, Cys, Thr or other amino acid, said peptide having cell-attachment-promoting-activity, and said peptide not being a naturally occurring peptide.”

otherwise infringing acts, a question of fact. For this reason, cases are more likely to go to trial, with juries deciding whether the defendant's activities satisfy the *Intermedics* standard and verdicts being reviewed only for substantial evidence. With biomedical technology becoming ever more complex and patent rights ever more important, doubtless many juries will grapple to determine—based on the facts of the case—when the causal chain of research events actually enters the safe harbor of the 271(e) Exemption.<sup>61</sup>

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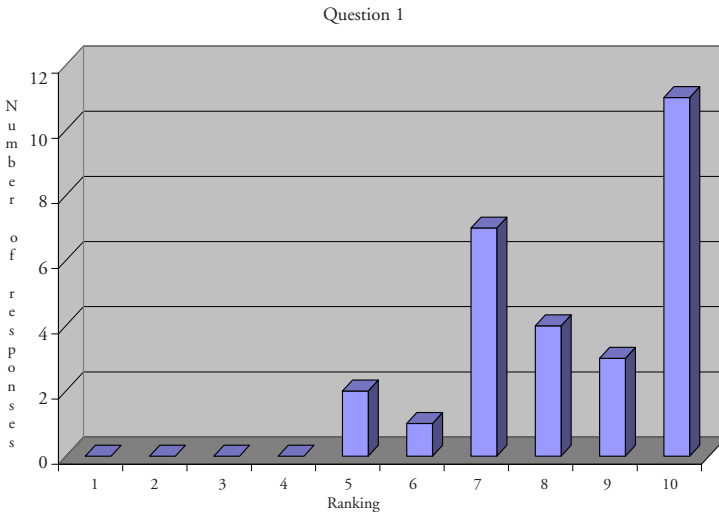
61 The authors wish to thank David Beckwith and Mauricio Flores for their constructive suggestions.



# WILLFULNESS/OPINION OF COUNSEL QUESTIONNAIRE SURVEY RESULTS<sup>1</sup>

*Robert G. Sterne and David K.S. Cornwell  
Sterne, Kessler, Goldstein and Fox  
Washington, D.C.*

Q1. On a scale of 1 to 10, where 1 means that this area of law is of no practical consequence to the practice of patent law, and 10 means this area is a severe problem, how would you classify the current state of the law of willfulness?



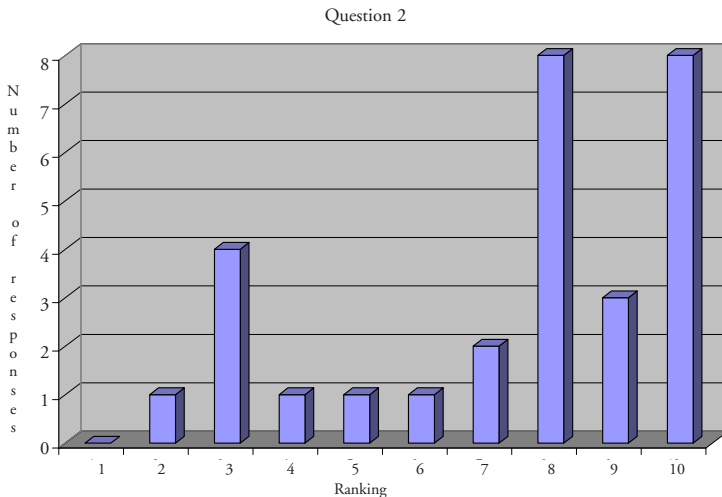
## Comments:

- 1) Although there are significant problems associated with the use of legal opinions, the “totality of circumstances” test is an easier trial component of fairness across a broad spectrum of cases.
- 2) Very important issue, but unlike other issues, (Markman, Festo, etc.) it is an issue primarily at trial.
- 3) Not clear about question.
- 4) Causes some confusion, but not as important as central issues of infringement and invalidity.

<sup>1</sup> This survey was taken at The Fourth Annual Sedona Conference<sup>SM</sup> on Patent Litigation, November 6-7, 2003, at the Radisson Poco Diablo resort in Sedona, AZ. A total of 29 people participated in this survey.

- 5) The likelihood of disqualification of opinion counsel as trial counsel greatly impacts our practice. The focus must turn to the clients good faith reliance on a belief of non-infringement.
- 6) Current willfulness jurisprudence creates an expensive charade — it does not adequately give consideration to good faith opinions of those skilled in the art. Also tends to disincentive product clearance.
- 7) We separate the “reliance witness” from the senior management who receives status information and risk analysis during litigation.
- 8) In many cases it plays no role whatsoever, but can become a behemoth in certain situations.
- 9) I have one phrase to describe the state of the law in this area: “Disney World for Lawyers”, a make-believe world.

Q2. On a scale of 1 to 10, where 1 signifies that this area has minimal impact and 10 signifies that it is a severe practical interference, how does the state of the law of willfulness affect your ability to provide unbiased, objective advice to your client about their patent infringement risks?



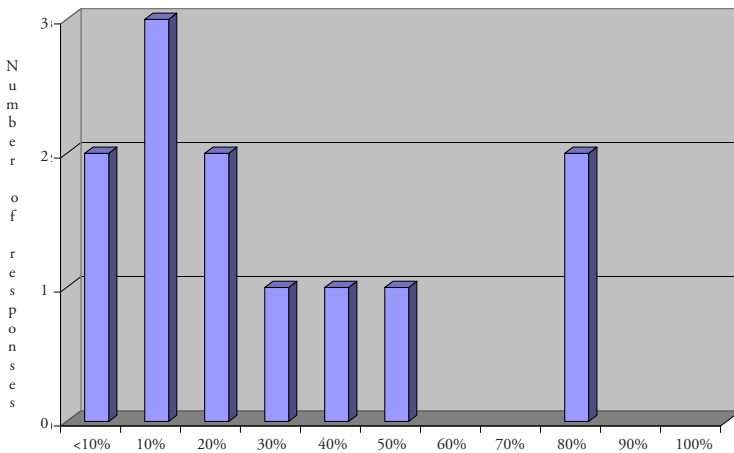
Comments:

- 1) I do not give opinions for use in evidence, but those in firms who do are seriously affected by that aspect of their opinions.
- 2) I am litigation — not part opinion giver.
- 3) It is just an issue of what is written. But would be better to write so that can be conveyed accurately and record made.
- 4) I am not a patent lawyer. I don't consider willfulness when I discuss pros and cons of an adversary's position.

- 5) But, it does greatly affect the mode of communicating that advice to clients.
- 6) This law has fundamentally altered the way advice about patent validity is rendered.
- 7) We are always concerned about waiver of privilege, usually due to businessman/women's "propensity to proliferate" — email is just too handy a tool for these people to ignore!
- 8) Cannot just prepare it without considering effects beyond client reading.
- 9) We separate the "reliance witness" from the senior management who receives status information and risk analysis during litigation.
- 10) Don't write opinions so I feel I can discuss issues w/o waiver.
- 11) Beating around the bush describes it.

Q3. In what percentage of the patent infringement cases that you handle does your firm act both as trial counsel and as opinion counsel?

Question 3

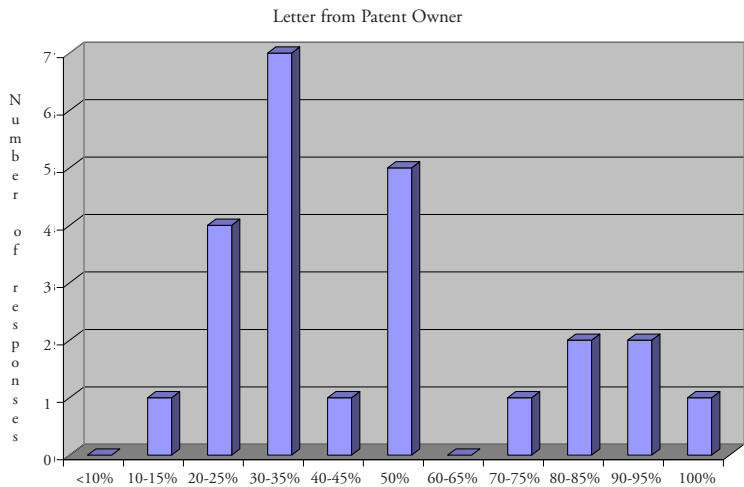
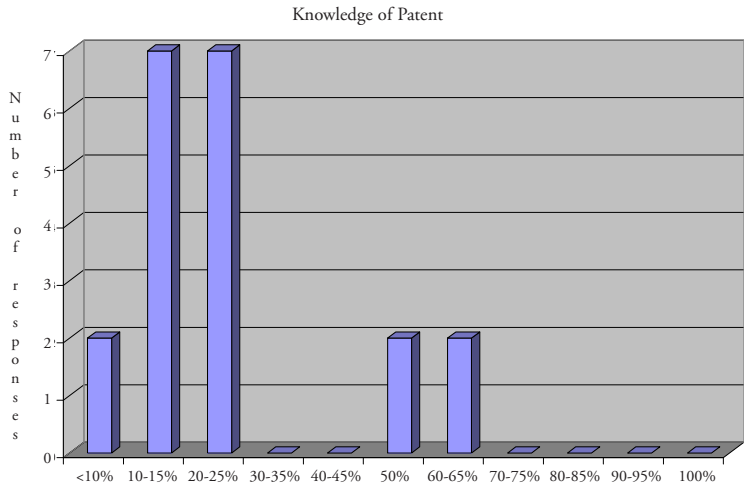


Comments:

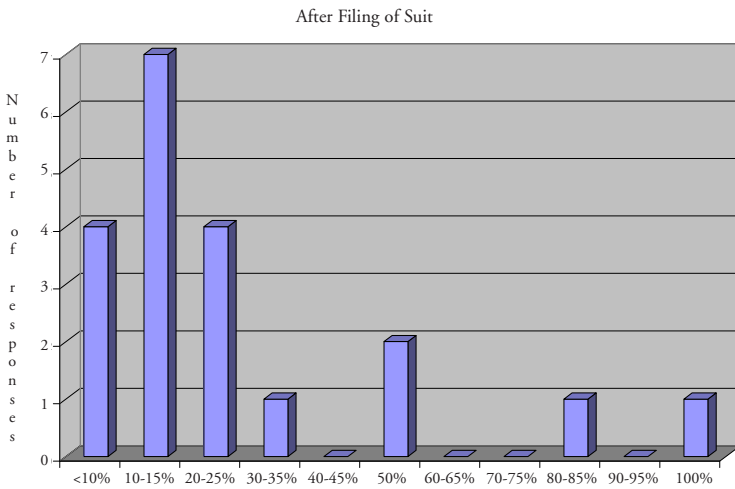
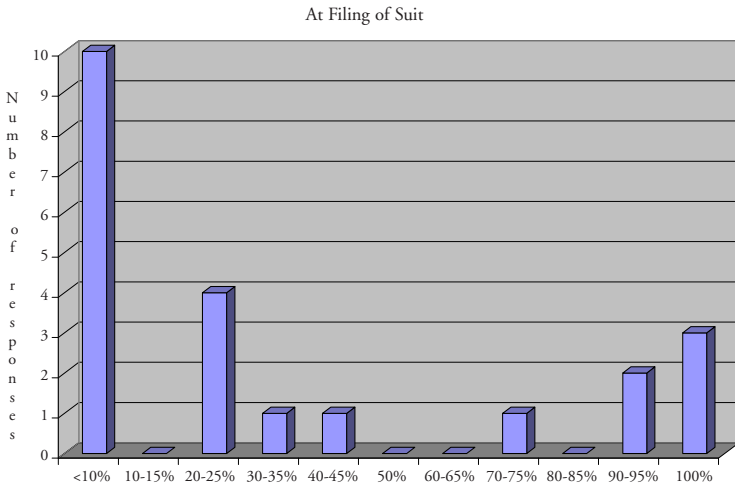
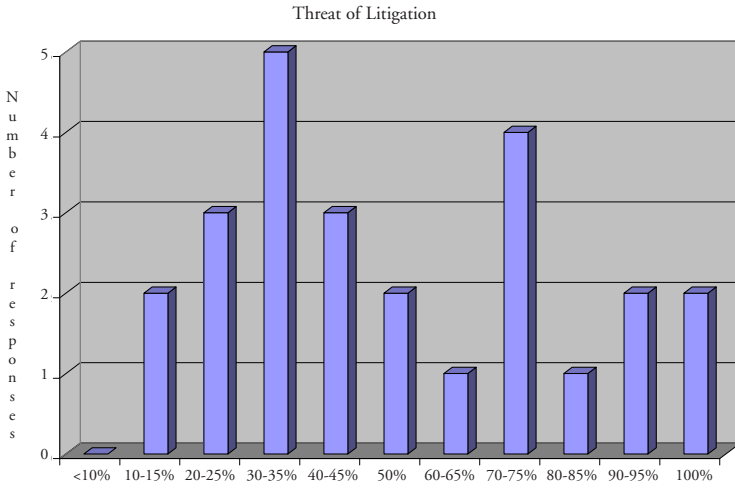
- 1) As few as possible.
- 2) But the percentage is dropping.
- 3) Occasionally.
- 4) The fact is that this is changing fast and at present we do no opinions in cases where we are counsel.
- 5) I am in-house, hence "n/a" - - and see some of the following answers as well.
- 6) In-house; "this is a no, no for now".

- 7) Only if the client insists, but even then use different groups of lawyers.
- 8) I am in-house general counsel.
- 9) Not in my office, but a little in other office. Generally this coverage, especially for anyone other than a very small client.

Q4. In those situations where you seek outside opinion counsel, estimate the percentage at each stage in the proceeding where opinion counsel is brought in:







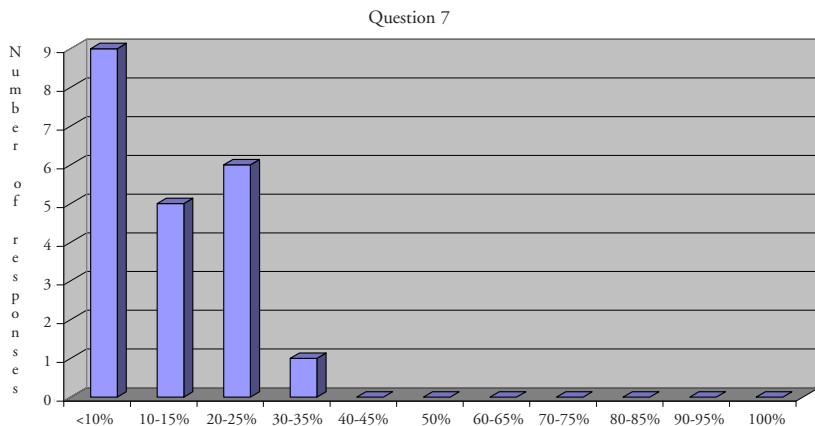
Q5. In which of the following circumstances do you believe it is necessary to obtain an opinion of counsel?

- 0        A client is aware of a patent, but has no reason to believe it infringes.
- 16       A client is aware of a patent and has been told by a third party that it infringes.
- 27       A client is aware of a patent, has read the patent and believe that it may infringe the patent.
- 16       A client receives a licensing letter with no accusation of infringement.
- 26       A client receives a C & D letter.

Q6. In light of the current state of the law, what is your opinion of best practices on proper staffing of an opinion of counsel defense?

- 0        My law firm, same teams.
- 4        My law firm, different teams.
- 5        My law firm does opinion, new trial firm brought in to provide defense.
- 23       My law firm provides defense, new law firm brought in to provide opinion.
- 1        Entire matter referred to new law firm.

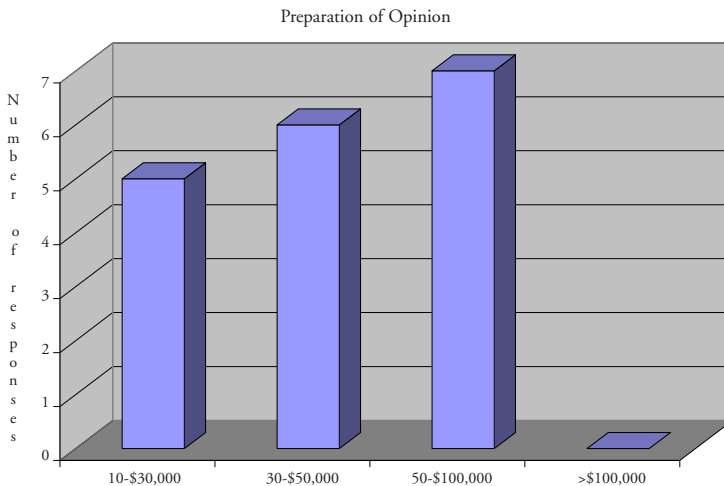
Q7. When your firm does not act as opinion counsel, but separate opinion counsel is used, what percentage of the cost of patent litigation can be attributed to the issue of willfulness?



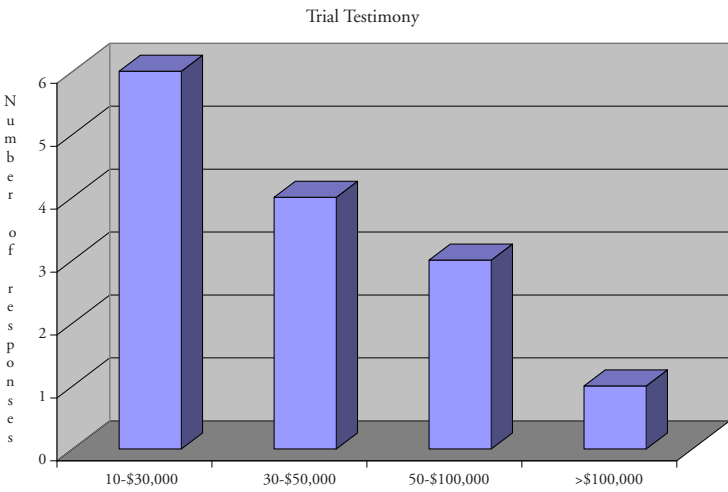
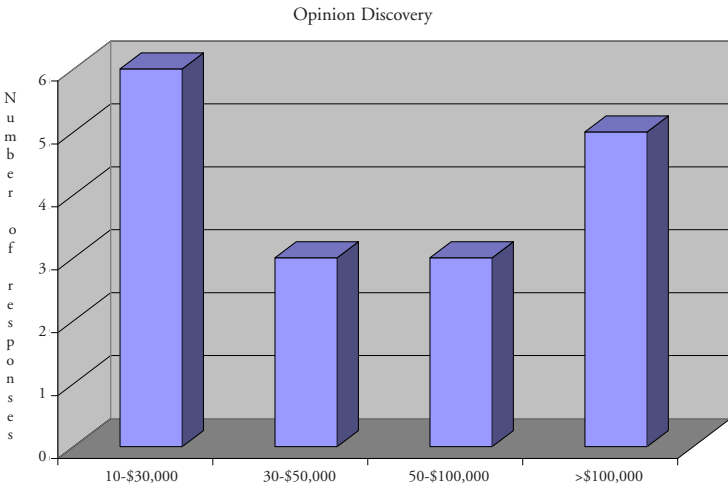
## Comments:

- 1) The opinion is likely to cost \$20K to \$75K or more. Discovery of the opinioning lawyer will require discovery and attendance at trial proportional to work done.
- 2) Keeping the opinion counsel separate is not that expensive, unless inconsistencies between their opinion and trial strategy appears. However there's overlap with other issues. The fact that this is changing fast and at present we do no opinions in cases where we are counsel.
- 3) Cost of litigation is high. Opinion costs more from outside source, but not much more.
- 4) The longer this litigation proceeds, the less material the cost of separate opinion counsel.
- 5) Very difficult to estimate.
- 6) Cost of litigation is not really the issue. At this point, the patent is already important enough to be the subject at litigation. The bigger issue is the cost of opinions to companies if you have to do one for every potentially problematic patent a company becomes aware of.
- 7) Bulk of the expense relates to litigation discovery – cost of opinion pales in comparison.

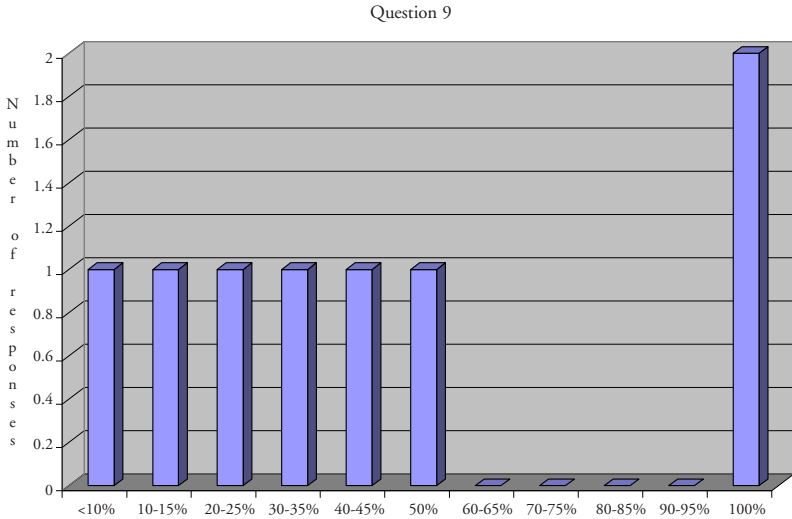
Q8. When your law firm acts only as trial counsel, what is the average costs of the infringement opinion component of case?



Preparation of opinion:



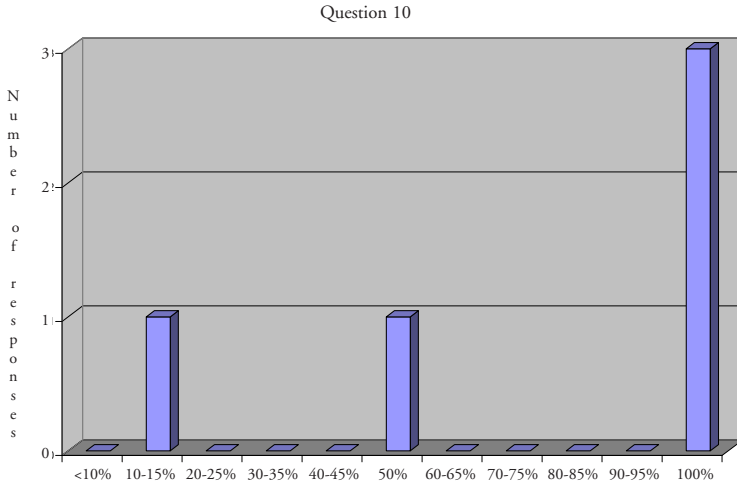
Q9. When acting as defense counsel, what percentage of your cases has resulted in a finding of willfulness?



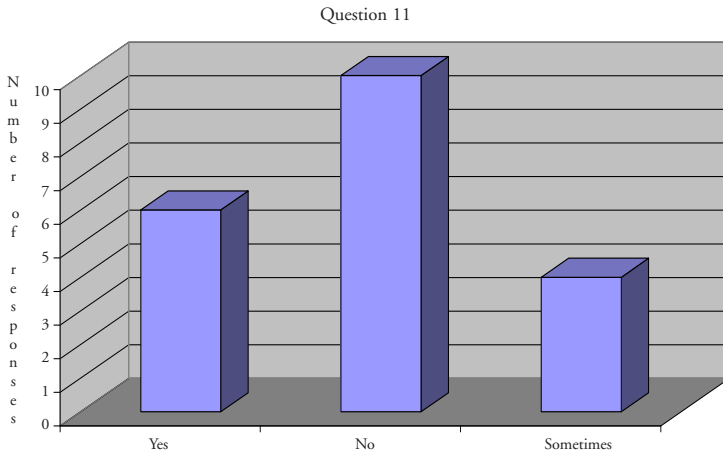
Comments:

- 1) Where infringement is found, 25%.
- 2) One case representing plaintiff, one case representing defendant; that total willfulness on less than 3 hours of total deliberation in Del.
- 3) One case settled.
- 4) Very lucky I guess!
- 5) Hard to estimate — so few go to trial. Only 1 willfulness finding and no enhanced damages.
- 6) I note that Judge misspoke in his jury instruction which said that you only look to see if reasonable belief if noninfringement, not invalidity. Jury found willfulness, but invalidity on 6 grounds.
- 7) Only 2 cases would fit the preamble of question.

Q10. In those cases where a finding of willfulness has occurred against your client, what percentage of cases has resulted in an award of enhanced damages and/or attorneys fees?



Q11. When you have used a separate law firm as opinion counsel, do you as trial counsel have direct contact with opinion counsel?



Comments:

- 1) Risky.
- 2) I think you have to.
- 3) Only to answer specific objective questions.
- 4) The entire purpose of having separate opinion counsel is to avoid any waiver.
- 5) We assist in selection of counsel, but have no contact after that.

- 6) I consider myself gatekeeper on this issue.
- 7) Limited to providing materials and prep for depo.
- 8) Not until opinion is completed.
- 9) In-house.
- 10) Direct contact increases chance that scope of waiver will reach to trial counsel.
- 11) On procedural matters.
- 12) Indirectly, through my staff litigation attorney who talks with both to be assured the opinion is not inconsistent.

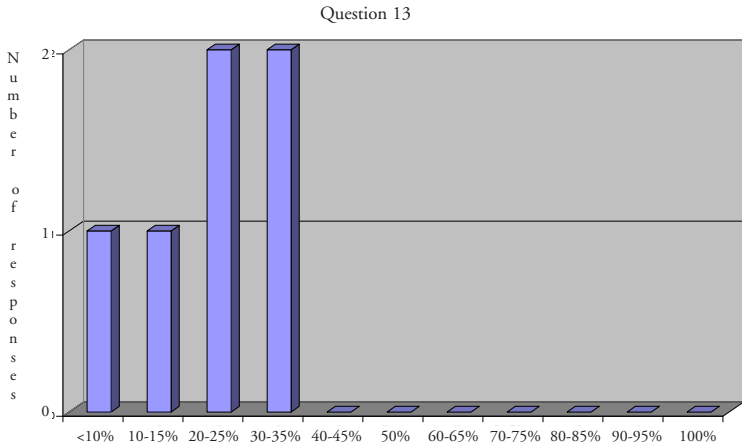
Q12. When you have used a separate law firm as opinion counsel, what role do your client's in-house attorneys play in working with opinion counsel?

Answers:

- 1) Work closely.
- 2) Intermediate.
- 3) Very little – they select the opinion counsel, but we make sure they have seen the proper material to give a competent opinion.
- 4) Will usually rely on opinion.
- 5) They are the primary contact with opinion counsel.
- 6) Sometimes they had written opinion, always involved.
- 7) Providing necessary evidence, not opinions.
- 8) Varies with client.
- 9) Only giving facts on accused subject matter.
- 10) In-house counsel works with opinion counsel and there is no contact with litigation counsel.
- 11) Used at times.
- 12) Managers of the process – liaisons with business persons and ultimately responsible for the result.
- 13) Provide information.
- 14) Co-ordinate opinion so that litigation counsel does not get involved.

- 15) In-house patent counsel retain opinion counsel, provide the appropriate information and instructions, and ultimately review the opinion with product decision makers.
- 16) Limited, careful, artificial due to discovery rules.
- 17) Provide prior art, technical info.
- 18) Primary contact.
- 19) They work directly with opinion counsel.
- 20) Provide reference for technical persons, read opinion and comment on it.
- 21) Varies, they deal directly with them.
- 22) Complete role.
- 23) Provide them with logistical support and background information. Advised not to provide opinions.

Q13. In what percentage of cases that you handle, does opinion counsel hire your firm as litigation counsel rather than your firm hiring opinion counsel?



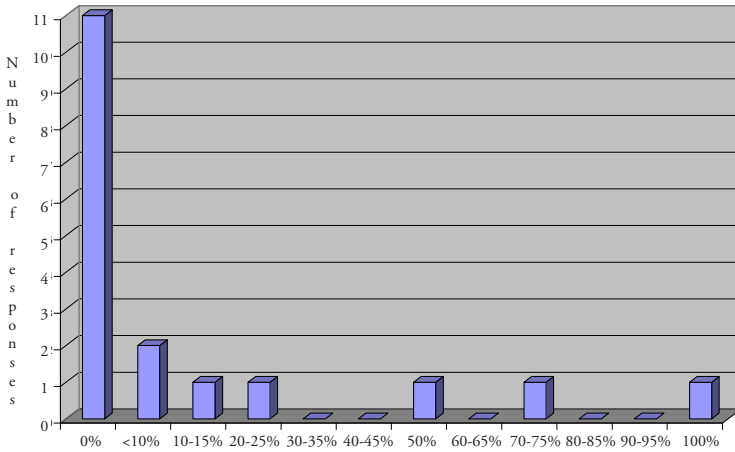
Comments:

- 1) Difficult to know role of other firms in many cases.
- 2) We have a policy now of not taking opinion if it would affect our ability to be litigation counsel.
- 3) In-house.
- 4) Client hires both.
- 5) We are trial counsel, we don't hire opinion counsel either; the client hires opinion counsel.

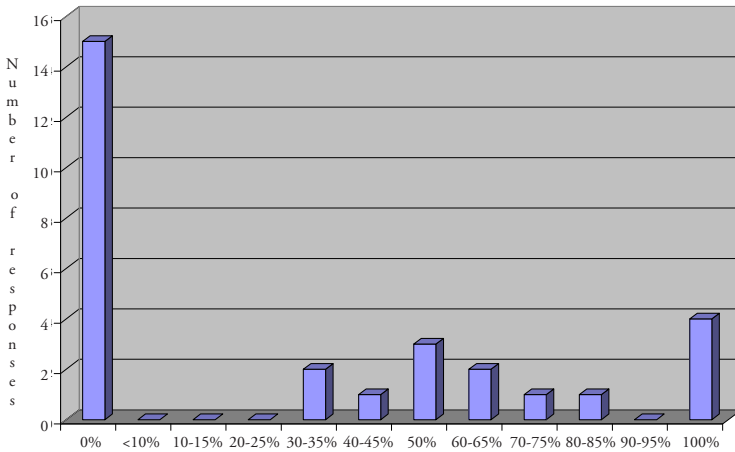


Q14. In your cases where opinions have been obtained, indicate by percentage who has acted as the reliance witness for your client?

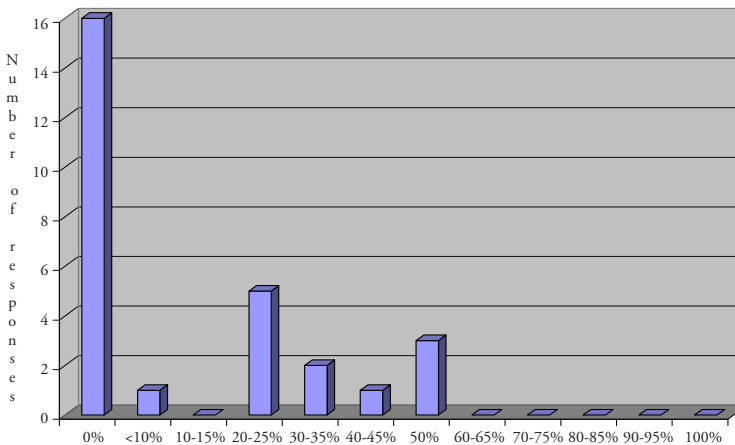
General Counsel

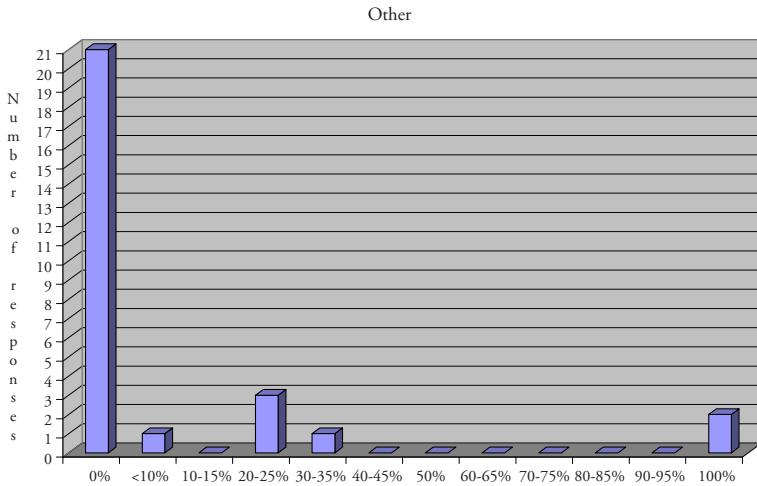
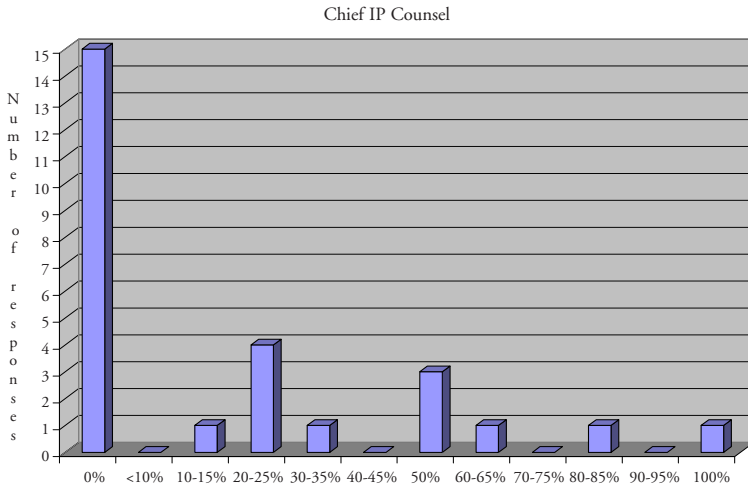


CEO or President



CTO's





Q15. If your client has a General Counsel, a CEO, a President, a CTO and a Chief IP Counsel, who do you prefer to act as the reliance witness in your cases?

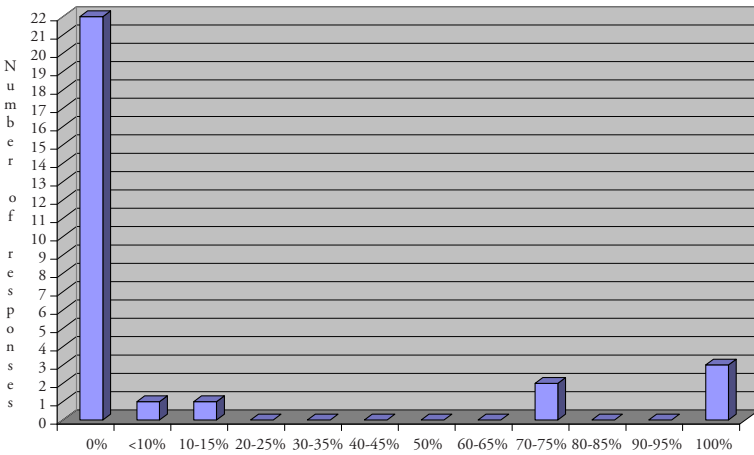
Answer:

- 1) IP Counsel and a business person.
- 2) President.
- 3) IP Counsel because he understands the opinion.
- 4) GC – I believe jury would expect the client lawyers to be the person relying.
- 5) President or CEO, whichever is the most knowledgeable and the best witness.
- 6) Whoever will be the best witness.

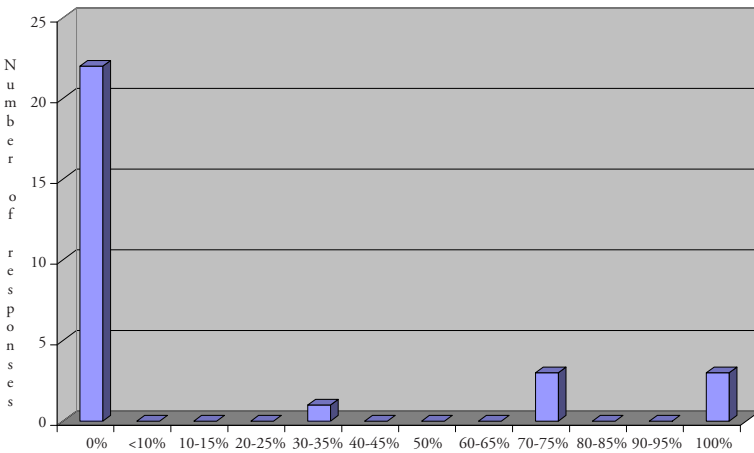
- 7) Probably based on who is a better witness.
- 8) CEO or Pres.
- 9) CEO or CTO or lesser management person responsible for the product in question.
- 10) Probably latter two.
- 11) CTO.
- 12) Depends on product and on decision maker for the product - Also, best witness.
- 13) CTO.
- 14) Person one step below Sr. Executive Officer level who has authority to make product decisions.
- 15) CTO.
- 16) Depends on how good of a witness he/she is.
- 17) Depends on who is best witness with control.
- 18) Depends on technology in patent.
- 19) President or CEO and Chief IP counsel.
- 20) Business or technical officer responsible for the accused device who can best testify as a witness.
- 21) CTO.
- 22) None of the above.
- 23) Business unit (division) general manager.
- 24) President, CEO. The buck stops there in a small company. If a large company, then Chief IP Counsel or CTO.

Q16. In those cases where you have turned over your opinion, indicate by percentage the extent of the ultimate waiver of privilege

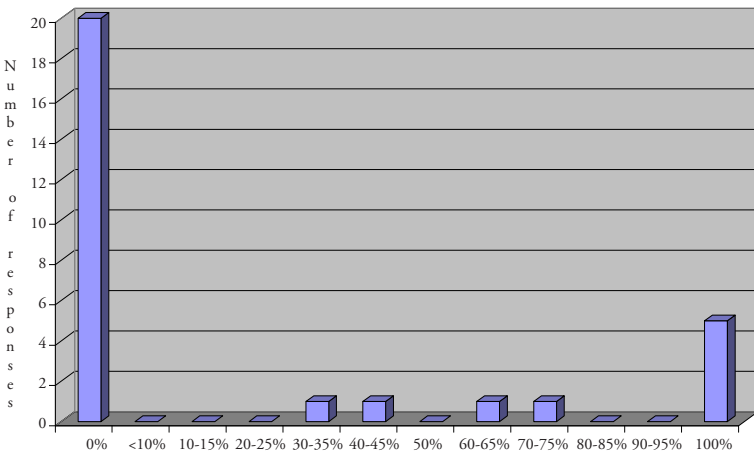
Just the Opinion



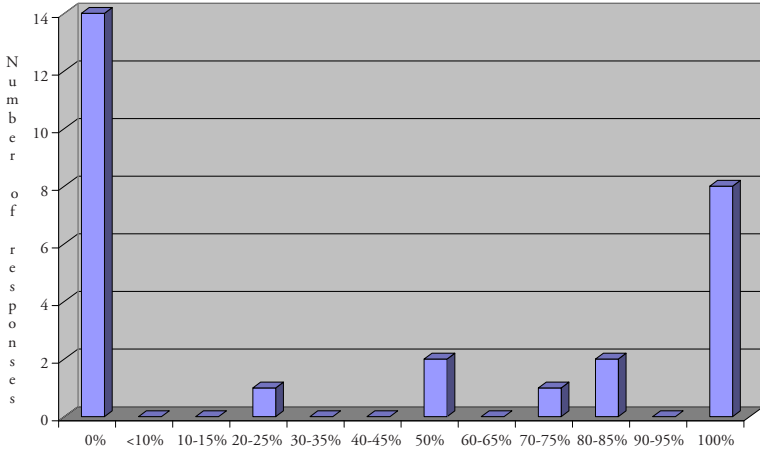
Drafts



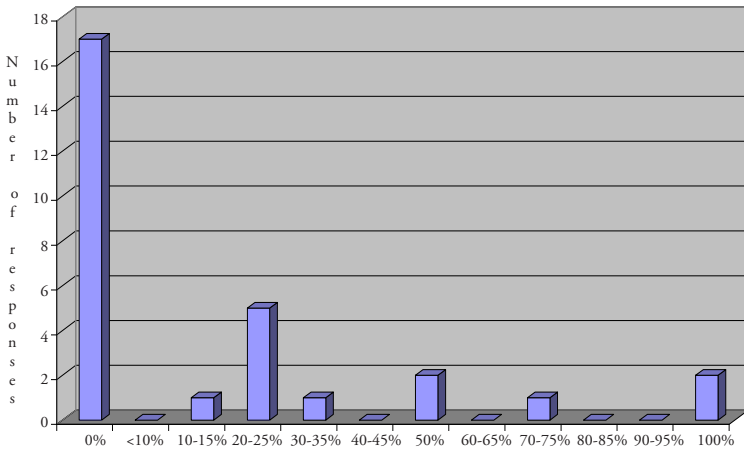
Meeting and Drafts



Entire Pre-Opinion Process



Entire Pro-Opinion & Later Activities of Opinion Counsel



Q17. In your experience, can opinion counsel ethically destroy drafts of the opinion?  
(check any that apply)

  7        no, never

 13       yes, if it is the normal practice of the lawyer to destroy drafts and  
litigation has not been initiated

  2       yes, if it is the normal practice of the lawyer to destroy drafts even if  
litigation has commenced

  9       yes, if the drafts were never shown to the client

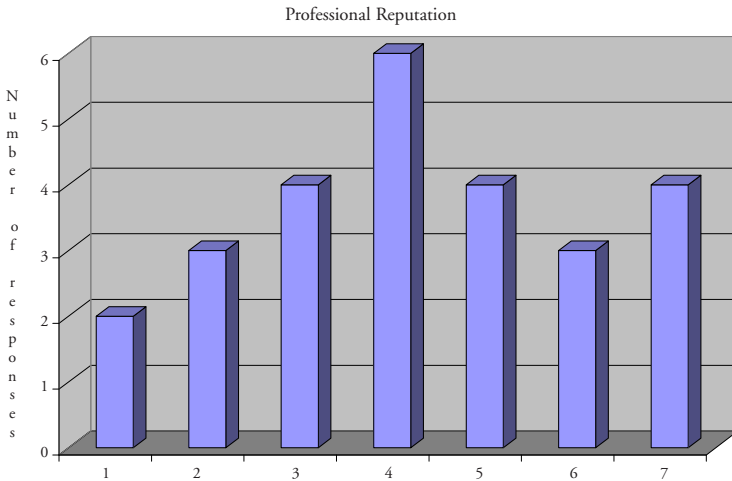
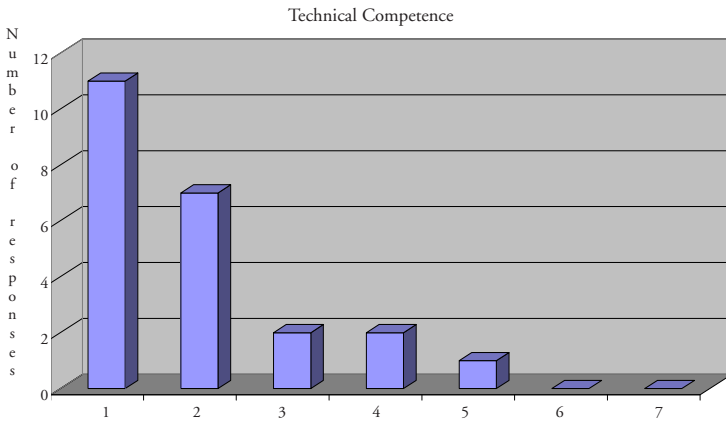
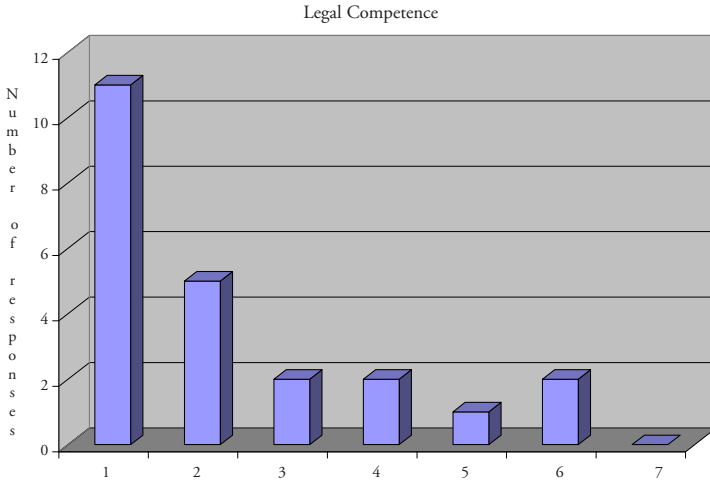
  0       yes, if only non-permanent (electronic) drafts were shown to the client

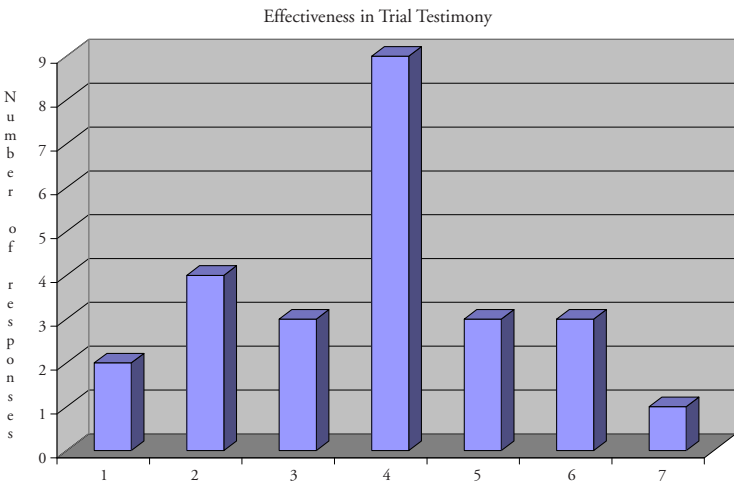
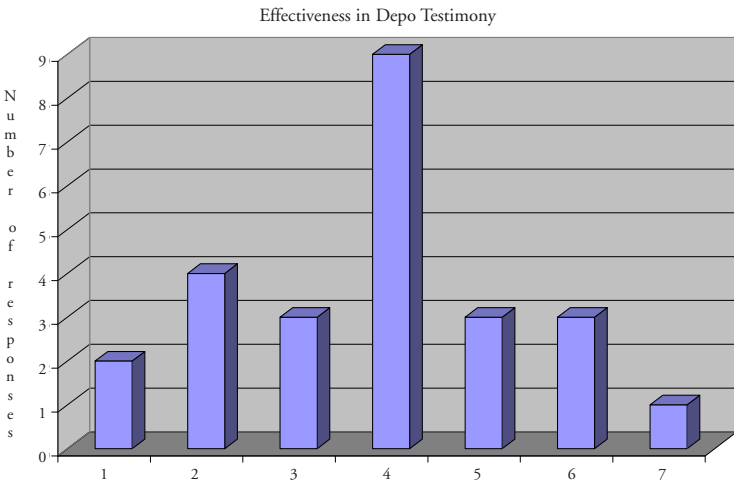
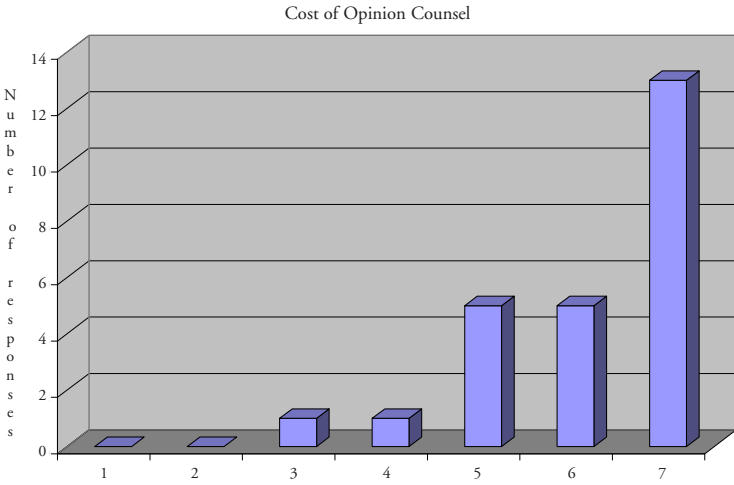
  0       yes, always

Comments:

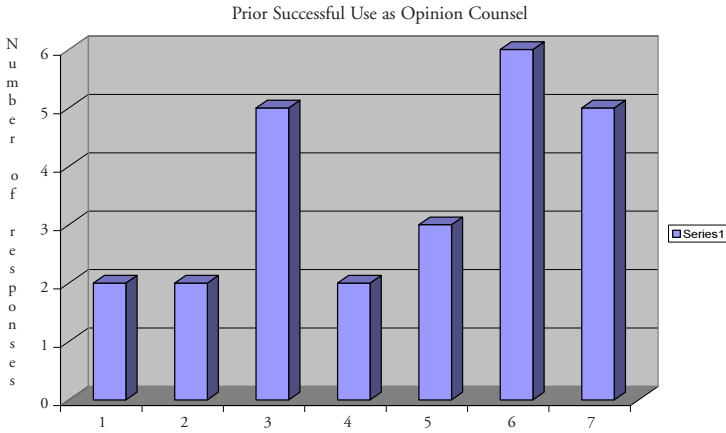
- 1) I do not think that drafts should be discoverable. We all rewrite things to express our ideas clearly. Once shown to the client, however, they go to state of mind and must go retained.
- 2) By draft I include what would normally be referred to a “rough drafts” that one circulated only within the firm.
- 3) Focus on properly – what was communicated to client.
- 4) Destruction of documents of litigation is imminent or in progress raises serious issues.
- 5) Client document retention and disposal policy should always be consulted.
- 6) This is a tough question, a lot of the complexity caused by the chaotic scope of waiver and the willfulness inference and local laws re: evidentiary issues.
- 7) Yes, if it is normal practice and if no threat of infringement has been received and there is no reasonable apprehension of suit.

Q18. Rank the following from 1 to 7 in their importance (with 1 being the highest) for selecting opinion counsel:

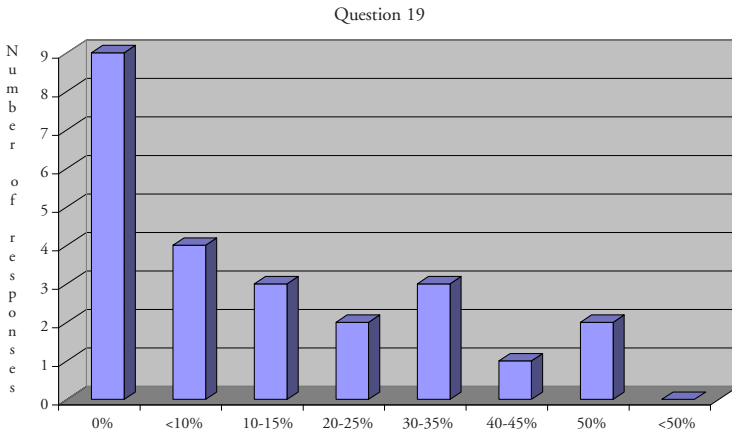








Q19. In what percentage of your cases do you deliberately elect not to obtain opinion of counsel?



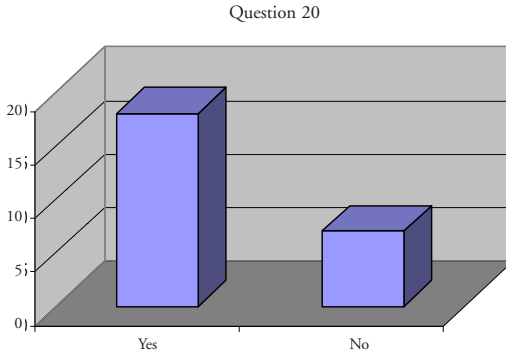
Comments:

- 1) Increasing.
- 2) Strong defense to a weak patent and cost is an issue.
- 3) Some cases have such low damage exposure that may not be worth it.
- 4) Few.
- 5) Many cases I am involved with, the cost is #1 problem. The prior question assumed opinion counsel was going to be selected. Smaller companies cannot afford full cost patent litigation, and this is a cost often cut right off the bat.
- 6) Only if patent has expired.
- 7) If we get sued or notice letter as a general practice but with some exceptions.
- 8) It is rare – given current law.

9) With respect to all patents my company may have “knowledge” of , about a third do not pursuant any measurable risk of litigation or damage.

10) Depends.

Q20. Do you subscribe to the strategy that opinions should be written primarily for the Court rather than for the client?

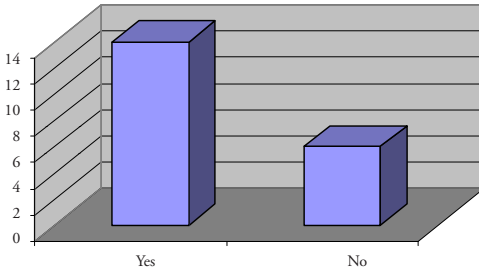


Comments:

- 1) Depends on whether the client wants an opinion that describes risks of error.
- 2) Opinions should be used primarily as an additional non-infringement/invalidity argument under current law.
- 3) Write for client first, but for court as close second.
- 4) They should be written with the idea in mind that a fact finder court eventually see them, but that should not drive the process.
- 5) Of course the opinion has to be an effort to give a real opinion, which client must read and consider, but the presentation has to be for an ultimate exhibit.
- 6) As a client, we're satisfied with oral opinions. Written opinions are a litigation defense tool.
- 7) Opinions need to be credible and assist the client in design strategies.

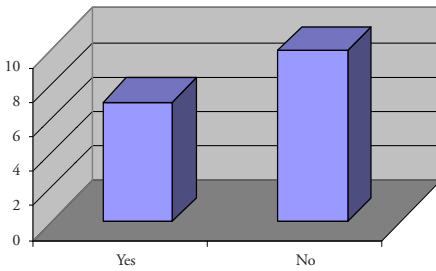
Q21. If you subscribe to the strategy that opinions should be written primarily for the Court, should they be simplified so as to distill the defense to a level easily understood by the Court?

Question 21



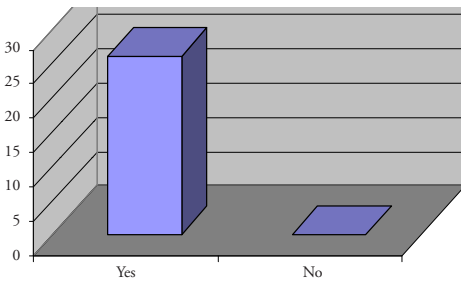
Q22. When acting as opinion counsel are you worried that you will be found liable for legal malpractice in a situation where willfulness is found and enhanced damages and/or attorneys fees are awarded?

Question 22

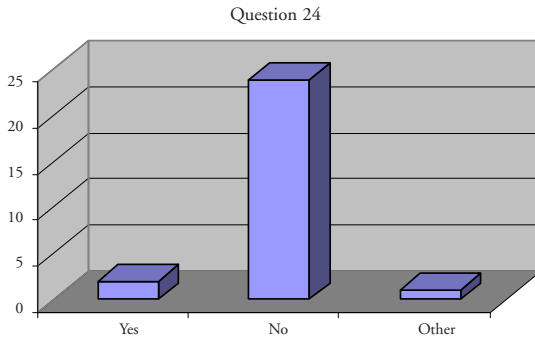


Q23. Do you believe that the Federal Circuit should reverse the “negative inference rule”?

Question 23



Q24. If a trial counsel tells his client that the client has a “difficult case” on the issue of patent infringement, should that conversation be discoverable if that opinion differs from a waived opinion of Opinion Counsel?



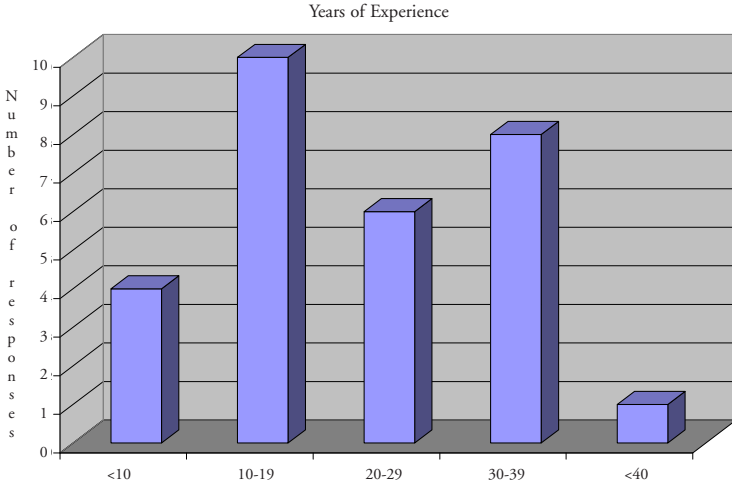
Comments:

- 1) I try to give litigation risk advice not patent advice. Court should not.
- 2) No, the changing tide of litigation is not relevant, there must be a time fixed to measure state of mind if indeed state of mind has any relevance.
- 3) It should not be discoverable because it undermines the ability of attorneys to counsel their clients
- 4) No, that would be no different from allowing discovery into the details of the trial team’s preparation for trial – there are always some issues that might cause spirited debate and even differences of opinion within the trial team, within client’s ranks, within opinion counsel’s ranks, etc. This would be a horrible result!
- 5) Absolutely not – there is a distinction between work product and attorney client privilege. Further, litigation counsel assesses litigation risk – which factors in many things, not just patent claims and scope.
- 6) Not if the opinion was pre-litigation and the trial counsel information after litigation of both are after litigation, then both should be discoverable.
- 7) Not after waiver extends to trial counsel (under current law).

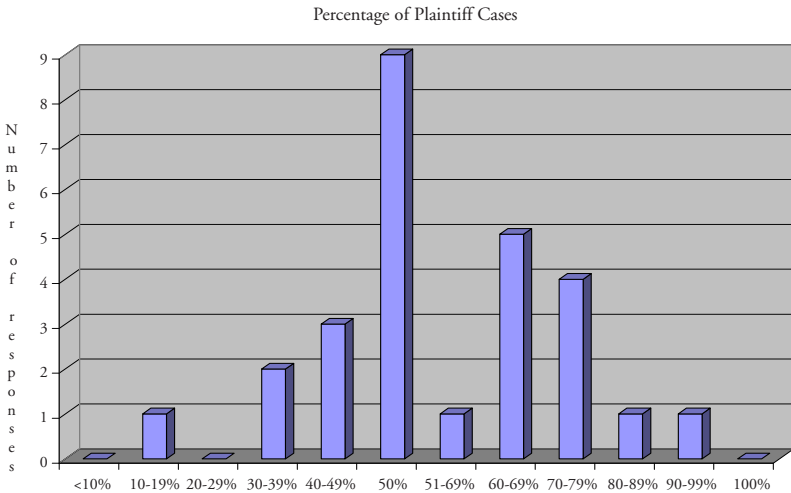
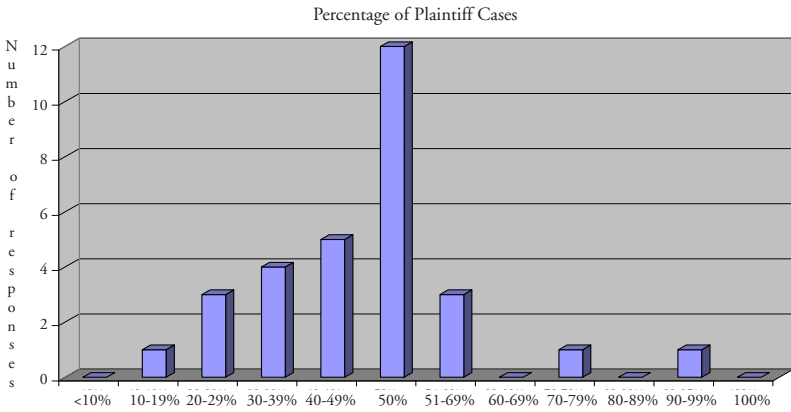
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# CONSUMER HARM AFTER *DENTSPLY*: NOT A TOOTHLESS TIGER

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## I. INTRODUCTION

Antitrust injury requires “injury of the type the antitrust laws were intended to prevent.”<sup>2</sup> Stated differently, antitrust injury requires injury to competition, not injury to competitors. Or as provided in the Clayton Act, a party suffers injury “by reason of anything forbidden in the antitrust laws.”<sup>3</sup> For the newcomer, each of these statements has a certain deceptive logic, until one tries to discern what, exactly, the antitrust laws were intended to prevent. The Supreme Court stated eloquently that:

The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions. But even were that premise open to question, the policy unequivocally laid down by the Act is competition.<sup>4</sup>

However, this statement does not help the average business person or non-antitrust lawyer know if certain actions will generally run afoul of the antitrust laws. One way to simplify the antitrust injury requirement is to tie it to consumer harm. Borrowing from *Northern Pacific Railway*, consumers are harmed by the inefficient allocation of economic resources and high prices because these practices cost more money.<sup>5</sup> Moreover, poor quality and progress harm consumers’ health and material welfare. Thus, for the average person, if an action causes consumer harm, it is most likely “forbidden by the antitrust laws” and thus “the type of injury the antitrust laws were intended to prevent”.

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<sup>2</sup> See *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 334 (1990); *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977); *Cargill Inc. v. Monfort of Colo., Inc.* 479 U.S. 104, 109-10 (1986).

<sup>3</sup> 15 U.S.C. Section 15(a) (2002).

<sup>4</sup> *Northern Pac. Ry. v. United States*, 356 U.S. 1, 4 (1958).

<sup>5</sup> *Id.*

The first part of this paper addresses consumer harm generally in the context of Sherman Act, Section 1 *per se* and rule of reason actions and causes of action under Section 2 of the Sherman Act. The second part of this paper explains how it is possible, at least in Delaware, for a defendant to defeat a Section 2 action where it has over 66% of the market, and where the court found it has engaged in anticompetitive exclusionary conduct, but where the court found that it did not cause consumer harm.

## II. CURRENT REQUIREMENTS OF CONSUMER HARM

### A. Sherman Act, Section 1

Section 1 of the Sherman Act provides that “[e]very contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce . . . is declared to be illegal.”<sup>6</sup> The Supreme Court has recognized that “the legality of an agreement or regulation cannot be determined by so simple a test as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains.”<sup>7</sup> As a result, the Court has found that only restraints of trade that *unreasonably* restrict competition violate Section 1.<sup>8</sup> *Per se* offenses are presumed to unreasonably restrict competition. Therefore, proof of consumer harm is not required to show an unreasonable restriction of competition, and thus a Section 1 violation. Rule of reason offenses, however, require a more delicate balancing act. In considering the balance of harms, the Supreme Court recently advised that the trier of fact consider empirical evidence of consumer harm.

#### 1. *Per Se* Violations of Section 1 of Sherman Act Do Not Require Proof of Consumer Harm

*Per se* offenses, such as price fixing and agreements to restrain trade do not require proof of consumer harm. Where a “practice facially appears to be one that would always or almost always tend to restrict competition and decrease output” instead of “one designed to increase economic efficiency and render markets more, rather than less, competitive” it is “*per se* illegal.”<sup>9</sup> In other words, *per se* offenses are agreements “whose nature and necessary effect are so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality.”<sup>10</sup> Thus, proof of consumer harm is not required because the activity, by its nature, is presumed to cause consumer harm.

#### 2. After *California Dental*, Plaintiffs Should Submit Empirical Evidence of Consumer Harm for a Rule of Reason Analysis

Section 1 allegations that do not rise to the level of *per se* illegality are analyzed under the rule of reason. Under a rule of reason analysis, “[t]he true test of legality is whether the restraint imposed is such as merely regulates and thereby promotes competition or whether it is such as may suppress or even destroy competition.”<sup>11</sup> In other words, “the finder of fact must decide whether the questioned practice imposes an unreasonable restraint on competition, taking into account a variety of factors, including the specific information about the relevant business, its condition before and after the restraint was imposed, and the restraint’s history, nature and *effect*.”<sup>12</sup>

<sup>6</sup> 15 U.S.C. Section 1 (2002).

<sup>7</sup> *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918).

<sup>8</sup> *State Oil v. Khan*, 522 U.S. 3, 10 (1997).

<sup>9</sup> *Broadcast Music Inc. v. CBS*, 441 U.S. 1, 19-20 (1979).

<sup>10</sup> *Northern Pac. Ry.*, 356 U.S. at 5; *see also NCAA v. Bd. of Regents*, 468 U.S. 85, 103-04 (1984) (“*Per se* rules are invoked when surrounding circumstances make the likelihood of anticompetitive conduct so great as to render unjustified further examination of the challenged conduct.”)

<sup>11</sup> *Chicago Bd. of Trade*, 246 U.S. at 238.

<sup>12</sup> *State Oil*, 522 U.S. at 10 (emphasis added).



The recent *California Dental Association v. FTC*<sup>13</sup> decision clarified the nature of injury that the moving party must establish under the rule of reason in a Section 1 claim. In *California Dental*, a nonprofit professional association of dentists sought review of a cease and desist order regarding the California Dental Association's advertising restrictions.<sup>14</sup> Before an FTC administrative hearing, the administrative law judge found that the advertising restrictions violated Section 1.<sup>15</sup> In that proceeding, however, the FTC staff did not offer economic evidence of consumer harm. The Ninth Circuit affirmed the FTC administrative judge's decision. The Circuit Court, however, was overturned by the Supreme Court who insisted on empirical evidence of consumer harm.<sup>16</sup> The Court said that the FTC should have looked at whether "the arrangements in question would have had an anticompetitive effect on customers and markets."<sup>17</sup> "The question is not whether the universe of possible advertisements has been limited (as assuredly it has), but whether the limitation on advertisements obviously tends to limit the total delivery of dental services."<sup>18</sup>

## B. Courts Consider Consumer Harm When Analyzing Claims Under Section 2 of the Sherman Act

A monopolization claim under Section 2 of the Sherman Act requires proof of monopoly power in the relevant market, i.e., the power to control prices or to exclude competition; and the willful acquisition or maintenance of that power, i.e., anticompetitive conduct that contributes to that power, not power that is the natural result of superior business practices or knowledge.<sup>19</sup>

Courts focus on the necessity of predatory conduct. In *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*,<sup>20</sup> the Supreme Court focused on whether the defendant "attempt[ed] to exclude rivals on some basis other than efficiency."<sup>21</sup> Similarly, in *Ocean State Physicians Health Plan v. Blue Cross & Blue Shield*,<sup>22</sup> the First Circuit noted that a "desire to crush a competitor standing alone is insufficient to violate the antitrust laws."<sup>23</sup> An examination of the case law regarding exclusionary conduct and predation shows that evidence of consumer harm is a significant factor to determine whether a defendant has violated Section 2 of the Sherman Act.

### 1. Predation Requires Evidence of Consumer Harm.

Predation is the practice of setting artificially low prices to drive competitors out of the market, and then raising prices to recoup this earlier loss. In *Brooke Group v. Brown & Williamson Tobacco Corp.*,<sup>24</sup> the Supreme Court addressed consumer harm in a predation case. It is not enough to show that a competitor charged low prices, because standing alone, lower prices are a benefit to consumers. A plaintiff must also show that the defendant "had a reasonable prospect, or, under Section 2 of the Sherman Act, a dangerous probability, of recouping its investment in below-cost prices."<sup>25</sup> Hence, it is not enough to show that competitors were forced out of business by the artificially low prices; a plaintiff must show that there would ultimately be consumer harm in the form of higher prices:

<sup>13</sup> 526 U.S. 756 (1999).

<sup>14</sup> *Id.*

<sup>15</sup> *Cal. Dental Ass'n v. FTC*, 128 F.3d 720, 724-25 (9th Cir. 1997).

<sup>16</sup> *Cal. Dental Ass'n*, 526 U.S. at 774.

<sup>17</sup> *Id.* at 770.

<sup>18</sup> *Id.* at 776; see also *id.* at 777 (directing courts to treat higher prices or reduced supply as evidence of anticompetitive effect).

<sup>19</sup> *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1996).

<sup>20</sup> 472 U.S. 585 (1985).

<sup>21</sup> *Id.* at 605.

<sup>22</sup> 883 F.2d 1101 (1st Cir. 1989), cert denied, 494 U.S. 1027 (1990).

<sup>23</sup> *Id.* at 1113.

<sup>24</sup> 509 U.S. 209 (1993).

<sup>25</sup> *Id.* at 224.

The plaintiff must demonstrate that there is a likelihood that the predatory scheme alleged would cause a rise in prices above a competitive level that would be sufficient to compensate for the amounts expended on the predation . . . '[i]n order to recoup their losses, [defendants] must obtain enough market power to set higher than competitive prices, and then must sustain those prices long enough to earn in excess profits what earlier gave up in below-cost prices.'<sup>26</sup>

If a firm simply decided to sell its product at an artificially low rate in perpetuity, this decision would benefit consumers because ultimately a low price is a significant factor in determining consumer welfare. Thus, it is the inevitable upswing in prices to recoup lost profits from the below-cost sales that harms consumers. As such, evidence of this consumer harm upswing is a necessary part of a predation action.

## 2. Exclusionary Conduct Requires Proof of Consumer Harm

Defining the relevant market is the key to determining whether an exclusive dealership will cause antitrust injury.<sup>27</sup> In general, courts presume that if an exclusive dealing arrangement forecloses less than 20% of the market, the agreement is legal. Similarly, if an arrangement forecloses more than 50% of the market, it is presumptively illegal. For exclusive dealing arrangements that fall between these guidelines, courts generally conduct a full rule of reason analysis to determine the effects of foreclosure on the market.

At the Fourth Annual Sedona Conference of Antitrust Law & Litigation, Jonathan M. Jacobson analyzed the nexus between market power, consumer harm, and exclusive dealing with competitors.<sup>28</sup> Mr. Jacobson reviewed four exclusionary conduct actions: *United States v. Microsoft Corporation*,<sup>29</sup> *Pepsi Co. v. Coca Cola Co.*,<sup>30</sup> *United States v. Visa USA*,<sup>31</sup> and *United States v. Dentsply, Inc.*<sup>32</sup>

Mr. Jacobson concluded that in each case where the court found defendants liable for exclusionary conduct, there was substantial proof of consumer harm.<sup>33</sup> In *Pepsi Co.*, plaintiffs' failure to prove market power, combined with undisputed evidence of competitive pricing demonstrated an absence of consumer injury.<sup>34</sup> In *Visa*, the court found that the conduct led to higher prices and reduced output.<sup>35</sup> Finally, in *Microsoft*, the court found that the possession of monopoly power in computer operating systems harms consumers through increased prices.<sup>36</sup> Thus, these cases, and Mr. Jacobson's analysis demonstrate that consumer harm is a necessary consideration when dealing with claims of exclusionary conduct.

In Mr. Jacobson's discussion of *Dentsply* at last year's conference, the government had recently defeated a motion for summary judgment by offering direct evidence of increased prices and poor quality as a result of an artificial tooth manufacturer's exclusive dealing practices. In August 2003, the United States District Court for the District of Delaware reversed this tack and entered judgment for defendant manufacturer.<sup>37</sup> The court based this decision on the fact that the government had not demonstrated consumer harm.<sup>38</sup>

26 *Id.* at 225-26 (citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 590-91 (1986)).

27 *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 329 (1961).

28 Jonathan M. Jacobson, *Market Power, Consumer Harm & Exclusive Dealing with Distributors*, THE SEDONA CONFERENCE JOURNAL, Fall 2002.

29 253 F.3d 34 (D.C. Cir.)(*en banc*), cert denied, 70 U.S.L.W. 3107 (U.S. 2001)(No. 01-236).

30 114 F.Supp.2d 243 (S.D.N.Y. 2000).

31 2001-2 Trade Cas. (CCH) ¶ 74,440 (S.D.N.Y. Oct. 9, 2001).

32 2001-1 Trade Cas. (CCH) ¶ 73,247 (D.Del. 2000), *superseded by United States v. Dentsply*, 277 F.Supp.2d 387 (D.Del. 2003) discussed *infra*.

33 *See supra*, note 26, at 33.

34 *Id.*

35 *Id.*

36 *Id.*

37 *Dentsply*, 277 F.Supp.2d at 454.

38 *Id.* at 452.

### III. *UNITED STATES V. DENTSPLY*: OVER TWO-THIRDS MARKET SHARE WITHOUT CONSUMER HARM DOES NOT LEAD TO A SECTION 2 VIOLATION

The government brought an action against Dentsply International, Inc. (“Dentsply”) alleging violation of sections 1 and 2 of the Sherman Act, and Section 3 of the Clayton Act.<sup>39</sup> The action focused on two components of Dentsply’s business practice: first, Dentsply’s dealer agreements, which provided that a dealer would lose its Dentsply account if it added a competing brand of teeth; second, Dentsply’s dealer agreements, which required dealers to stop selling competing brands in order to obtain the Dentsply account.<sup>40</sup> Despite these agreements and despite Dentsply’s 65% market share, the District Court found that Dentsply did not violate Section 2 of the Sherman Act because the government did not prove that Dentsply’s actions caused consumer harm.<sup>41</sup>

#### A. Factual Background

In an extensive finding of fact section, the court found that the relevant market for purposes of this action was “the sale of prefabricated artificial teeth in the United States.”<sup>42</sup> Participants in this market are divided into four categories: (1) manufacturers; (2) dealers; (3) dental laboratories; and (4) dentists.<sup>43</sup> Dentsply sold to dental laboratories and the court concluded that the laboratories were the consumers for purposes of a consumer harm analysis.<sup>44</sup>

Dentsply was the largest of the roughly 12-13 artificial teeth manufacturers who sell teeth in the United States. Dentsply did not own its own dealers and sells its teeth exclusively to independent dealers.<sup>45</sup> It retained the dominant position in the artificial tooth market and in 2001 had net sales in excess of \$40 million.<sup>46</sup> At the time of the lawsuit, Dentsply’s revenue market share was between 75-80% and its unit basis market share was 67%.<sup>47</sup>

In 1993, Dentsply adopted a dealer distribution agreement that required dealers, or prospective dealers, to:

- (1) provide Dentsply with their financial statements;
- (2) place an initial minimal order of \$50,000 in teeth and \$10,000 in merchandise;
- (3) place initial orders of \$10,000 if they were merchandise-only dealers;
- (4) place orders via the Bar Code Entry Order System;
- (5) submit a written plan indicating what incremental business would be gained by Dentsply;

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<sup>39</sup> *Id.* at 390. The Third Circuit is currently reviewing the lower court’s decision.

<sup>40</sup> *Id.*

<sup>41</sup> *Id.* at 452.

<sup>42</sup> *Id.* at 390.

<sup>43</sup> *Id.* at 391.

<sup>44</sup> *Id.* at 452.

<sup>45</sup> *Id.* at 392.

<sup>46</sup> *Id.* at 395.

<sup>47</sup> *Id.* at 451.

- (6) not add further tooth lines to the product offering (“Dealer Criterion 6”);
- (7) make payment within terms Dentsply specified;
- (8) resell Trubyte products only to end-users such as dental labs, dental schools and dentists;
- (9) report end-user sales by zip-code on a monthly basis; and
- (10) limit drop shipments to 10% per quarter.<sup>48</sup>

Dealer Criterion 6 specifically stated that, “[i]n order to effectively promote Dentsply/York products, dealers that are recognized as authorized distributors may not add further tooth lines to their product offering.”<sup>49</sup>

Not all consumers purchased their teeth through a dealer. The government’s expert economist testified that direct distribution was a “viable” method for distributing artificial teeth.<sup>50</sup> He also testified that Dentsply’s rivals were “not foreclosed completely” from the United States market for artificial teeth.<sup>51</sup> At trial, dental laboratory witnesses testified that they preferred to purchase teeth directly from the manufacturer because of the cost savings. Other witnesses testified that purchasing directly from the manufacturer was a more reliable way to purchase teeth.<sup>52</sup>

#### B. The Government’s Evidence that Dentsply Monopolized the Artificial Tooth Market

As mentioned above, the government had earlier defeated Dentsply’s motion for summary judgment by offering direct evidence of increased prices and poor quality as a result of Dentsply’s exclusive dealing practices.<sup>53</sup> In this trial on the merits, the court found that Dentsply’s justification for Dealer Criterion 6 was “pretextual”. “Dentsply’s prelitigation rationale for Dealer Criterion 6 was expressly to exclude competitors from dealers and not to focus dealers or protect Dentsply’s investment in promoting artificial teeth.”<sup>54</sup> The court based this conclusion on the government’s evidence that:

- (1) Dentsply’s expert admitted that exclusive dealing with dealers was not necessary to protect promotion with dentists and consumers;
- (2) no evidence existed of dealers practicing ‘bait and switch’ tactics despite years of opportunity with grandfathered brands;
- (3) most promotion was brand specific and not free-ridable;
- (4) Dentsply enforced Dealer Criterion 6 against a dealer that did not carry Dentsply teeth but only merchandise;

<sup>48</sup> *Id.* at 412-13.

<sup>49</sup> *Id.* at 412.

<sup>50</sup> *Id.* at 398.

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

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> *Id.* at 453 (citing *LePage’s Inc. v. 3M*, 324 F.3d 141, 162 (3rd Cir. 2003) (“When a monopolist’s actions are designed to prevent one or more new or potential competitors from gaining a foothold in the market by exclusionary, i.e. predatory, conduct, its success in that goal is not only injurious to the potential customer but also to competition in general.”))

- (5) Dentsply threatened a dealer with losing its dealership of other products beyond artificial teeth; and
- (6) Dentsply approved a dealer despite concluding that there was no need for additional distribution.<sup>55</sup>

### C. Conclusions of Law

Despite Dentsply's high market share, and the "pretextual" Dealer Criterion 6, the court concluded that Dentsply did not monopolize the market for artificial teeth.<sup>56</sup> "Monopoly power is generally defined as the power to control prices or to exclude competition, and the size of market share is a primary determinant of whether monopoly power exists."<sup>57</sup> Based on Dentsply's market share, the court could infer market power. Dentsply's revenue market share was between 75-80% and its unit basis market share was 67%. Moreover, it had maintained a dominant market share for several years. Under traditional market share analysis, Dentsply met the threshold for market power.<sup>58</sup> The court reasoned, however, that high market share was insufficient in this action. The government also needed to prove that Dentsply had the power to control prices or to exclude competition.<sup>59</sup>

The court first found that although Dentsply's Dealer Criterion 6 clearly intended to exclude competitors from dealers, it did not exclude competitors from the consumer dental laboratories. Direct sales to dental laboratories was "a viable and, in some ways, advantageous method of distribution."<sup>60</sup> The court also noted that Dentsply did not have the power to exclude competitors from selling directly to the dental laboratories. Because the court found that dental laboratories were the consumer, and because Dealer Criterion 6 did not harm the dental laboratories, the court held that Dentsply was not engaged in monopoly behavior.<sup>61</sup>

The court also found that Dealer Criterion 6 did not demonstrate willful acquisition or maintenance of monopoly power. It noted that the government failed to prove that Dentsply had created a market with supra-competitive pricing.<sup>62</sup> Without extensive analysis, the court concluded that "[u]nder the rule of reason...the circumstances of the artificial tooth market require a finding that Dentsply's Dealer Criterion 6 is not an unreasonable restraint on competition."<sup>63</sup> While the government offered evidence of Dentsply's anticompetitive intent, the court concluded that, "because direct distribution is viable, non-Dentsply dealers are available and Dentsply dealers may be converted at any time, the DOJ has failed to prove that Dentsply's action have been or could be successful in preventing 'new or potential competitors from gaining a foothold in the market[.]'"<sup>64</sup> Based on this reasoning, the court entered judgment for defendant.

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<sup>55</sup> *Id.* at 453.

<sup>56</sup> *Id.* at 451.

<sup>57</sup> *Id.* (quoting *Pennsylvania Dental Ass'n v. Med. Serv. Ass'n of Pennsylvania*, 745 F.2d 248, 260 (3d Cir. 1984); Grinnell, 384 U.S. at 571 ("The existence of such power ordinarily may be inferred from the predominant share of the market.")).

<sup>58</sup> *Id.* (citing *American Tobacco Co. v. United States*, 328 U.S. 781, 797 (1946)(finding that over two-thirds market share is a monopoly) and Grinnell, 384 U.S. at 571).

<sup>59</sup> *Id.* at 450-51 (citing *Oahu Gas Serv. Inc. v. Pac. Res. Inc.*, 838 F.2d 360, 366 (9th Cir. 1988) ("[M]arket share is just the starting point for assessing market power. A high market share, though it may ordinarily raise an inference of monopoly power, will not do so in a market with low entry barriers or other evidence of a defendant's inability to control prices or exclude competitors.")).

<sup>60</sup> *Id.* at 452.

<sup>61</sup> *Id.*

<sup>62</sup> *Id.* at 453.

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

<sup>64</sup> *Id.* at 453.

#### IV. CONCLUSION: *DENTSPLY* INDICATES THAT THE FUTURE OF CONSUMER HARM HAS BITE

In *Dentsply*, there was substantial evidence of anticompetitive, exclusionary intent combined with overt exclusionary acts and market share above 66%, enough to presume monopoly power. The government had succeeded on summary judgment, and by any standard, seemed poised to succeed at trial. The “hole in their boat”, however, was defendant’s simple explanation of substitutability. The defendant established that consumers could avoid Dentsply’s monopolistic actions in the dealer market by buying direct from the manufacturer. Based on the consumers’ ability to substitute away from defendants’ control of the dealer market, the court found that the defendant was not liable for a violation of Section 2 of the Sherman Act. Here, the lack of consumer harm was fatal to the government’s action. Going forward, it remains to be seen whether consumer harm, standing alone, can deliver a similar blow to defendants.

# THE CONSUMER HARM INQUIRY IN RECENT CASES: A REQUIRED ELEMENT OF PROOF OR AN AFTERTHOUGHT?

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## I. INTRODUCTION

The purpose of the antitrust laws is to protect competition and consumer welfare. Both courts and the enforcement agencies seemingly agree that consumer harm, in the form of actual or threatened market-wide, material and sustained reduction in output (in either quantity or quality) or an increase in price, is a required element in proving an antitrust violation in cases arising under both Sections 1 and 2 of the Sherman Act (other than those involving *per se* violations or the “quick look” doctrine). Indeed, the Supreme Court has made clear that actual harm to consumers must be proven. However, lower courts have not always followed the Supreme Court’s instructions. In two cases decided in 2003, the Second Circuit’s decision in *United States v. Visa U.S.A.* and the Third Circuit’s decision in *LePage’s v. 3M*, the courts have not required proof of actual consumer harm.

## II. THE SUPREME COURT REQUIRES PROOF OF CONSUMER HARM IN CASES ARISING UNDER SECTIONS 1 AND 2 OF THE SHERMAN ACT

Ever since its proclamation in *Brown Shoe* that the antitrust laws protect “competition, not competitors,”<sup>1</sup> the Supreme Court has taken every opportunity to emphasize that the antitrust laws exist for the benefit of consumers.<sup>2</sup> Accordingly, it has stated that proof of consumer harm is a necessary element in cases brought under both Sections 1 and 2 of the Sherman Act.

Under Section 1, the Court, in *California Dental Ass’n v. Federal Trade Comm’n*,<sup>3</sup> insisted on actual empirical evidence of consumer harm. A non-profit professional association of dentists sought judicial review of a Federal Trade Commission (“FTC”) cease and desist order directed at advertising restrictions that had been imposed by the California Dental Association (“CDA”). Those restrictions related to discount advertising and advertising related to the quality of dental services. The CDA claimed the restrictions were

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\* Kevin and Chuck, partners at Simpson Thacher, gratefully acknowledge the assistance of their colleagues, Ann Rappleye and Arman Oruc, counsel and associate at the Firm, respectively, in preparing this article.

<sup>1</sup> *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

<sup>2</sup> See, e.g., *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 458 (1993) (“The purpose of the [Sherman] Act is not to protect businesses from the working of the market; it is to protect the public from the failure of the market”); *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979) (“Congress designed the Sherman Act as a ‘consumer welfare prescription’”).

<sup>3</sup> 526 U.S. 756 (1999).

intended to assist members in complying with its code of ethics and with state law. In a proceeding initiated by the FTC, an administrative law judge found that restrictions on discount and quality advertising amounted to an unlawful restraint on trade. The FTC introduced no empirical evidence and no expert economist testified that consumers had been harmed by the advertising restrictions. The Ninth Circuit Court of Appeals affirmed the administrative law judge's decision and characterized the advertising restrictions as "naked restrictions on price."<sup>4</sup>

The Supreme Court rejected that characterization, insisting that empirical evidence of actual consumer harm was required:

[The Ninth Circuit's] observations brush over the professional context and describe no anticompetitive effects. Assuming that the record in fact supports the conclusion that the CDA disclosure rules essentially bar advertisement of across-the-board discounts, it does not obviously follow that such a ban would have a net anticompetitive effect here. Whether advertisements that announced discounts for, say, first-time customers, would be less effective at conveying information relevant to competition if they listed the original and discounted price for checkups, X-rays, and fillings, than they would if they simply specified a percentage discount across the board, seems to us a question susceptible to empirical but not *a priori* analysis.<sup>5</sup>

The Court further elaborated on its criticism of the lower court and the Ninth Circuit Court of Appeals for having missed the ultimate issue of consumer harm:

[T]he relevant output for antitrust purposes here is presumably not information or advertising, but dental services themselves. The question is not whether the universe of possible advertisements has been limited (as assuredly it has), but whether the limitation on advertisements tends to limit the total delivery of dental services.<sup>6</sup>

Here, the Supreme Court refused to draw an inference of anticompetitive harm without actual evidence of higher prices or reduced supply to consumers, the hallmarks of consumer injury.

The notion of consumer harm has been an integral part of the Supreme Court's treatment of claims arising under Section 2 of the Sherman Act. In predatory pricing cases, for example, the Court has observed that the requirement that a plaintiff prove recoupment ensures that conduct that benefits consumers is not condemned under the antitrust laws: "although unsuccessful predatory pricing may encourage some inefficient substitution toward the product being sold at less than its cost, unsuccessful predation is in general a boon to consumers."<sup>7</sup>

In cases arising under Section 2 based on exclusionary practices, the Supreme Court has required a nexus between the exclusionary practice and the welfare of consumers. Indeed, it has required proof as to how consumers have been harmed by the challenged

<sup>4</sup> 128 F.3d 720, 727 (9th Cir. 1997).

<sup>5</sup> 526 U.S. at 774.

<sup>6</sup> *Id.* at 776.

<sup>7</sup> *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993).



practice. *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, an exclusionary practices case, is instructive.<sup>8</sup> That case involved a dispute among downhill skiing facilities in Aspen, Colorado. Plaintiff Aspen Highlands owned one facility, while defendant Aspen Skiing Co. owned the other three in the area. The parties had entered into a joint marketing arrangement whereby they offered an “All Aspen” ticket that permitted ticket holders to ski at all four facilities. When Skiing Co. discontinued its participation in the joint marketing program, Aspen Highlands brought a Section 2 claim, alleging that Skiing Co. had monopolized the market for downhill skiing in the area and had made it extremely difficult for Aspen Highlands to compete.

The Supreme Court upheld the lower court’s decision that Aspen Skiing’s conduct had violated Section 2. In addition to finding that Aspen Skiing had not offered an efficiency justification for discontinuing its participation in the joint marketing program, the Court also held that Aspen Skiing’s conduct harmed consumers.<sup>9</sup> Aspen Highlands had introduced ample evidence at trial that consumers preferred the “All Aspen” ticket, including that of an expert marketing witness and anecdotal evidence from a number of witnesses, including a tour operator, an officer of a Ski Club and the marketing director of Aspen Highlands’ ski school.<sup>10</sup> The Court concluded:

Thus the evidence supports an inference that Ski Co. was not motivated by efficiency concerns and that it was willing to sacrifice short-run benefits and consumer goodwill in exchange for a perceived long-run impact on its smaller rival.<sup>11</sup>

The nexus between the injury to Aspen Highlands and the corresponding harm to consumers as a result of Aspen Skiing’s conduct seems to form the basis for the finding of liability.

Two decisions by circuit courts of appeals in 2003, one brought under Section 1 of the Sherman Act and the other brought under Section 2, have failed to follow the Supreme Court’s mandate regarding proof of consumer harm. In *United States v. Visa U.S.A., Inc.*, the Second Circuit Court of Appeals affirmed the decision of the trial court that the two payment card networks’ loyalty rules restrained trade in violation of Section 1.<sup>12</sup> Neither the lower court nor the Second Circuit Court of Appeals insisted on any actual evidence of consumer harm. In *LePage’s Inc. v. 3M*, the Third Circuit Court of Appeals, *en banc*, affirmed the jury’s verdict that exclusionary conduct, including bundled rebates and exclusive dealing, violated Section 2.<sup>13</sup> There was no consideration of consumer harm in *LePage’s*. Rather, consumer harm appears to have been presumed based on the defendant’s exclusionary conduct. These decisions are discussed in detail below.

### III. *UNITED STATES V. VISA U.S.A., INC.*

Both Visa and MasterCard are organized as open joint ventures that are owned by their member banks.<sup>14</sup> There is no limit to the number of banks that may become members of the Visa or MasterCard network. A member of the Visa or MasterCard network may also be a member of the other network. The member banks in the Visa and MasterCard

<sup>8</sup> 472 U.S. 585 (1985).

<sup>9</sup> *Id.* at 608-10.

<sup>10</sup> *Id.* at 606-07.

<sup>11</sup> *Id.* at 610-11.

<sup>12</sup> 344 F.3d 229 (2d Cir. 2003). Kevin represented MasterCard International, Inc. in this litigation. However, the views expressed herein are those of Kevin and Chuck, and do not represent the views of MasterCard or any other client.

<sup>13</sup> No. 00-1368, 00-1473, 2003 WL1480498 (3d Cir. March 25, 2003).

<sup>14</sup> For simplicity, we use “banks” herein to refer to all the various types of financial institutions that are part of the Visa and MasterCard networks.

networks may operate as “issuers,” “acquirers,” or both. An “issuer” issues cards to cardholders and serves as a liaison between the network and the individual cardholder. An “acquirer” acquires the card-paid transactions of a merchant and then acts as liaison between the network and the merchants accepting the networks’ payment cards with which it has contracted. Card-issuing members compete with each other as well as American Express and Discover to attract individuals to whom they issue cards, choose the features to be offered with each card, select the credit and payment terms and requirements, and bear the credit risk.

Visa and MasterCard operate as non-profit organizations that are funded largely through service and transaction fees paid by member banks. They manage the brand and operate the physical networks for processing card transactions. Visa and MasterCard each have promulgated rules that prohibit its member banks from issuing American Express or Discover Cards, otherwise known as “loyalty rules.”

American Express and Discover, the other two major card systems in the United States, are each vertically integrated entities that combine the issuing, acquiring and network functions. (This is often referred to as a “closed loop” system). They deal directly with consumers, to whom they issue cards, and merchants, by acquiring and processing transactions. American Express is the largest issuer of credit and charge cards in the United States, measured by transaction volume.

Changing its long-standing business strategy of a closed-loop system, American Express invited a select group of banks in the Visa and MasterCard networks to issue American Express cards in 1996. Banks refused, some citing the need to convert or sell existing MasterCard and Visa portfolios in light of the loyalty rules. The Department of Justice (“DOJ”) challenged the loyalty rules under Section 1, claiming that the rules were a horizontal combination of member banks that unreasonably restrained trade in the market for network services.

After a lengthy bench trial, the Honorable Barbara Jones found that the loyalty rules restrained trade in violation of Section 1.<sup>15</sup> On the issue of consumer harm, Judge Jones found that the loyalty rules “significantly reduced product output and consumer choice in the issuing market and have reduced price competition in the network services market.”<sup>16</sup> Interestingly, Judge Jones was able to find that this consumer harm was “undeniable” without being offered *any* actual evidence of such harm by the DOJ.<sup>17</sup> Indeed, the DOJ’s expert economist, Professor Michael Katz, never addressed it at all. He submitted over 200 pages of written testimony, none of which address the issue of whether consumers would obtain significantly more cards if the loyalty rules were abolished, or whether consumers would pay lower prices. On cross-examination, Professor Katz agreed that his job was to determine whether the loyalty rules had a negative effect on consumer welfare, however he did not do any empirical analysis to attempt to quantify the consumer harm.<sup>18</sup> The following colloquy from Mr. Katz’s cross-examination is illustrative:

Q: Now, I know from reading your testimony that you believe that your but-for world would have been better for competition than the world we actually have, but I don’t find in your report any indication of how much

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<sup>15</sup> 163 F. Supp.2d 322 (S.D.N.Y. 2001).

<sup>16</sup> *Id.* at 330.

<sup>17</sup> *Id.* at 406.

<sup>18</sup> Cross Examination of Michael Katz, July 11, 2000 (Day 18), at pp. 3497-98.

better off or in fact any information from which I might make such a calculations, is that fair?

A: It is correct that I have not included any sort of numerical calculation.<sup>19</sup>

\* \* \*

Q: Now, turning to another point, I looked through your direct testimony, Professor Katz, and I didn't find any attempt by you to quantify the number of cards that you would expect to be issued in the event that the [loyalty] rules were to be eliminated. Am I correct that –

A: Yes, there is no attempt by me to make a prediction about the number of cards, that's correct.<sup>20</sup>

\* \* \*

Q: Let me ask you, have you measured in an empirical way any price increases in this case?

A: In terms of the narrow conception of pricing, how a price change has gone from a particular number of dollars and cents to another, no.<sup>21</sup>

With respect to the DOJ's claim of reduced output of cards as a result of the loyalty rules, Visa and MasterCard argued that American Express and Discover were very successful at reaching consumers other than through the associations' member banks. Judge Jones agreed that this argument was true.<sup>22</sup> Indeed, she found that, despite the loyalty rules, "there are many alternative card distribution channels available to American Express and Discover other than the associations' member banks . . . ."<sup>23</sup> Kenneth Chenault, the Chairman and CEO of American Express, acknowledged that the Company has the ability to reach every American consumer, except maybe those "in the mountains of West Virginia." Judge Jones further found, and the Second Circuit recognized, that "American Express is the largest single card issuer in the United States, as measured by transaction volume . . . [and] Discover is the fifth largest issuer."<sup>24</sup> Moreover, Judge Jones found that consumers have "thousands" of credit card choices and "already [have] plenty of cards and product features."<sup>25</sup>

Nevertheless, she held that the loyalty rules have "hampered" American Express and Discover as networks, which she tied, once again without any empirical evidence, to lessening consumer choice.<sup>26</sup>

The Second Circuit Court of Appeals affirmed Judge Jones' decision.<sup>27</sup> With respect to the issue of harm to competition, the Second Circuit held:

<sup>19</sup> *Id.* at p. 3498.

<sup>20</sup> *Id.* at July 12, 2000 (Day 19), p. 3728.

<sup>21</sup> *Id.* at July 14, 2000 (Day 21), at p. 4053.

<sup>22</sup> 163 F. Supp.2d at 383.

<sup>23</sup> *Id.* at 382-383.

<sup>24</sup> 344 F.3d 229, 237 (2d Cir. 2003).

<sup>25</sup> 163 F. Supp.2d. at 383.

<sup>26</sup> *Id.*

<sup>27</sup> 344 F.3d 229. Visa and MasterCard have petitioned the Supreme Court for a writ of certiorari, which request is pending.

The district court found that Visa U.S.A. and MasterCard's exclusionary rules harm competition by "reducing overall card output and available card features," as well as by decreasing network services output and stunting price competition. We cannot say that these conclusions were erroneous.<sup>28</sup>

The Second Circuit neither mentioned consumer welfare in its opinion, nor appeared to notice that the DOJ had adduced no empirical evidence of consumer harm.

Moreover, the Court ignored its own well-established rule of reason standard. The Second Circuit has squarely held that, with respect to allegations that competitors have been foreclosed or limited in their ability to distribute or market their products, the legal question is whether competitors can reach the ultimate consumer through alternative distribution channels. This rule of law is applicable to both vertical and horizontal restraints.<sup>29</sup> The rationale behind this standard is self-evident: where consumers can avail themselves of the benefits of competitive offerings, the competitive process is functioning, and the courts need not intervene. If they do so, they are merely assisting specific competitors, rather than safeguarding the competitive process for consumers.

While acknowledging that the rule of reason standard applies here, the Second Circuit mistakenly concluded that the level of inquiry required under the rule of reason somehow turns on whether an agreement is appropriately characterized as horizontal or vertical. After concluding that the loyalty rules are horizontal restraints among the member banks, the court summarily concluded "such arrangements are exemplars of the type of anticompetitive behavior prohibited by the Sherman Act."<sup>30</sup> Having concluded that the foreclosure standard set forth in *CDC* and *Clorox* does not apply, the Second Circuit ignored the undisputed evidence that American Express could reach consumers. In doing so, the court effectively applied a *per se* test with respect to consumer harm in the context of joint ventures.

#### IV. *LEPAGE'S V. 3M*

*LePage's* is an exclusionary conduct case. Defendant 3M manufacturers, among other things, Scotch brand tape. Until the early 1990s, 3M had more than 90% of the market for brand-name transparent tape. Plaintiff *LePage's*, an office supply manufacturer, began selling "private label" transparent tape, which is sold under the particular retailer's name, in the 1980s. By 1992, *LePage's* had captured 88% of the private-label tape market. 3M decided to enter the private label tape market in the early 1990s.

*LePage's* claimed that 3M used a "monopoly broth" of bundled rebates and exclusive dealing-type arrangements to try to destroy the market for private-label tape and steer customers back to its Scotch brand tape. The bundled rebates allowed customers such as Kmart, Staples and Office Depot to earn cash rebates from 3M if they purchased not only tape, but also products in a number of different product lines. 3M set "targets" for each customer. Failure to reach a target in one product line meant that the customer lost the

<sup>28</sup> *Id.* at 240.

<sup>29</sup> See *CDC Techs. v. Idexx Labs., Inc.*, 186 F.3d 74, 80 (2d Cir. 1999) (holding defendant's exclusive distributorships did not cause competitive harm where plaintiff achieved nationwide distribution coverage on its own and its sales increased after alleged restraints were put in place); *Clorox Co. v. Sterling Winthrop, Inc.*, 117 F.3d 50, 59 (2d Cir. 1997) (finding a horizontal agreement lawful where plaintiff was free to reach consumers in the marketplace using alternative brands); *North Am. Soccer League v. National Football League*, 670 F.2d 1249, 1259, 1261 (2d Cir. 1982) (analyzing whether joint venture's horizontal rule that prohibited NFL owners from owning teams in other sports leagues resulted in significant foreclosure of competition). See also *SCFC LLC, Inc. v. Visa USA, Inc.*, 36 F.3d 958, 964-65 (10th Cir. 1994) (holding that Supreme Court precedent involving horizontal joint ventures does not imply any "differing antitrust analysis," and that, as in all rule of reason cases, to be judged anticompetitive the joint venture agreement must "actually or potentially harm consumers"); *U.S. Healthcare, Inc. v. Health Source, Inc.*, 986 F.2d 589, 595 (1st Cir. 1993) (assessing harm to consumers from exclusivity provisions of HMO physician contracts under a foreclosure standard).

<sup>30</sup> 344 F.3d at 242.

rebate across all the product lines. LePage's further claimed that these bundled rebates forced retailers to cease or severely limit their purchases of tape from suppliers other than 3M if they were to have any chance of meeting 3M's targets and, in turn, earning a cash rebate. 3M's plan, according to LePage's, was to drive LePage's out of business and then abandon the private-label tape business, leaving the higher-priced Scotch brand tape as the only tape on the market. By the time of trial, LePage's claimed that it barely was surviving.

A jury returned a verdict against 3M on LePage's claims under Section 2 for monopolization and "attempted maintenance of monopoly power." The District Court granted 3M's motion for judgment as a matter of law on the attempted maintenance claim, but upheld the verdict in all other respects and denied 3M's motion for a new trial.<sup>31</sup> On appeal, the Third Circuit Court of Appeals reversed the District Court's judgment on LePage's Section 2 claim by a divided vote.<sup>32</sup> The Third Circuit granted rehearing *en banc*, withdrew its divided opinion, and affirmed the District Court's judgment.<sup>33</sup> 3M petitioned the Supreme Court for a writ of certiorari, which request was denied on June 30, 2004.

On the issue of anticompetitive effect, consumer harm was never mentioned by the District Court or the Third Circuit Court of Appeals either time it considered the case. At trial, LePage's experts, Ken Baseman and Terry Musika, never opined on whether consumers were harmed, much less to what degree.

In its *en banc* decision, the Third Circuit apparently simply assumed that harm to a competitor, LePage's, necessarily led to harm to competition:

When a monopolist's actions are designed to prevent one or more new or potential competitors from gaining a foothold in the market by exclusionary, i.e., predatory, conduct, its success in that goal is not only injurious to the potential competitor but also to competition in general. It has been recognized, albeit in a somewhat different context, that even foreclosure of "one significant competitor" from the market *may* lead to higher prices and reduced output.<sup>34</sup>

Although the Third Circuit cited *Aspen Skiing*, stating that it is "pertinent to the case before us," the Court did not appear to notice that plaintiff Aspen Highlands *had, in fact*, introduced evidence of consumer harm, not simply evidence of harm to itself alone.<sup>35</sup>

Nor was LePage's required to prove that 3M priced below its cost and that 3M could later recoup (over 3M's strenuous objections) because the majority held that LePage's had not made a predatory pricing claim.<sup>36</sup> 3M argued that its conduct was legal as a matter of law because it never priced its transparent tape below its cost, LePage's never contested this assertion, and above-cost pricing "is the very conduct that the antitrust laws wish to promote in the interest of making consumers better off."<sup>37</sup> As Judge Greenberg pointed out in his dissent, LePage's economist admitted that LePage's was not as efficient a tape producer as 3M, and LePage's never demonstrated how much it would have to lower its prices to compete with 3M.<sup>38</sup> While a discussion of the heart of 3M's argument is beyond the scope of this paper, this case illustrates the danger that, without a consumer harm

31 No. Civ. A. 97-3983, 2000 WL 280350 (E.D. Pa. March 14, 2000).

32 277 F.3d 365 (3d Cir. 2002).

33 No. 00-1368, 00-1473, 2003 WL 1480498 (3d Cir. March 25, 2003).

34 *Id.* at \*15 (emphasis added).

35 *Id.* at \*6-7.

36 *Id.* at \*8.

37 *Id.* at \*4.

38 *Id.* at \*31, \*33.

requirement, exclusionary acts towards competitors, which are simply torts, will be brought under the rubric of the antitrust laws.<sup>39</sup> Here, without any evidence that consumers were injured, the most that should have been concluded is that 3M committed a business tort against LePage's.

## V. CONCLUSION

We should not lose sight of the fact that consumer welfare is the ultimate objective of the antitrust laws. Requiring empirical evidence of consumer injury will not only carry out the Supreme Court's mandate but, importantly, will force litigants and courts to engage in real-world assessments of various business practices that are grounded in actual market facts. Paying attention to the presence or absence of actual consumer injury is the best way to ensure that pernicious conduct, as opposed to vigorous competition, will be addressed.

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<sup>39</sup> See *Fishman v. Estate of Wirtz*, 807 F.2d 520, 570 (7<sup>th</sup> Cir. 1986) (Easterbrook, J., dissenting) ("The foremost scholars of antitrust agree that the laws are designed for the benefit of consumers and should not be used to advance any other interest. . . . These additional objectives do not require fetching humdrum business torts within the reach of antitrust. . . ."); see also Eleanor M. Fox, *What is Harm to Competition? Exclusionary Practices and Anticompetitive Effect*, 70 Antitrust L.J. 371, 382 & n. 32 (2002) ("In the last decade the Supreme Court has said that antitrust cases must be based on market harm, not unfair exclusion, and not even malicious exclusion").

# WILLIAMSON OIL V. PHILIP MORRIS: WHATEVER HAPPENED TO JURY TRIALS?

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## I. INTRODUCTION

For the 2002 Sedona Antitrust Conference, I provided a paper entitled “Proof of Conspiracy in Antitrust Cases and the Oligopoly Problem,” subsequently published in the *Sedona Conference Journal*, Volume 4, Fall 2003. Here, I will address what I believe to be the one significant decision in this area since my last paper, *Williamson Oil Co., Inc. v. Philip Morris USA*, 346 F.3d 1287 (11<sup>th</sup> Cir. 2003). The *Williamson Oil* case presents, either expressly or implicitly, virtually all of the significant issues connected with proof of conspiracy in an oligopoly setting. Hereafter, this paper will review the decision itself and comment on the issues it raises.

## II. THE DECISION: THE UNDERLYING CONTROVERSY

This was an action brought by a class of cigarette wholesalers against Philip Morris, R.J. Reynolds, Brown & Williamson, and Lorillard. The claim was that the cigarette manufacturers conspired between 1993 and 2000 to fix wholesale list prices for cigarettes. The wholesalers relied entirely on circumstantial evidence in support of their claim. The district court granted summary judgment in favor of the manufacturers, and the Eleventh Circuit affirmed on appeal.

As noted by the Eleventh Circuit, “The modern American tobacco industry is a classic oligopoly. Between 1993 and 1999, appellees—the nation’s four largest cigarette manufacturers—along with Liggett Group, Inc., manufactured more than 97% of the cigarettes sold in the United States.” 346 F.3d at 1291. During the 1990s, a price gap arose in the industry between premium brands, such as Marlboro, and discount or generic cigarettes. Philip Morris, the market leader with a share of 42 to 50 percent, was primarily a manufacturer of premium brands and hostile to the price competition from discount cigarettes. In 1992 and 1993, Philip Morris tried unsuccessfully to increase the price of its discount cigarettes, but on both occasions rescinded its price increase when its competitors did not follow. 346 F.3d at 1291-92.

Following these two unsuccessful efforts to increase prices for discount cigarettes, Philip Morris announced on April 2, 1993, that it was drastically cutting prices for its leading brand, Marlboro, with a 21 percent market share, and “forgoing price increases on other premium brands ‘for the foreseeable future.’” 346 F.3d at 1292. This event became known as “Marlboro Friday.” *Id.* The effects of the Philip Morris action were to shift market

share from discount cigarettes to Marlboro and other premium brands, and to send a message to the industry that Philip Morris “was willing to take drastic competitive measures (indeed, to sacrifice profits) in order to protect the market share of its flagship brand.” *Id.* “Finally, it set off a price war” among the cigarette companies, as competitors matched Philip Morris’s price reduction. *Id.*

After roughly six months of competitive carnage, the manufacturers began raising wholesale prices and continued to do so through early 2000. From May of 1995 to January of 2000, there were 11 price increases for cigarettes at wholesale, in which all of the defendants joined. 346 F.3d at 1293-94. The claim of the wholesalers was that these price increases resulted from conspiracy, rather than from the normal operation of competitive forces. In support of their claim, the wholesalers relied on numerous plus factors that accompanied the parallel conduct of the manufacturers. The Court of Appeals reviewed and rejected each of these plus factors, as will be discussed more fully hereafter.

In response to the wholesalers’ accusations, in addition to denying conspiracy and claiming their conduct to be mere conscious parallelism typical of an oligopoly, the cigarette companies raised three primary defenses. First, they showed that although wholesale price competition may have diminished, competition increased at the retail level during the period of the alleged conspiracy. “Indeed, during the alleged conspiracy period, the manufacturers spent on retail competition more than twice the amount the wholesalers claim to have been overcharged.” 346 F.3d at 1294. Second, the manufacturers showed that not until 1998 did wholesale prices rise to the level that had prevailed before Marlboro Friday. Third, the cigarette companies demonstrated “that significant market share shifts occurred within the tobacco industry during the alleged conspiracy period.” 346 F.3d at 1295. The Court summarized the defendants’ position as follows:

Distilled to its essence, the argument espoused by PM, RJR, B&W and Lorillard is that in an oligopoly, reason and economic rationality often dictate parallel pricing behavior, and that the evidence presented by the class is perfectly consistent with such “conscious parallelism.” The manufacturers further assert that various acts on which appellants do not focus, or that the class mischaracterizes, established conclusively that appellees’ behavior from 1993 through 2000 is dramatically inconsistent with any collusive behavior. Accordingly, they say, even if appellants had established the existence of a plus factor, and thus created an inference of conspiracy, that inference has been fully rebutted. [346 F.3d at 1298.]

### III. THE DECISION: THE ELEVENTH CIRCUIT’S ANALYTICAL FRAMEWORK

Much of the Eleventh Circuit’s discussion, after stating the controversy, concerned the method of analysis to be used on a motion for summary judgment. Initially, the Court acknowledged the difficulty of distinguishing between illegal price fixing and mere conscious parallelism, which does not violate the Sherman Act according to the Eleventh Circuit. The Court also observed that “it is only in rare cases that a plaintiff can establish the existence of a conspiracy by showing an explicit agreement; most conspiracies are inferred from the behavior of the alleged conspirators,” and from other circumstantial evidence (economic and otherwise), such as barriers to entry and other market conditions.” 346 F.3d at 1299-1300, quoting from *City of Tuscaloosa v. Harcros Chems., Inc.*, 158 F.3d 548, 569 (11<sup>th</sup> Cir. 1998), and *Seagood Trading Corp. v. Jerrico, Inc.*, 924 F.2d 1555, 1573 (11<sup>th</sup> Cir. 1991).<sup>1</sup>

<sup>1</sup> The Court also conceded, “In the unusual case where the plaintiff is able to muster direct evidence of price fixing, summary judgment is categorically inappropriate.” 346 F.3d at 1300.



Parsing the Supreme Court's decisions in *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986), and *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984), the Eleventh Circuit required that "inferences of a price fixing conspiracy drawn from circumstantial evidence [must] be reasonable" to survive summary judgment, and the plaintiff "must present evidence 'that tends to exclude the possibility' that the alleged conspirators acted independently." 346 F.3d at 1300. From these well-established, albeit somewhat murky, principles, the Eleventh Circuit then launched into the test it had established to evaluate whether the plaintiffs' proof tended to exclude the possibility of independent conduct.

The Eleventh Circuit announced the test it had developed for avoiding summary judgment, which is that plaintiffs "must demonstrate the existence of 'plus factors' that remove their evidence from the realm of equipoise and render that evidence more probative of conspiracy than of conscious parallelism." 346 F.3d at 1301. The Eleventh Circuit defined a plus factor as "any showing . . . that 'tends to exclude the possibility of independent action.'" *Id.*

The Court then went on to outline a three-step process for resolving a defense motion for summary judgment in a price-fixing case:

In short, there are three steps to the summary judgment analysis in the price fixing context. First, the court must determine whether the plaintiff has established a pattern of parallel behavior. Second, it must decide whether the plaintiff has demonstrated the existence of one or more plus factors that "tends to exclude the possibility that the alleged conspirators acted independently." *Matsushita*, 475 U.S. at 588, 106 S.Ct. at 1356 (internal punctuation and citation omitted). The existence of such a plus factor generates an inference of illegal price fixing. Third, if the first two steps are satisfied, the defendants may rebut the inference of collusion by presenting evidence establishing that no reasonable factfinder could conclude that they entered into a price fixing conspiracy.

In undertaking this analysis, the district court is obligated to give the price fixing plaintiff(s) "the full benefit of their proof without tightly compartmentalizing the various factual components and wiping the slate clean of scrutiny of each." *Id.*

The Eleventh Circuit also provided a statement of conditions that may disqualify a plus factor from having probative value. Specifically,

. . . a statement could not constitute a plus factor— *i.e.*, could not be said by a reasonable factfinder to tend to exclude the possibility [of] independent behavior or to establish a price fixing conspiracy—(1) if it required the jury to "engage in speculation and conjecture to such a degree as to render its finding 'a guess or mere possibility,'" . . . or (2) if to infer conspiracy from the evidence the jury necessarily would engage in "fallacious reasoning." [Citation omitted.] Moreover, "if [appellants'] theory is economically senseless, no reasonable jury could find in its favor, and summary judgment should be granted." [346 F.3d at 1302.]

These tests are to be applied with respect to each alleged plus factor.

The Eleventh Circuit rejected as mere semantic bickering the plaintiffs' argument that "the evidence constituting" a plus factor "must merely 'tend to establish' a conspiracy, as opposed to 'tend to exclude' independent action." 346 F.3d at 1303. According to the Eleventh Circuit, this is a distinction without a difference, inasmuch as evidence that tends to establish a conspiracy is no different from evidence that tends to exclude independent action.

In summarizing the analysis to be applied, the Eleventh Circuit concluded that because parallel action was conceded, "the key questions on appeal are (1) whether appellants have shown the existence of a plus factor so as to create an inference of conspiracy; and (2) if so, whether appellees are able to rebut that inference." 346 F.3d at 1305.

#### IV. THE DECISION: ANALYSIS OF ALLEGED PLUS FACTORS

The next part of the Eleventh Circuit's decision consisted of its analyzing, one by one, each of the eleven plus factors claimed by the wholesalers to constitute proof of conspiracy. The plus factors included:

- (1) signaling of intentions; (2) permanent allocations programs; (3) monitoring of sales; (4) actions taken contrary to economic self-interest, including (a) little analysis of whether to follow price increases, (b) B&W and RJR pulling away from the discount cigarette market, (c) the May 1995 price increase lead by RJR and followed by Philip Morris, (d) Philip Morris' agreement to base the initial [Management Science Associates] . . . payments on market capitalization rather than market share, and (3) "excessive" price increases after the MSA; (5) nature of the market; (6) strong motivation; (7) reduction in the number of price tiers; (8) opportunities to conspire; (9) pricing decisions made at high levels; (10) the smoking and health conspiracy; and (11) foreign conspiracies. [*Id.*]

The Eleventh Circuit's analysis, rejecting each plus factor, was as follows:

##### A. Signaling

The Court rejected the initial price reduction by Philip Morris on Marlboro Friday as a signal to fix prices, essentially because the price reduction by Philip Morris was procompetitive. The Court supported this reasoning by quoting from *Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223-24 (1993) ("Even in an oligopolistic market, when a firm drops its prices to a competitive level to demonstrate to a maverick the unprofitability of straying from the group, it would be illogical to condemn the price cut.") The Court also excused the response of other cigarette companies to Marlboro Friday in complying with Philip Morris' understood desire to reduce the price gap between premium and discount cigarettes.

It is plain to us that RJR and B&W's actions are readily explained as economically rational, self-interested responses to Marlboro Friday. PM's premium price cuts strongly suggested to its competitors that any attempt to gain market share for discount brands through further price cuts would not be accepted. . . . The only viable way for RJR and B&W to increase their revenues was to raise prices in a manner that would not provoke a competitive response from PM, which is precisely the action that the class labels a signal of conspiracy. Put simply, this action is no more indicative of collusion than it is of lawful, rational pricing behavior. [346 F.3d at 1307.]

Other alleged signaling through public statements was rejected by the Eleventh Circuit as taking statements out of context. The Court also said, in excusing a statement by one executive that his company would not be escalating any price war, “it is clear that further price reductions of either the premium or discount brands would have reduced B&W’s revenues without increasing its market share. Broughton’s statement simply recognizes this economic fact, nothing more.” 346 F.3d at 1308. Finally, the Court rejected Philip Morris’ announcement of a permanent allocation program as signaling, because Philip Morris had a “contingency plan” to be implemented if competitors did not follow, and because Philip Morris presented evidence that allocation was “necessary to combat trade loading by wholesalers, which resulted in excess product returns, disruptions in shipping patterns and stale product.” 346 F.3d at 1309.

## B. Actions Against Manufacturers’ Economic Interests

To begin with, the Eleventh Circuit urged caution in any analysis of whether action was contrary to economic self-interest, “lest we be too quick to second-guess well-intentioned business judgments of all kinds.” 346 F.3d at 1310. “Thus, if a benign explanation for the action is equally or more plausible than a collusive explanation, the action cannot constitute a plus factor.” *Id.* The Court then rejected as a plus factor competitors’ following price increases by Philip Morris because the Court found that manufacturers could not expect to achieve increased market share through lower pricing. This was so because of likely retaliation by Philip Morris and because of the unlikelihood of wholesalers’ passing on price reductions to retailers. The Court also rejected absence of financial analysis as a plus factor because “[o]nce appellees perceived that raising prices was their wisest economic strategy, no extensive discussion or planning was needed to implement this strategy each time a competitor initiated a price increase.” 346 F.3d at 1311. The Court also found that smaller manufacturers were acting consistently with their economic interests when they followed price increases and shifted business from discount to premium brands. The Court concluded that the evidence was “in equipoise . . . equally consistent with collusion as with lawful competition, and accordingly, under *Matsushita* and *Harcros*, it cannot represent a plus factor.” 346 F.3d at 1313.

The Court also found that it was not against the self-interest of the cigarette companies to exchange sales information, because “although the sharing of information can be seen as suggesting conspiracy, as appellants allege, it also can be seen equally as a necessary means to the receipt of its competitors’ information.” *Id.* Putting the matter more colorfully:

To draw an analogy, each company’s willingness to give its own information can be viewed as the ante in a poker game. To ante is irrational only if there is no legitimate reason why one would be playing the game; yet here, the game is oligopolistic competition, which everyone concedes is lawful, and the ante is perfectly consonant with the desire to play. [*Id.*]

The Court ruled the allocation programs not to be against interest because of their tendency to discourage trade loading. According to the Court, “contemporaneous documents demonstrate conclusively that this was the actual motivation for the programs.” 346 F.3d at 1314.

### C. Monitoring of Sales through MSA

Here, the Court found insufficient evidence of concerted activity, and also found each manufacturer had a legitimate independent interest in obtaining competitive information from its rivals.

### D. Smoking and Health Conspiracy

The plaintiffs claimed as a plus factor a cigarette industry conspiracy beginning in 1953 to restrict competition on the basis of health. The Court rejected this as a plus factor because “there is no evidence that these activities continued to transpire during the period in question, *i.e.*, 1993-2000.” 346 F.3d at 1316.

### E. Foreign Conspiracies

The Eleventh Circuit affirmed the trial court’s exclusion of evidence of price-fixing conspiracies in foreign countries, because the plaintiffs “had failed to show that *any* of the actions allegedly undertaken by appellees overseas were illegal under the applicable foreign law.” *Id.* (emphasis in original). This failure of proof destroyed any nexus between such foreign price fixing and the alleged United States price-fixing conspiracy.

### F. History and Structure of the Tobacco Industry

The Court rejected evidence of market structure as a plus factor because “the majority of the market characteristics on which the class focuses are simply indicia that the tobacco industry is an oligopoly, which is perfectly legal.” 346 F.3d at 1317.

As for the industry’s history of antitrust violations, the district court noted that the class had failed to direct it to any precedent for holding such to be indicative of a present antitrust violation. *See Holiday Wholesale Grocery*, 231 F.Supp.2d at 1305 (“The law generally disfavors use of such ‘historical’ evidence.”) (citations omitted). Appellants have failed to do so on appeal as well. [346 F.3d at 1317-18.]

### G. Dampening of Market Share Shifts

The Court rejected this as a plus factor because the evidence showed market shares to have shifted more than in the period predating the conspiracy.

### H. Credit Memos Making Price Increases Prospective

The Eleventh Circuit found a failure of proof on this claim, “[b]ecause there is no evidence that these credit memos actually delayed the implementation of price increases.” 346 F.3d at 1319.

### I. Opportunities to Conspire and the Restriction of Decisionmaking Authority to High-Ranking Corporate Officers

The Court basically held that opportunity to conspire, in itself, cannot constitute a plus factor. “Indeed, the opportunity to fix prices without any showing that appellees *actually*

conspired does not tend to exclude the possibility that they did not avail themselves of such opportunity or, conversely, that they actually did conspire.” *Id.* (emphasis in original).

## V. THE DECISION: REBUTTING THE PRESUMPTION

Although the Eleventh Circuit found that the plaintiffs’ had not established even one plus factor, the Court went on to hold that the defendants had “readily rebutted the resulting inference of collusion” through showing that they had “spent a combined \$25.256 billion on promotional allowances, coupons and retail value added’ between 1993 and 2000, an amount that is more than double the sum allegedly overcharged.” 346 F.3d at 1320-21. Also, defendants rebutted the presumption by showing that prices did not reach pre-conspiracy levels until more than five years after the beginning of the alleged conspiracy, and that market shares shifted significantly during the period of the alleged conspiracy. In short, the cigarette manufacturers presented a coherent and compelling counter-explanation for their conduct, which overwhelmed the plaintiffs’ evidence of conspiracy. Even had the plaintiffs established any plus factor, the cigarette companies “would have rebutted any inference that they conspired to fix prices by demonstrating that the class’s conspiracy theory is utterly implausible.” 346 F.3d at 1323.

## VI. COMMENTS ON DECISION

Under the Eleventh’s Circuit’s view of matters, Judge Posner never had a chance. Neither his views on antitrust economics nor his decision in *In re High Fructose Corn Syrup Antitrust Litig.*, 295 F.3d 651 (7<sup>th</sup> Cir. 2002) received even the slightest acknowledgement or consideration in the Eleventh Circuit’s decision.

In his extrajudicial writings, Judge Posner has challenged the economic model that conscious parallelism in oligopolies produces supracompetitive pricing without agreement. R. A. Posner, “Oligopoly and the Antitrust Laws: A Suggested Approach,” 21 *Stanford Law Rev.* 1562 (June 1969); *Antitrust*, pp. 51-100, “Price Fixing and the Oligopoly Problem,” (2d ed.) (University of Chicago 2001). According to Judge Posner, “. . . the interdependence theory of oligopolistic pricing . . . is inadequate.” *Antitrust*, p. 57. This is because time lags in matching price reductions and differences in ability to expand output in response to price reductions render price competition feasible in oligopolies. Similarly, price reductions may not affect rivals and provoke retaliation if they result in sales to new customers, or are only partial. Moreover, the interdependence theory does not adequately explain how prices have risen above competitive levels. Judge Posner argues that matching price increases involves choices to forgo benefits from competing that are against self-interest in the absence of agreement. To Judge Posner, “there is no sound basis in economic theory for thinking that if there are just a few major sellers in a market, competition will disappear automatically.” *Antitrust*, p. 69. He says, “The interdependent theorists tend to leap from the sound proposition that concentration is a necessary condition of tacit collusion to the unsound proposition that it is a sufficient condition.” *Antitrust*, pp. 68-69. “Each seller must still decide whether to limit output, and this implies at least tacit negotiation with his major competitors.” *Antitrust*, p. 69. Thus, “it may be possible to demonstrate through economic evidence the existence of collusive pricing even though no overt acts of collusion are detected.” *Antitrust*, p. 79. Judge Posner concludes, “This is where I part company with most other economically minded students of antitrust policy. . . . If the economic evidence in a case warrants an inference of collusive pricing, there is neither legal nor practical justification for requiring evidence that will support the further inference that the collusion was explicit rather than tacit.” *Antitrust*, p. 94.

According to Judge Posner, “If seller A restricts his output in the expectation that B will do likewise, and B restricts his output in a like expectation, there is a literal meeting of the minds.” *Antitrust*, p. 94. This type of offer and acceptance analysis reappears in Judge Posner’s decision in the *Fructose* case, 295 F.3d 651 at 654. It is also consistent with the Supreme Court’s analysis in *American Tobacco Co. v. United States*, 328 U.S. 781, 810 (1946).

In both his treatise and his decision in *Fructose*, Judge Posner provides a catalog and discussion of the types of economic evidence that may be sufficient to demonstrate the existence of agreement in an oligopolistic market. Such evidence may include “fixed relative market shares”; “market wide price discrimination”; “exchanges of price information”; “regional price variations”; “identical bids”; “price, output, and capacity changes at the formation of the cartel”; “industry wide resale price maintenance”; “declining market shares of leaders”; “amplitude and fluctuation of price changes”; and “exclusionary practices.” *Antitrust*, pp. 79-93. In *Fructose*, Judge Posner discusses such structural factors as oligopoly, fungibility of product, entry barriers, and excess capacity. He discusses conduct plus factors that include identical list prices, information exchanges, price discrimination, and stable market shares in a period of rising demand.

The views of Judge Posner are at odds with the generally accepted so-called Turner view that conscious parallelism can produce supracompetitive pricing in oligopolistic markets without agreement or collusion. Courts often express this position by stating that supracompetitive prices that are the result of conscious parallelism alone do not violate Section 1 of the Sherman Act. As Judge Posner has argued for years, however, this proposition is not self-evident. His decision in *Fructose* may in part be an effort to revive the debate on this point.

What is significant in the *Williamson Oil* decision is its total acceptance and embrace of the Turner position, without any acknowledgement of the contrary views of Judge Posner. For example, the Eleventh Circuit rejects any notion that reducing prices in an oligopoly can result in any benefit to the initiator of the price reduction.

As explained *supra*, it is clear that further price reductions of either the premium or discount brands would have reduced B&W’s revenues without increasing its market share. Broughton’s statement simply recognizes this economic fact, nothing more. [346 F.3d at 1308.]

With all due respect, the Eleventh Circuit’s conclusion that this is an “economic fact” is not universally shared by economists, particularly those in agreement with Judge Posner.<sup>2</sup> The Eleventh Circuit’s wholehearted acceptance of the Turner position guides its entire analysis and determines its result. For example, when viewing the plaintiffs’ economic evidence of market structure and behavior for the cigarette industry, which Judge Posner might consider probative of agreement, the Eleventh Circuit concludes, “The problem with this argument, however, is that the majority of the market characteristics on which the class focuses are simply indicia that the tobacco industry is an oligopoly, which is perfectly legal.” 346 F.3d at 1317.

Lack of receptivity to the Posner position is only a starting point in explaining the result reached by the Eleventh Circuit. Equally noteworthy is the Eleventh Circuit’s absolute

<sup>2</sup> Even stronger refutation of the Turner view appears in an excellent recent article by Gregory J. Werden, “Economic Evidence on the Existence of Collusion: Reconciling Antitrust Law with Oligopoly Theory,” 71 *Antitrust Law Journal* 719 (2004). The article reviews the impact of game theory and the Prisoner’s Dilemma on the development of modern oligopoly theory. Werden explains how economic theory now rejects the Turner view that conscious parallelism alone will invariably produce non-competitive pricing in an oligopoly. The article also sets out how courts deciding antitrust cases have been woefully ignorant of modern oligopoly theory.

rejection of opportunity to conspire as a plus factor. According to the Eleventh Circuit, the opportunity to conspire cannot be a plus factor “without any showing that appellees *actually* conspired.” 346 F.3d at 1319 (emphasis in original). This is of course the equivalent of saying opportunity is never a plus factor, and thus flies in the face of the Supreme Court and most other circuits, which continue to list opportunity as a plus factor.

Equally curious is the Eleventh Circuit’s treatment of evidence of price-fixing agreements in other countries, and its unwillingness to consider the tobacco industry’s history of antitrust violations. The Court held that evidence of price-fixing agreements in other countries could not be considered a plus factor without a showing that the extraterritorial price fixing violated the laws of the foreign countries in which it occurred. The Court cited no authority to support this result, nor does logic support it. Regardless of legality, foreign price-fixing arrangements provided, in the plaintiffs’ view, “a mechanism to ‘establish and revise, and to monitor and enforce agreements to coordinate.’” 346 F.3d at 1317. Certainly, that the cigarette companies were fixing prices outside the United States tends to exclude the possibility that they were acting independently in setting prices within the United States. Allowing this evidence is consistent with the long line of federal antitrust decisions admitting similar evidence under the Kindred Acts Doctrine, as well as Federal Rule of Evidence 404(b), to show motive, intent, a common scheme or plan, and the absence of mistake. See *Continental Ore Co. v. Union Carbide Corp.*, 370 U.S. 690, 710 (1962); *Alexander v. National Farmers Org.*, 687 F.2d 1173, 1196 (8<sup>th</sup> Cir. 1982); *Affiliated Capital Corp. v. City of Houston*, 735 F.2d 1555, 1564-65 (5<sup>th</sup> Cir. 1984); *In re Coordinated Pretrial Proceedings*, 907 F.2d 432, 452-53 (9<sup>th</sup> Cir. 1990); *Movie 1 & 2 v. United Artists Communications*, 909 F.2d 1245, 1250 (9<sup>th</sup> Cir. 1990); *United States v. Southwest Bus Sales, Inc.*, 20 F.3d 1449, 1456 (8<sup>th</sup> Cir. 1994).

Equally mysterious is the Eleventh Circuit’s refusal to consider the history of antitrust violations of the cigarette industry, because the plaintiffs failed to cite “any precedent for holding such to be indicative of a present antitrust violation.” 346 F.3d at 1317-18. One is tempted to ask whether the judges in the Eleventh Circuit employ law clerks. Even if no law clerks were available to assist in the *Williamson Oil* opinion, the judges could readily have turned to any antitrust hornbook and seen a truly illustrious compendium of Supreme Court decisions in which the Court considered the history of the industry at issue, including the cigarette industry itself, even going back well before the passage of the Sherman Act. *Standard Oil Co. v. United States*, 221 U.S. 1, 76 (1911); *United States v. Lehigh Valley R.R. Co.*, 254 U.S. 255, 266-70 (1920); *United States v. Reading Co.*, 253 U.S. 26, 43-45 (1920); *United States v. American Tobacco Co.*, 221 U.S. 106, 160, 166, 181-82 (1911); *American Tobacco Co. v. United States*, 328 U.S. 781, 796 (1946). Indeed, had the Eleventh Circuit looked at the cited page in the 1946 *American Tobacco* case, it would have found exactly the authority it was looking for in the Supreme Court’s oft-repeated statement, “Size carries with it an opportunity for abuse that is not to be ignored when the opportunity is proved to have been utilized in the past.” *United States v. Griffith*, 334 U.S. 100, n.10 (1948); *United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 174 (1948); *United States v. Swift & Co.*, 286 U.S. 106, 116 (1932), all of which contain the same language. Given the plethora of authority to support consideration of a history of past antitrust violations, the Eleventh Circuit’s refusal to consider this evidence because the plaintiffs apparently furnished no citations is both baffling and inexcusable.

Moreover, the summary judgment test devised by the Eleventh Circuit, as applied in the *Williamson Oil* case, is highly questionable, and vulnerable to the criticism that it unconstitutionally deprives plaintiffs of their Seventh Amendment right to a jury trial. To avoid summary judgment, according to the Eleventh Circuit, the plaintiff in a price-fixing

case must show, first, parallel behavior, and, second, “the existence of one or more plus factors that ‘tends to exclude the possibility that the alleged conspirators acted independently.’” 346 F.3d at 1301. The plus factor must be economically plausible and must not require the jury to engage in speculation and conjecture. 346 F.3d at 1302. (Compare, however, Judge Posner’s statement in *Fructose* that “conjecture has its place in building a case out of circumstantial evidence.” 295 F.3d at 660.) Even if the plaintiff meets this burden, however, summary judgment will be appropriate if the defendants “rebut the inference of collusion by presenting evidence establishing that no reasonable factfinder could conclude that they entered into a price fixing conspiracy.” 346 F.3d at 1301. According to the Eleventh Circuit, the cigarette companies did just that by demonstrating substantial shifts in market shares, price increases that took five years to reach pre-conspiracy levels, and increased spending in retail competition that greatly exceeded the gains from the wholesale price increases implemented by the alleged conspirators.

The Court’s analysis, however, raises two substantial questions. First, one must ask why a plaintiff who can show conscious parallelism and one or more plus factors should be deprived of a jury trial because of defense evidence that does not disprove the existence of the plus factors, but merely shows an alternative explanation for the defendants’ conduct. Sorting out conflicting explanations would appear to be exactly what juries are for. Second, application of this test in the *Williamson Oil* case appears to fall into the three traps defendants lay for courts in summary judgment motions, as enumerated by Judge Posner in *Fructose*. These three traps are weighing conflicting evidence, failing to consider the plaintiffs’ proof as a whole, and confusing the existence of a conspiracy with its efficacy. 295 F.3d at 655-56. That the cigarette companies may not have been as successful as they hoped in raising wholesale prices, because of their propensity to compete at retail, does not establish that there was no wholesale price-fixing conspiracy, but only that it was not particularly effective.

Finally, the Eleventh Circuit seems wholly to have missed the boat in its consideration of the probative value of Marlboro Friday. In its most basic terms, Marlboro Friday involved the dominant firm in an oligopoly making a price reduction as a well understood signal that it would no longer tolerate price competition by other oligopoly members. Thereafter, when the dominant firm raised prices, the competitors all immediately matched, in a series of price increases spanning mid-1993 to early 2000. There is a strong likelihood that Judge Posner would regard this as sufficient evidence of an agreement to engage in supracompetitive pricing. The Eleventh Circuit, however, refuses to consider Marlboro Friday as a plus factor, *i.e.*, signaling, because the initial price reduction by Philip Morris, standing alone, was procompetitive. One cannot imagine, however, a more egregious instance of viewing the plaintiffs’ evidence piecemeal, and refusing to view the evidence as a whole. The Eleventh Circuit acknowledged that Philip Morris, through Marlboro Friday, intended to convey a message of no more price competition; it also acknowledged that the message was received and clearly understood by the other cigarette companies. Yet when price increases began, the Eleventh Circuit wholly ignored the transmittal and receipt of the Marlboro Friday message, because the original price reduction, standing alone, was procompetitive, notwithstanding the intent of Philip Morris to use it as the springboard for future collusive price increases. The Court’s reasoning is supported neither by logic, nor by precedent. It also transgresses the well-established rule that an unlawful scheme may consist of acts wholly innocent in themselves. *American Tobacco Co. v. United States*, 328 U.S. 781, 809 (1946); *Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 707 (1962).



## VII. CONCLUSION

The *Williamson Oil* case is an important, fascinating, and, in this writer's view, wrongheaded decision, which raises and highlights most of the issues that attend summary judgment motions in price-fixing cases in oligopolistic industries. The opinion is well worth study and analysis if one is to understand what the unsettled issues are in this area, and where the law ultimately is headed.



# PROOF OF CONSPIRACY IN VERTICAL AND HORIZONTAL PRICE-FIXING CASES: THE INTERSECTION OF LAW, ECONOMICS, AND POLICY

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## I. INTRODUCTION

Section 1 of the Sherman Act prohibits contracts, combinations and conspiracies in restraint of trade. For many years, the courts have held that both horizontal and vertical price-fixing agreements are per se illegal. Because proof of concerted action to fix prices establishes liability, the focus in the cases has been primarily on what is required to prove concerted action. The purpose of this article is to compare and contrast how and why the courts have defined the line between unilateral and concerted action.

There are interesting parallels in the law relating to proof of horizontal and vertical agreements. In the horizontal context, merely “tacit collusion” is not sufficient to trigger Section 1 liability, although, as Richard Posner strongly argued before he went on the bench, the economic effect is indistinguishable from explicit collusion by the same firms. Similarly, in the vertical context, a manufacturer’s unilateral policy not to deal with retailers who do not follow its suggested prices is not sufficient to trigger Section 1 liability, although it may be no less effective in achieving the desired result than a signed agreement with the same retailers.

In both contexts, it would not be a stretch to say that agreement existed. Members of a highly concentrated market are inevitably aware of the effect of their actions on the other firms. As Posner argued, one could use principles of unilateral contract to find an agreement sufficient for purposes of Section 1. The declaration of the “policy” by a manufacturer and the subsequent conscious acquiescence by retailers dependent on the manufacturer’s products is, if anything, even easier to characterize as an agreement. It is fairly well established that a defendant will prevail if the plaintiff proves nothing more than those minimum facts. The interesting question is how much more proof is necessary to give the jury the opportunity to decide the case.

We have arrived at the current standards for separating permissible unilateral conduct from illegal concerted agreement through a long process of the courts mechanically applying precedent with an occasional overlay of antitrust policy as understood at the time.

I believe that the appropriate rule for horizontal conspiracies is correctly stated and applied in the recent decision of the Seventh Circuit in *In re High Fructose Corn Syrup Antitrust Litigation (HFCS)*, 295 F.3d 651 (7th Cir. 2002). That ruling appropriately combines the economic concerns about cartel activity in concentrated industries with the statutory

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\* I appreciate the assistance of Aaron Myers of Fenwick & West L.L.P.

requirement of concerted action and role for the jury in our system of justice. In this context, there are no serious inconsistencies between the legal standards and a rational antitrust policy.

In contrast, the law concerning the standard of proof for a vertical price fixing agreement represents an effort to minimize the effect of substantive law that cannot be reconciled with changes in the closely analogous area of vertical non-price restrictions. While the current law effectively insulates the changes in the non-price arena from *per se* treatment, it leaves an unacceptably broad range of competitively harmless or even beneficial business practices subject to the draconian *per se* rule.

## II. HORIZONTAL AGREEMENTS

Horizontal price-fixing agreements are the most fundamental violations of the antitrust laws. Treatment of such agreements as *per se* illegal is generally accepted as appropriate. As Richard Posner has pointed out, the *per se* standard means that the law prohibits *attempts* because no proof of actual market effect is required. However, since participants in the market are the best informed about the market conditions, the assumption that such agreements will rarely be futile is probably legitimate.

A more controversial issue has been whether to require proof of explicit agreement in the form of meetings, communications, and the like. Before he went on the bench, Richard Posner argued strongly that Section 1 could and should be applied to the type of tacit agreements involved in oligopolistic interdependence. Posner argued that tacit agreements had the same harmful effect on consumers as explicit ones. Indeed, he argued that the focus on proving explicit agreement had the effect of diverting enforcement resources from the practices that had the greatest risk to the economy to those that were far less serious. While he acknowledged that a finding of concerted action was required under Section 1, Posner argued that tacit agreements could qualify as a form of unilateral contract. Don Turner had argued that oligopolists were merely making a rational response to the market conditions in which they found themselves. Posner responded that the firms in highly concentrated markets always have the choice of producing the volume that would equate price with their marginal cost.

Ultimately, Posner's position proved to be too extreme for the courts. Ironically, in relatively recent years, the pendulum swung strongly in the other direction, based in substantial part on analogous observations about the nature of competition in concentrated markets. Confusion about the standard resulted in part from the mechanical lifting of language from one kind of case to another. In *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986), the Court faced a claim of a long-term *predatory pricing* conspiracy by Japanese television makers. Relying on economic studies concluding that predatory pricing was rarely successful, the Court required a higher level of proof for a conspiracy that it found to be inherently unlikely.

The language from *Matsushita* then was repeated in yet another type of case. In *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984), the Court addressed the sufficiency of the proof of conspiracy in the context of an alleged vertical price-fixing conspiracy. As discussed in more detail below, the decision in *Monsanto* was motivated in large part by a better economic understanding of the nature of the relationships and incentives of manufacturers and their distributors.

The language from *Matsushita* and *Monsanto* was then applied in the context of alleged horizontal price-fixing agreements in concentrated markets. Of course, in every case subject to the preponderance of the evidence standard, the plaintiff must show that conspiracy is more likely than not. But, the language from *Matsushita* took on a life of its

own, and courts (at least seemingly) began to hold that juries were not entitled to decide the case if there was any alternative reading of the evidence that was consistent with unilateral action. This standard became particularly problematic when applied in the context of highly concentrated markets. Those markets are the ones often characterized by the tacit collusion that so concerned Posner. However, since tacit collusion is not considered to be concerted action and the performance of concentrated markets often resembles that of markets where collusion is occurring, the result was to find alternative explanations for evidence that were fully consistent with collusion in markets where that danger was the greatest.

The ironic result of the “strong” application of *Matsushita* in concentrated markets was to make it hardest to prove conspiracy where conspiracy was more likely to succeed and, therefore, where it was most likely. This swung the pendulum to the polar opposite of Posner’s suggestion that tacit collusion alone was sufficient to satisfy Section 1. It was therefore an interesting coincidence that now-Judge Posner was on the Seventh Circuit panel in *HFCS*. The trial judge had essentially taken the approach that if there was a possible non-conspiratorial interpretation of each piece of evidence (i.e. if it was ambiguous), the plaintiff had failed to meet its burden as a matter of law.

In *HFCS* the Seventh Circuit first considered whether the market was one that was conducive to conspiracy and found that it was. It next considered whether there was evidence that the market was performing in a non-competitive manner and found that there was. But, the court then recognized that, while this evidence might establish tacit collusion, the law required proof of express conspiracy. After reviewing the evidence, the court held that, while some of the evidence was ambiguous in the sense that it could possibly support different conclusions, the evidence as a whole was more than minimally sufficient to be submitted to the jury.

The problem is that circumstantial evidence is inherently ambiguous. If only unambiguous evidence were allowed, horizontal price-fixing could only be proved through direct evidence. Although such evidence sometimes exists, the nature of conspiracy is that one must often rely on indirect evidence.

The problem with the requirement of a strong reading of the *Matsushita* language is that some evidence that would be relatively clear in a relatively unconcentrated market is less clear in a concentrated market—precisely because of the potential for tacit collusion noted by Posner. To the extent that this reasoning prevailed, the result would be to make it harder to prove conspiracy in those markets where collusion is easiest and most likely to occur. While one might conclude that punishing purely tacit collusion is the wrong course, making it harder to prove conspiracy in concentrated markets is equally wrong.

The recent decisions from the courts of appeals on proof of conspiracy are fact-specific. It is possible to read *HFCS* as consistent with the other cases such as *See, e.g., In re Baby Food Antitrust Litigation*, 166 F.3d 112 (3d Cir. 1999); *Blomkest Fertilizer, Inc. v. Potash Corp. of Saskatchewan, Inc.*, 203 F.3d 1028 (8th Cir. 2000); *City of Tuscaloosa v. Harcros Chemicals, Inc.*, 158 F.3d (11th Cir. 1998). The courts cited the same cases, but one has to acknowledge that the tone of Judge Posner’s opinion is different, as is his treatment of the issue of ambiguous evidence.

At the end of the day, the question of whether there is sufficient circumstantial evidence to go to the jury will be a matter of judgment. Certainly, more than a few isolated statements in memos should be required. However, where there is substantial evidence of explicit agreement—albeit capable of being interpreted either way—the case should be given to the jury. This result creates a strong incentive for companies in concentrated industries to go out of their way to avoid conspiracies.

### III. VERTICAL AGREEMENTS

Vertical price-fixing has been per se illegal for almost as long as horizontal price-fixing. The basic rule dates from *Dr. Miles Medical Company v. John D. Park & Sons Company*, 220 U.S. 373 (1911). The case that has come to define the requirement of an agreement is *United States v. Colgate & Co.*, 250 U.S. 300 (1919). In *Colgate*, the Court held that a manufacturer is free to announce a policy defining the terms under which it will deal with retailers and then cease doing business with those retailers who violate the policy. Based on *Colgate* alone, one might argue that the underlying rationale for the decision was some poorly articulated sense of the inherent autonomy rights of manufacturers, rather than the absence of concerted action. In my discussion with ordinary citizens unencumbered by any knowledge of the doctrine of unilateral contracts, they almost always think that the conduct unambiguously permitted by *Colgate* sounds like an agreement to them. However, numerous subsequent decisions have characterized the presence or absence of agreement as the key factor.

Over the years following *Colgate*, a number of cases essentially limited the case to its facts. To the extent that the manufacturer did anything beyond the simple announcement and refusal to deal, the courts tended to find evidence of agreement. These cases did not make much sense in the context of a discussion of agreement. Why, for example, does the fact that the manufacturer used its wholesalers to help police the policy make it more likely that there was an agreement with the retailers? Plainly, the point was that the additional steps made it more likely that the policy would be effective, and the courts started with the assumption that it was a bad thing for the policy to succeed.

The turning point for vertical price fixing law was the decision of the Supreme Court in *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977). *Sylvania* was a non-price restriction case, and the Court took pains to point out that the issue of vertical price fixing was not presented. Nevertheless, the intellectual foundation of the decision severely undercuts the use of per se analysis for vertical price-fixing. *Sylvania*, of course, overruled the per se rule for vertical non-price agreements. It recognized that there were legitimate, pro-competitive reasons why a manufacturer might want to impose restrictions on its distributors in the interest of selling its product more effectively. It also recognized the disciplining effect of interbrand competition. To the extent that the manufacturer made a mistake about whether a non-price restriction would benefit its ability to compete, the existence of active interbrand competition would quickly reveal and punish that mistake.

In the absence of some market power, vertical non-price restrictions are unlikely to be found to be illegal. Yet, there was a significant risk to this new legal regime. The fact is that the whole point of using vertical non-price restrictions is to give some price protection. So, for example, if a manufacturer gives a retailer an exclusive territory, that retailer is a “monopolist” in that product and to the extent that the product is differentiated, may have some ability to price higher than it would have in the face of active intrabrand competition. It is the extra money from that higher margin that provides the money to provide additional display and demonstration, as with a stereo showroom for high-end stereo products. If an agreement that *affected* prices were sufficient to trigger Section 1, the decision in *Sylvania* would be effectively eliminated. So, in *Business Electric Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988) the Court held that the per se rule only applies where there is an agreement as to price or price levels.

Although *Sharp* did not directly address the standards for proving agreement, it was clearly motivated by a concern to protect *Sylvania*. The decision in *Monsanto* directly

addressed both *Colgate* and the proof necessary to establish agreement. The Court recognized the collaborative relationship between manufacturer and distributor and held that the mere fact that a manufacturer terminated a discounting dealer after complaints from another distributor was not sufficient to establish an agreement between the manufacturer and the complaining distributor. The Court also reaffirmed the *Colgate* doctrine as a limit on the per se rule against vertical price fixing.

Short of reversing the rule against vertical price fixing, the Court has done what it can do to limit the damage from that rule. At a minimum the ability to state a policy and act on it still exists as permissible action that is not subject to Section 1. The mere fact of acting after receiving a complaint from another distributor is not sufficient to go to the jury on the issue of agreement. And, only agreements that directly address prices are within the per se rule. But the fact remains that a wide area of policies addressing prices are at risk. It is not clear how much more than the mere announcement and refusal to deal is permitted without amounting to an agreement. If courts apply normal standards for when a fact question is presented, most cases will go to juries with extremely unpredictable results. As a practical matter, when large field organizations are involved, it is hard to imagine a case where there is not some evidence of something beyond the mere announcement of the policy and refusal to deal. Sales persons will lose their commissions when retailers are terminated, making it highly likely that some entreaties to “get back in line” and “get with the program” will occur. There is not much history of these cases being tried, but ordinary jurors may have trouble understanding the economic arguments for why it is legitimate for manufacturers to try to keep prices higher. A dislike for the goal makes it is much more likely that jurors would find that an agreement exists.

#### IV. CONCLUSION

Although there has been some intermingling of judicial standards for proving conspiracy between horizontal and vertical price fixing cases, the issue of agreement cannot be completely separated from the issue of the underlying substantive law. Society benefits from laws that make it costly to engage in cartel behavior. While it would be wrong to make it illegal for companies in concentrated industries to breathe, neither should they be given a pass because they are in markets where tacit (and explicit) collusion is easy. The *HFCS* case got it about right. In contrast, the law concerning vertical price fixing is decided unclear and bad. It is clear that the basic proposition of *Colgate* is good law, but the reality is that few cases will have such pristine facts. If, as seems likely, cases involving additional facts will go to juries, there will be a great risk of liability for conduct that has essentially the same justifications and lack of competitive risk as vertical non-price restrictions that are now subject to the rule of reason.





# GRUNTS, WINKS, & NODS: WHAT MEETS THE AGREEMENT ELEMENT OF A SECTION 1 CLAIM?

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I have an antitrust plaintiffs perspective on what should satisfy the agreement element of a Section 1 claim. Far too many antitrust concerns are ignored because of how the agreement element of the antitrust claim is analyzed by courts. For want of direct evidence demonstrating that conspirators conveyed agreement with a grunt, a wink, or a nod, a course of conduct that unreasonably restrains trade far too often fails to meet the agreement element of a Section 1 claim.

## *Independent Decision Making Is an Important Antitrust Theme*

I begin with the reminder that agreement is of course a fundamental tenet of Section 1 claims. As the United States Supreme Court explained in *Copperweld Corp. v. Independence Tube Corp.*,<sup>2</sup> Section 1 “reaches unreasonable restraints of trade effected by a ‘contract, combination . . . or conspiracy’ between separate entities. It does not reach conduct that is “wholly unilateral.”<sup>3</sup> The Court emphasized that Congress treated concerted activity more strictly than unilateral conduct because concerted activity deprives the marketplace of the independent centers of decision making that competition assumes and demands. In any conspiracy, two or more entities that previously pursued their own interests separately are combining to act as one for their common benefit. This not only reduces the diverse directions in which economic power is aimed but suddenly increases the economic power moving in one particular direction.<sup>4</sup>

The fundamental value is to preserve separate independent decision makers on core competitive issues and foster competition on the merits as determined by the choices made by purchasers, as opposed to competition as defined by an agreement.<sup>5</sup>

Yet, separate decision makers do not necessarily make separate decisions. Of course and as a matter of overview antitrust theory, everybody doing the same thing -- even on core competitive issues like pricing -- is usually not an antitrust violation. As to commodities, everybody pricing the same may indicate a competitive market generating a market price. For oligopolies, one firm must pay attention to and often follow (and certainly respond to) the prices charged by another firm. That dynamic often leads to the same pricing.

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1 Director of Litigation, Antitrust Bureau, New York State Department of Law. The opinions expressed here are my own views, and not necessarily the views of the Antitrust Bureau, New York Attorney General Eliot Spitzer, New York State, or any other state.

2 467 U.S. 752 (1984).

3 467 U.S. at 768 (emphasis in original).

4 467 U.S. at 768-69.

5 Recently, in *Verizon Communications Inc. v. Law Offices of Curtis v. Trinko, LLP*, No. 02-682, slip op. at 8 (U.S. Jan. 13, 2004), the Court characterized collusion as “the supreme evil of antitrust.”

Similarly, many retailers will use the retail price suggested by the manufacturer. Thus, the challenge is to identify when decisions are not being made separately, without relying solely on evidence that the decisions are the same.

*Agreement is a Hard Element to Establish*

Defendants prefer any discussion of agreement to begin and end with *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*<sup>6</sup> This preference is perfectly understandable, because the defendants in *Matsushita* prevailed on summary judgment and plaintiffs were not allowed to submit their case to a fact finder, despite plaintiffs offering significant evidence of agreement. The Court's summary of evidence offered and the result the defendants obtained illustrate the point:

In sum, . . . neither petitioners' pricing practices, nor their conduct in the Japanese market, nor their agreements respecting prices and distribution in the American market, suffice to create a "genuine issue for trial."

*Matsushita*, 475 U.S. at 597.

Plaintiffs do not salute and try to temper defendants' reliance on *Matsushita*. One of the cases I cite for that purpose is also a Supreme Court case, *Brown v. Pro Football*, a decade more recent, and an 8-1 decision (as opposed to *Matsushita's* 5-4):

Antitrust law . . . sometimes permits judges or juries to premise antitrust liability upon little more than uniform behavior among competitors, preceded by conversations implying that later uniformity might prove desirable, see, e.g., *United States v. General Motors Corp.*, 384 U.S. 127, 142-43 (1966); *United States v. Foley*, 598 F.2d 1323, 1331-1332 (4th Cir. 1979), or accompanied by other conduct that in context suggests that each competitor failed to make an independent decision, see, e.g., *American Tobacco Co. v. United States*, 328 US 781, 809-10 (1946); *United States v. Masonite Corp.*, 316 US 208, 226-27 (1939); *Interstate Circuit, Inc. v. United States*, 306 U.S. 208, 226 (1939). See generally Philip Areeda, Antitrust Law Section 1416-1427 (1986); Donald Turner, The Definition of Agreement Under The Sherman Act: Conscious Parallelism and Refusals to Deal, 75 Harv. L. Rev. 655 (1962).<sup>7</sup>

Another one of my favorites is a Judge Posner decision, *Isaksen v. Vermont Casting, Inc.*: When a conspirator warns a non-complying dealer to "raise your prices or else" and the distributor "merely grunts but complies," there is an agreement.<sup>8</sup>

Despite my preferences, courts cite and rely on *Matsushita* much more than *Brown* and *Isaksen*. Using Judge Posner's words from *Isaksen*, plaintiffs can often prove the "conspirator's warning" and the "distributor's compliance." Yet, for want of the "grunt," even when the opportunity and motive to "grunt" is present, Section 1 cases are lost.<sup>9</sup> Indeed, the standard sometimes seems so high and businesses seem to have become so oblivious to the risk of antitrust liability that plaintiffs can gather evidence sufficient to

<sup>6</sup> 475 U.S. 574 (1986).

<sup>7</sup> 518 U.S. 231, 241 (1996).

<sup>8</sup> 825 F.2d 1158, 1164 (7th Cir. 1987).

<sup>9</sup> The more legalistic definition by the Supreme Court of the agreement element is a "conscious commitment to common scheme," which in a resale price maintenance case could be shown by evidence that the manufacturer sought and distributor "communicated its acquiescence or agreement" to prices "suggested" by the manufacturer. *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 764 n.9 (1984).

make and prevail on motions for summary judgment on liability.<sup>10</sup> That is, the evidence that a plaintiff needs to survive summary judgment is sometimes enough not only to overcome defendants' denials but also enough to establish summarily the agreement.

States<sup>11</sup> and other plaintiffs can blunt the force of *Matsushita* by arguing that *Matsushita* applies only when the economic theory asserted by plaintiffs is implausible.<sup>12</sup> In *Matsushita*, the Court considered plaintiffs' allegations that defendants agreed to price below costs in the United States over a 20-year period, with the goal of eliminating U.S. competitors. The Court found this theory "irrational" and "implausible," and ruled in favor of defendants. Again as phrased by the Court, but this time with the ellipsis filled in:

In sum, in light of the absence of any rational motive to conspire, neither petitioners' pricing practices, nor their conduct in the Japanese market, nor their agreements respecting prices and distribution in the American market, suffice to create a "genuine issue for trial."

*Matsushita*, 475 U.S. at 597 (emphasis added).

Elsewhere in the opinion, the five judge majority in *Matsushita* described what it meant by "the absence of any rational motive to conspire." The Court limited "rationality" to economics, stating that an "implausible" claim is a claim "that simply makes no economic sense."<sup>13</sup> The Court further limited its discussion of "economic" motive to "profit" motive. The Court stated that plaintiffs' claim was that "monopoly profits" would ultimately compensate the defendants.<sup>14</sup>

*Matsushita's* conclusion that defendants lacked "any rational motive" is flawed as a matter of statutory construction, economic theory, and fact. Illegal agreements in restraint of trade should not be limited to agreements for which the defendants can expect to profit or otherwise benefit economically. The question simply should be whether Section 1 was violated. Section 1 does not require the defendant to profit. Murder, jay-walking, and pollution need not be profitable (or even economically rational) to be illegal, and neither should unreasonable restraints on trade.

Moreover, as a matter of theory, plausibility should not turn on the economic profitability for the defendant.<sup>15</sup> Various economic theories, like game theory, could explain the conspiracy alleged by the plaintiffs in *Matsushita*.<sup>16</sup> But from my perspective and more fundamentally, the people who make and implement decisions for businesses, act for reasons other than the profit to be made by the business.<sup>17</sup> Scientists who are not economists have long explained human behavior in the workplace without assuming that only behavior that is economically profitable to the business can occur.

<sup>10</sup> *In re Cardizem CD Antitrust Litig.*, 105 F. Supp. 2d 682 (E.D. Mich. 2000), aff'd, 332 F.3d 896 (6th Cir. 2003); *New York v. St. Francis Hospital*, 94 F. Supp. 2d 399 (S.D.N.Y. 2000).

<sup>11</sup> In addition to arguments in various briefs in their litigations, States have addressed the agreement element of a section 1 claim in amici briefs in support of petitions for certiorari, which petitioners were denied. Brief of Amici Curiae States in Support of Petition for Certiorari, *Habman Albrecht, Inc. v. Potash Corp. of Saskatchewan Inc.*, 531 U.S. 815 (2000) (No. 99-1844); Brief of California in Support of Petition for Certiorari, *Gangi Bros. Packing Co. v. Cargill, Inc.*, 529 U.S. 1037 (2000) (No. 99-1218). These amici are available on the advocacy portion of the webpage of the State Enforcement Committee of the ABA's Antitrust Section: <http://www.abanet.org/antitrust/committees/state-antitrust/advocacy.html>.

<sup>12</sup> E.g., *Ezzo's Investments, Inc. v. Royal Beauty Supply, Inc.*, 94 F.2d 1032, 1035-36 (6th Cir. 1996).

<sup>13</sup> 475 U.S. at 587.

<sup>14</sup> 475 U.S. at 584.

<sup>15</sup> I should probably admit that I have long been skeptical of relying too heavily on economic analysis, as opposed to relying on case law analysis, in antitrust cases. *Robert Hubbard, Potential Production: A Supply Side Approach for Relevant Product Market Definitions*, 48 *Fordham L. Rev.* 1199, 1204 n. 22 (1980), reprinted in XIV J. Reprints for Antitrust L. & Econ. 621, 626 (1984).

<sup>16</sup> E.g., Charles E. Koob, *Whither Predatory Pricing? The Divergence Between Judicial Decisions and Economic Theory: The American Airlines and Virgin Atlantic Airways Cases*, 3 *Sedona Conference J.* 9 (2002).

<sup>17</sup> Even accepting a limitation to only economic incentives, the decision makers for businesses are motivated by economic incentives other than the overall profitability of the business, such as the profitability of his or her part of the business, his or her compensation or job security, or the scope of the executive's domain.

Finally and as a matter of fact, if behavior occurs, that behavior by definition is plausible.<sup>18</sup> Indeed, the Court may have come around on this point. In *Matsushita*, when the Court's theory did not mesh with the alleged facts, the Court refused to allow plaintiffs to submit their allegations to a fact finder. Six years later in *Image Technical*, the Court declared that an economic theory that "does not explain the actual market behavior revealed in the record" should be rejected.<sup>19</sup> When the economic theory did not mesh with the facts, the Court appropriately allowed the plaintiff to present those facts.

Indeed, some of the cases illustrate that the plausibility of the plaintiff's economic theory should not be a basis for rejecting a plaintiff's claim if plaintiff's claim is otherwise permissible. Like pornography, economic plausibility can be in the eye of the beholding judge, and judges behold differently. For example, in *Potash* the six-judge *en banc* majority responded to plaintiffs' theory that the agreement could be inferred in part from companies following a price leader as "ridiculous," reasoning that of course one firm's price rise would be followed in an oligopolistic market.<sup>20</sup> Relying on facts, the five-judge dissent listed various price rises that had not been followed prior to the alleged conspiracy.<sup>21</sup> Similarly, the *Potash* majority held that direct communications by competitors on price after the price had been quoted, as a matter of "common sense," did not support a finding of agreement.<sup>22</sup> The dissent in *Potash* accepted the economic theory that such communications could be found to demonstrate the monitoring and enforcement of an agreement on price, much like a theory deemed "plausible" by the Third Circuit in *Petruzzis*.<sup>23</sup>

#### *A More Nuanced Read of Matsushita Is Appropriate*

All this is not to say that plaintiffs should have prevailed in *Matsushita*, or even that plaintiffs should have been permitted to present their case to the fact-finder. Antitrust law should be skeptical of businesses complaining that competitors are charging too little because such allegedly predatory acts look a lot like aggressively competitive acts. Perhaps the result in *Matsushita* reflects that skepticism: the Court refused to allow a finding of an illegal agreement to be based on defendants' price-cutting, which "the Court characterized as 'the very essence of competition.'"<sup>24</sup> And perhaps the agreement element of a Section 1 claim was the only way to express that skepticism. For example, defendants had not appealed the holding that a horizontal predatory pricing conspiracy was *per se* illegal.<sup>25</sup>

The Court also has paused when presented with inferences of an agreement in resale price maintenance cases. The Court in *Monsanto* recognized that communications between suppliers and distributors was a necessary and useful part of the competitive process. Accordingly, the Court held that a retailer's complaint to the supplier about a competing retailer's prices and the supplier's termination of the competing retailer, without

18 Perhaps the most cogent rebuttal to the Court's conclusion in *Matsushita* that the claim was economically implausible is that the ultimate goal of the conspiracy alleged by the plaintiffs in *Matsushita* appears to have been achieved. U.S. manufacturers of consumer electronics are simply not the competitive force they once were and the defendants' profitability appears to have been enhanced by the demise of those U.S. manufacturers. In addition, the victory may have contributed to the manufacturers of consumer electronics being insensitive to their obligations under the antitrust laws as relates to resale price maintenance. E.g., *Maryland v. Mitsubishi Electronics America, Inc.*, 1992-1 Trade Cas. (CCH) Section 69,743 (D. Md. 1992) (fifty states and D.C., \$8 million settlement); *New York v. Nintendo of America, Inc.*, 775 F. Supp. 676 (S.D.N.Y. 1991) (50 states and D.C., more than \$29 million settlement); *New York v. Matsushita Elec. Corp.*, 89 Civ. 0368 (S.D.N.Y. 1989) (50 states, \$16 million settlement).

19 *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 112 S. Ct. 2072, 2085 (1992).

20 *Blomkest Fertilizer, Inc. v. Potash Corp.*, 203 F.3d 1028, 1034 (8th Cir. 2000) (en banc) ("In the face of these circumstances and with the price leadership of PCS in this oligopolistic industry, it would have been ridiculous for the remaining companies to not also raise their prices in a parallel fashion." (emphasis added)).

21 *Blomkest Fertilizer, Inc. v. Potash Corp.*, 203 F.3d 1028, 1039-40 (8th Cir. 2000) (en banc) (dissent) ("In fact, [four separate companies] had each tried to increase prices unilaterally during 1986 and were forced to rescind the increases when the other producers undercut them.").

22 Id. at 1034.

23 Id. at 1042-43; *Petruzzis's IGA Supermarkets, Inc. v. Darling-Delaware Co.*, 998 F.2d 1224, 1233 (3d Cir. 1993) (a cartel needs enforcement mechanisms).

24 *InterVest, Inc. v. Bloomberg, L.P.*, 340 F.3d 144, 162 (3d Cir. 2003) (quoting *Matsushita*, 475 U.S. at 594).

25 475 U.S. at 584-85 ("The Court of Appeals found that respondents' allegation of a horizontal conspiracy to engage in predatory pricing, if proved, would be a per se violation of section 1 of the Sherman Act. Petitioners did not appeal from that conclusion." (citation and footnotes omitted)).

more, was not enough evidence of a resale price agreement to survive summary judgment.<sup>26</sup> Yet, any sort of link between the complaints and the termination was. The specific evidence held adequate by the Court in *Monsanto* included Monsanto telling price cutters that they would not get supplies, which the Court labeled direct evidence of the alleged agreement.<sup>27</sup> In addition, the Court pointed to “arguably more ambiguous” evidence, consisting of a newsletter from a distributor to his dealer-customers reporting on a meeting with Monsanto discussing “efforts to get the market in order” and that “every effort will be made to maintain a minimum market price level.”<sup>28</sup> Despite the propriety of communications between suppliers and distributors, the “ambiguity” of the evidence, and Monsanto’s letter six weeks later “disavow[ing] any intent to enter into an agreement on resale prices,” the Court held that interpretation of this evidence “properly was left to the jury.”<sup>29</sup>

The challenge is to apply a rule that incorporates the Court’s skepticism in *Matsushita* and the pause in *Monsanto*.<sup>30</sup> The Ninth Circuit’s phrasing of the rule begins to meet the challenge: A “trial judge should not permit an inference of antitrust conspiracy from circumstantial evidence where to do so would have the effect of deterring significant procompetitive conduct.”<sup>31</sup> Yet, most cases lack the nuance used in that phrasing.

Rather, far too many courts do not permit an inference of an agreement from circumstantial evidence where to do so would have the effect of deterring arguably procompetitive conduct, or, even worse, mere arguably permissible conduct. In applying that relaxed rule, these cases contrast sharply with articulation of the applicable law in *Brown*, which was quoted more fully above:

Antitrust law . . . sometimes permits judges or juries to premise antitrust liability upon little more than uniform behavior among competitors, preceded by conversations implying that later uniformity might prove desirable or accompanied by other conduct that in context suggests that each competitor failed to make an independent decision.<sup>32</sup>

The most problematic of these cases are circuit court decisions addressing allegations of *per se* illegal agreements among horizontal competitors. One plaintiff lost on summary judgment despite evidence that a questionnaire on how to compete was completed by competitors and everyone’s completed questionnaire was distributed by a trade association. The general conclusion of those questionnaires was that defendants “could best compete” by enforcing exclusivity provisions in their contracts, which the competitors later did.<sup>33</sup> Using the Ninth Circuit’s rule, I do not see a procompetitive benefit of conveying and conferring about competitive strategies at a trade association meeting and would not shield this activity from potential antitrust liability. Similarly, one of the defendants secured

<sup>26</sup> *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 763-64 (1984). In a footnote, the Court added “We do not suggest that evidence of complaints has no probative value at all, but only that the burden remains on the antitrust plaintiff to introduce additional evidence sufficient to support a finding of an unlawful contract, combination, or conspiracy” *Id.* at 764 n.8.

<sup>27</sup> 465 U.S. at 765.

<sup>28</sup> 465 U.S. at 765-66 & n.10.

<sup>29</sup> 465 U.S. at 766 n.11.

<sup>30</sup> This rule would be something other than the usual concepts that arise when asking whether adequate evidence has been presented by the plaintiffs to continue the litigation. The rule would apply only if plaintiffs presented some evidence of the agreement.

<sup>31</sup> *In re Petroleum Products Antitrust Litigation*, 906 F.2d 432, 439 (9th Cir. 1990).

<sup>32</sup> *Brown v. Pro Football*, 518 U.S. 231, 241 (1996).

<sup>33</sup> *Thompson Everett, Inc. v. National Cable Advertising, L.P.*, 57 F.3d 1317, 1324 (4th Cir. 1995).

summary judgment despite sufficient evidence from which to infer a market allocation agreement among two other companies in the industry, all three companies competing only for new accounts, direct communications including socializing between the prevailing defendant and the conspiring defendants, and other evidence.<sup>34</sup> Again, I do not see the procompetitive benefits of socializing with your competitors and do not think antitrust law should shield that activity from potential antitrust liability. My final example is a grant of summary judgment to one defendant, while other defendants had already pled guilty to a price-fixing agreement. The evidence against the prevailing defendant included nearly identical price lists as those of the conspiring defendants, the conspiring defendants' price lists in the prevailing defendant's files, meetings and telephone conversations between the prevailing defendant and the conspiring defendants (including conversations about prices), and other evidence that "could be interpreted as evidence of a horizontal conspiracy but also could be construed in a benign light."<sup>35</sup> Again, I do not see the procompetitive benefits of communications among competitors that we need to protect, and permitting the inference of an agreement is neither anticompetitive or substantially anticompetitive.

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<sup>34</sup> *Petruzzi's IGA Supermarkets, Inc. v. Darling-Delaware Co.*, 998 F.2d 1224, 1234-37, 1241, 1246 (3d Cir. 1993).

<sup>35</sup> *In re Citric Acid Litigation*, 191 F.3d 1090, 1102-06 (9th Cir. 1999).

# THE “COMPLEXITIES” OF ELECTRONIC DISCOVERY

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It’s an honor to be asked to attend this conference on the critical issue of electronic discovery, and a great personal privilege for me to be able to serve as one of the faculty members.

In this paper I will not attempt to produce a law review-style commentary on electronic discovery. I’m sure I was not invited because I’m a prominent expert on electronic discovery *per se*. However, like most of us here, I’m sure, I have spent entire days, if not weeks, working through discovery matters with co-counsel and opposing counsel, and more and more it involves electronic discovery, either in whole or in part. I was fortunate to be asked to serve as a discussant at a Civil Justice Roundtable on electronic discovery sponsored by the Conference of Chief Justices in November 2003. And of course I have discussed this topic with numerous other attorneys from both sides of the courtroom, some of whom are convinced that “digital is different.”

But actually, I think I’m here in a representative capacity, and I’m very proud of the people I represent. I am the current president of the Roscoe Pound Institute,<sup>1</sup> which is essentially a legal “think tank.” The Institute was established in 1956 (under the name Roscoe Pound–American Trial Lawyers Foundation) to honor and build on the work of Roscoe Pound, who served as Dean of the Harvard Law School from 1916 to 1936 and was one of the law’s greatest thinkers and educators. If you ever run into an old set of the *Encyclopaedia Britannica* in an antiquarian book store, you’ll see that Roscoe Pound was the only American lawyer on its Advisory Board.<sup>2</sup>

The Roscoe Pound Institute shares Dean Pound’s philosophy of sociological jurisprudence—an interdisciplinary approach to the development of practical, relevant legal concepts embracing both the public arena and legal associations. We consider the law to be a dynamic system that is influenced by social conditions and that, in turn, influences society. This philosophy is the driving force of the Roscoe Pound Institute. We have numerous programs, publications, and research grants through which we promote open, ongoing dialogue with the academic and judicial communities and the public on issues critical to protecting and ensuring the right of citizen access to the American civil justice system.

I also had the honor of serving, in 1999-2000, as president of the Association of Trial Lawyers of America (ATLA),<sup>3</sup> and although I am not here in any official capacity to represent ATLA, I will try to represent my colleagues as well as I can. ATLA is a bar association whose members for the most part (but not exclusively) represent plaintiffs in personal injury, civil rights, employment, and environmental litigation; the defense in

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1 See <http://www.roscoepound.org>.

2 1 ENCYCLOPAEDIA BRITANNICA vii (14<sup>th</sup> Edition 1929).

3 See <http://www.atla.org/>

criminal cases; and either side in commercial and family litigation. It has approximately 50,000 members, and those members represent literally millions of clients. I am *tremendously* proud of what my fellow ATLA members do, and have done, to help to balance the scales of justice and make our American civil justice system the best in the world. Many of our members, of course, are involved routinely in matters concerning electronic discovery in the course of their work.

## I. SOME THOUGHTS ON “COMPLEXITY”

At the top of my paper I referred to electronic discovery as a “critical issue.” I’m sure many of our conference attendees will agree that it is “critical.” But I want to emphasize from the start that I call electronic discovery a “critical issue” primarily because I believe that, if this category of discovery is mishandled—whether by litigants, by judges, by court rulemakers or by our elected representatives in Washington and in the states—it can lead to terrible miscarriages of justice. That’s what I think is “critical” at this time about electronic discovery. I think my colleagues in the consumer bar would agree with me on that.

This is called the 2004 Conference on Complex Litigation. No doubt we will hear about important information management matters that can get complex—and the very fact that computers are involved may cause some of us to think of it as complex—but I don’t feel that this subject is *inherently* complex. Electronic discovery turns up in rather mundane litigation as well as complex litigation. And the sometimes complex processes of electronic information handling are, at the most basic level, quite simple. One of my favorite definitions of what a computer does is that it detects the difference between 1 and 0—and it does it at the speed of light. It can certainly *get* more complex than that, and we can argue over what a “document” is or isn’t in the 21<sup>st</sup> Century, but I think we should remember that in the often inscrutable “minds” of our computers, that’s what it all is: 1 or 0?

Further on the matter of “complexity,” I have to observe that we in the consumer bar have run into this term a lot during the past quarter century. It comes up with some frequency, often in areas where our colleagues in the corporate or insurance defense bar would like to change something. That can happen through court decisions, through legislation, or, lately, through the process of making rules for the federal and state courts—a process that’s underway right now on this complex subject of electronic discovery. Thus, we in the consumer bar have seen challenges to the existing order that involve, *inter alia*:

- The Constitutional right to trial by jury. Some cases, it is said, are just too *complex* for our friends and neighbors to understand when they serve as jurors. So we hear, “Let’s take complex cases out of the jury system.”<sup>4</sup>
- Scientific and technical evidence and expert testimony. “It’s often just too *complex* for jurors to understand. Let’s turn it over to judges.”<sup>5</sup>
- Class actions. “Many class actions are just too *complex* to be handled by the state courts. Let’s pull them into the federal court system, and preclude state courts from entertaining parallel actions.”<sup>6</sup>

<sup>4</sup> *But see* Neil Vidmar, “Juries, Judges and Civil Justice,” paper presented to the Roscoe Pound Institute’s 2001 Forum for State Court Judges.

<sup>5</sup> *But see Scientific Evidence In the Courts: Concepts and Controversies* (Report of the 1997 Roscoe Pound Foundation Forum for State Court Judges).

<sup>6</sup> *See* James E. Rooks Jr., “Rewriting the rules for class actions: Rulemaking has become another front in the tort ‘reform’ wars,” 38 TRIAL 18 (Feb. 2002).



- Discovery in general. “It’s getting too *complex*, with all of these overbroad discovery demands made by litigants. Let’s pare down the scope of discovery and make it easier to get sanctions and awards of costs for ‘discovery abuse.’”<sup>7</sup>

And the latest is the reason we’re here today:

- Information stored on computers. “It’s all getting much too *complex*. Let’s streamline it by excusing parties from producing all the material requested, and give them a pass if they should accidentally destroy some of it.”<sup>8</sup>

Really, it’s enough to give a consumer lawyer one of those things the psychologists call a “complex.”

I’m not a “country lawyer,” but in Georgia where I practice we do have some great country lawyers. We also have some very sophisticated lawyers who like to bill themselves as “country lawyers.” So the minute opposing counsel tells you he’s “just a country lawyer,” you know your client may be in major trouble!

I’ve begun to think the same way about the many alleged “complexities” of the civil justice system: all of the mechanisms consumers need to use to prove their cases and obtain just resolutions of their legal matters have become very “complex,” and it always seems to be the corporate and insurance defense bars that make these discoveries of these pockets of complexity. They must have quite a research department.

In any event, it will probably surprise no one that the members of the Pound Institute and of ATLA are opposed to changing the existing system of discovery in the federal or state courts—whether by court rule, legislation, or other means—to respond to complaints that electronic discovery has gotten too “complex.” In December 2002 the then president of ATLA, Mary Alexander, wrote to the Advisory Committee on Civil Rights of the Judicial Conference of the United States to tell its members that we don’t need special federal court rules for electronic discovery. She wrote, “If I had to sum up ATLA’s position on this subject in a single sentence, it would be this: ‘Information is information, and electronic discovery is discovery.’”<sup>9</sup>

I haven’t seen anything yet, in anything I’ve read or listened to, that makes me feel any differently than Mary Alexander said a year and a half ago.

Let me now make a few observations about the topics of the two sessions of the conference on which I serve as a faculty member: (1) privilege and (2) retention of records and some questions associated with retention.

## II. PRIVILEGE & PRIVACY VS. EFFICIENCY

Anyone who has been involved in a litigation practice knows that privilege is a characteristic of information that must be, and usually is, closely guarded. Information produced in discovery typically is reviewed for any privileged content before it is turned over

<sup>7</sup> *But see Controversies Surrounding Discovery and Its Effect on the Courts* (Report of the 1999 Roscoe Pound Institute Forum for State Court Judges).  
<sup>8</sup> *But see* Dec. 20, 2002, Letter of ATLA President Mary Alexander to Advisory Committee on Civil Rules, available at <http://www.kenwithers.com/rulemaking/index.html>.

<sup>9</sup> *Id.*

to other parties so that production of the privileged material can be objected to—or, at least, so that claims of privilege will not be lost through inadvertent production that might be treated as a waiver of privilege. That review process, as we know, can be time-consuming and (time being money) expensive. Efficiency is important.

In my opinion, the only differences between paper discovery and electronic discovery on the privilege front are in the typical ease of access to electronically stored information and, sometimes, the volume of documents involved. These might be considered competing characteristics: information is comparatively easy to access, but its volume can amplify concerns about the cost of performing privilege reviews and about inadvertently waiving privilege.

To ease those concerns, and to promote efficiency, some parties stipulate that any privileged information that is disclosed inadvertently will be returned to the producing party. It also appears to be an increasing practice for parties dealing with masses of electronically stored information to stipulate to a “quick peek.” The requesting party is permitted to review all electronic information and designate the part deemed relevant, and the producing party reviews the designated documents for any privilege issues at a later time. Only at that time is the producing party required to assert privilege.

This approach, needless to say, can save a good deal of time and money all around. However, state substantive law can erect at least two barriers to it: (1) in some states, ethical rules *require* lawyers to take advantage of privileged documents that are disclosed inadvertently, so that a lawyer bound by such a rule may not enter into a “quick peek” stipulation; and (2) in some states, substantive law of privilege does not empower a reviewing party to waive privilege on behalf of other parties. Thus the *reviewing* party can be bound by its “quick peek” stipulation, but the disclosure during the “quick peek” process will destroy the privilege more generally, and the producing party could not assert privilege in subsequent litigation against other parties.

I believe it was suggested, at the recent conference the federal Advisory Committee on civil rules held at Fordham Law School in February, that the federal rules should be amended (1) to make it clear that “quick peek” stipulations are permissible; (2) perhaps to empower the court to *require* “quick peek” procedures, and, more radically, (3) to amend the rules to *pre-empt state law governing ethical responsibilities and privilege*.

To my knowledge, the problems that can be created by “quick peek” stipulations are found in only a small number of cases. Some plaintiffs’ lawyers have endorsed these kinds of stipulations as practical ways to accelerate discovery and, ultimately, the resolution of the case. What they agree to, I can generally agree to. But court rules should be of general effect, drafted to tackle problems that are general problems. For situations that are unusual, as these are, the best approach is to rely on the discretion of the judge who is actually involved with the case on a continuing basis. So I don’t believe it is necessary (or perhaps even possible) to draft court rule amendments to cover all “quick peek” stipulations. This is really a question of what makes the best practice, and should not be a matter for formal rulemaking. By the same token, good practice, I’m sure we all know, cannot easily be *ordered*, so I also think it would be unwise to amend the rules to empower courts to *require* “quick peek” arrangements. Beyond that, though, I am *appalled* by the notion that a generalized rule for the federal courts might some day pre-empt state substantive law on privilege and ethical conduct.

Most lawyers do not get involved in the court rulemaking process (though I think many more should do so), and they may not be familiar with the limits that are placed on rulemakers. To them, the federal Rules Enabling Act<sup>10</sup> may appear to be a nicety, a mere housekeeping provision, or just arcana. To the federal rulemakers, however, the Rules Enabling Act is of vital importance. Without it, the rulemakers are literally out of business. And the Act does not permit the promulgation of rules that affect substantive law, of which the law of privilege is a part.<sup>11</sup> One of our other panelists at the Conference of Chief Justices Civil Roundtable in November 2003 was Judge Shira Scheindlin of the U.S. District Court for the Southern District of New York, who is also a faculty member at this conference. I recall that she expressed some concerns about the Rules Enabling Act during the discussion.

Our federal court rules *cannot* have been intended to interfere with or displace the ethical duties imposed on attorneys by their states of licensure. If a rule were adopted that purported to do so, its validity under the Rules Enabling Act would be questionable—and, I can assure you, its validity would be challenged promptly in the first court that attempted to impose it.

### III. ELECTRONIC DOCUMENT RETENTION (AND DESTRUCTION)

Privilege presents some thorny questions, but actually the most interesting part of this conference is the new proposal on document destruction policies that has been advanced by my new friend Tom Allman. Until very recently, Tom was the General Counsel of the multinational chemical manufacturer BASF Corporation, and he has used the General Counsel Committee of the National Center for State Courts as a forum to promote a model rule on electronic discovery.<sup>12</sup>

Tom's model rule would limit a producing party's duty of production of electronically stored information to "data or information that is responsive to the request and is reasonably available to the responding party in the ordinary course of business."<sup>13</sup> It would provide for cost-shifting if the information is *not* "reasonably available . . . in the ordinary course of business"<sup>14</sup> and it would further provide that

[n]othing in these rules shall require the responding party to suspend or alter the operation in good faith of electronic backup or other routine disaster recovery or document retention systems absent a preservation order issued upon good cause shown, which shall not issue unless the standards applicable to obtaining injunctive relief are met.<sup>15</sup>

Seen in the *best* light, this proposal would allow potential producing parties to design their own document destruction programs to a very narrow standard, operate it in such a way that information is disposed of before litigation can get off the ground, require an extremely high level of proof before a preservation order can be obtained, and then be excused for any information that has been destroyed in the meantime.

10 28 U.S.C. "2071 et seq." 2071(a) provides that "[t]he Supreme Court and all courts established by Act of Congress may from time to time prescribe rules for the conduct of their business. . . ."

11 ' 2072 (b) provides that "[s]uch rules shall not abridge, enlarge or modify any substantive right."

12 See Thomas Y. Allman, "A Proposed Model for State Rules re Electronic Discovery," Presentation to General Counsel Committee of the National Center for State Courts, Nov. 15, 2001, available at [http://www.kenwithers.com/articles/rules\\_debate/model\\_state\\_rule.html](http://www.kenwithers.com/articles/rules_debate/model_state_rule.html) (visited March 12, 2004). The language proposed in 2001 has been modified somewhat (see below).

13 See Attachment A, Proposed Model Rule, section (a). The language quoted here was presented in a Dec. 9, 2002, comment letter from Thomas Y. Allman, General Counsel of BASF Corporation, to Peter McCabe, secretary of the Committee on Rules of Practice and Procedure, Judicial Conference of the United States. The text is downloaded from <http://www.kenwithers.com/rulemaking/index.html>.

14 *Id.* Section (b).

15 *Id.* Section (c).

We do not need to go far to find some real-world examples of what could be done with any discovery regime that is premised on an “ordinary course of business” standard. The paradigm example might be the Arthur Andersen accounting firm’s document destruction plan,<sup>16</sup> which received considerable public attention in 2002. The events that transpired involving this plan involved paper discovery, not electronic, but this is an area in which digital is *not* different.

Ostensibly, Andersen employees were merely reminded to follow the plan the company designed for them. It was referenced in court in May 2002 when an Andersen partner pleaded guilty to federal charges, testifying that “I obstructed justice . . . I instructed people on the engagement team *to follow* a document-retention policy which I knew would result in the destruction of documents.”<sup>17</sup> Other parts of the Andersen plan that did relate to electronically stored information are also pertinent. The policy prescribed destruction of electronic material in such a way as to make recovery impossible—or *extremely expensive*. One section ordered that “Deletion of information from electronic files will be accomplished in such a way that precludes the possibility of subsequent retrieval by AA personnel or third parties.” Another specified that, “For electronic files, appropriate techniques (such as ‘absolute delete’) should be used to make sure the data cannot be reconstructed from the storage mechanism on which it resided.” And a third provided that “The destruction of all working papers and electronic data must be accomplished in such a way as to prevent the data from falling into unauthorized hands and to prevent any possibility of reconstruction from partially destroyed files.”

Another example exists that is even more pertinent to the BASF proposal. It appeared in a newspaper article about the U.S. Department of Justice’s litigation against the tobacco companies. The DOJ lawyers, the story related, “complained to [Judge Gladys] Kessler . . . that top Philip Morris officials deleted thousands of e-mail messages they should have kept—some of which couldn’t be retrieved because the corporation purges its entire e-mail system every three weeks.”<sup>18</sup>

During a question-and answer period at the recent Fordham conference, Tom Allman was asked if, under a self-designed document destruction program like Phillip Morris’s, (1) the purged information would be considered “not reasonably available in the ordinary course of business,” with the requesting party required to pay for its reconstruction and production and (2) Phillip Morris would qualify for safe harbor treatment because it had followed its own (i.e. self-designed) plan. I understand that Tom responded that the information *would* be considered inaccessible; that the requesting party *could* be required to pay for its production, and that the producing party *would* be entitled to “safe harbor” treatment. If I’m wrong, Tom can correct me when we meet again in Sedona. But if I’m right, the BASF proposal could be used by some litigants to “plan” their way right out of responsibility for misdeeds.

#### IV. A FEW SUCCESS STORIES

In dealing with many issues surrounding the civil justice system we all tend to get very caught up with so-called “horror stories.” I’m sure you all know most of the outrageous stories I’m referring to, like medical negligence suits where someone’s wrong limb was

16 Arthur Andersen & Co., *Practice Administration: Client Engagement Information—Organization, Retention and Destruction*, Statement No. 760, February 2000 (on file with author; downloaded from Andersen web site in January 2002, but no longer be available on the Internet).

17 Carrie Johnson, “Enron Auditor Admits Crime: Andersen’s Duncan Ordered Shredding,” *Washington Post*, Tuesday, May 14, 2002, at A1. (Emphasis added.)

18 Tom Schoenberg, “DOJ Fires at Lawyers for Big Tobacco,” *LEGAL TIMES*, January 22, 2003, available at <http://www.law.com/servlet/ContentServer?pagename=OpenMarket/Xcelerate/View&c=LawArticle&cid=1042568686185&live=true&cst=1&pc=0&cpa=0> (visited February 18, 2004).

amputated, or the healthy half of their brain was removed instead of the side with the tumor, or the mix-up in pathology slides that caused a healthy woman to endure a double mastectomy—only to learn that she never had cancer in the first place. Those are the kind of stories I always think of as “horror stories.”

We even hear some horror stories where the thing at stake is just money, not life or health. We hear that there are organizations that spend huge amounts of money on document production, and rumors about parties settling because they thought the cost of discovery would be ruinous, etc. On the other side, we’ve heard of successful handling of electronic discovery matters in the litigation concerning Ford automobiles with Firestone tires, Rezulin (involving database production), the Microsoft antitrust litigation, and in the litigation concerning phenylpropanolamine (PPA, an ingredient of over-the-counter cold medications).

I would like to point out just three cases involving electronic discovery in major ways where the problems were resolved through a combination of professionalism of the lawyers involved and good judicial management. (I had no involvement in any of these cases.)

*Propulsid.*<sup>19</sup> This was a Multi-District Litigation case handled in federal court in New Orleans by Judge Eldon Fallon. It has a lot of fascinating facets. Luckily I don’t have to recount all of them, because Judge Fallon established an Internet site dedicated just to that litigation, where you can see all of the pleadings, motions, status reports, stipulations, etc. for the whole case.<sup>20</sup> It’s a marvel of governmental transparency. It’s been quite a large case. Some 300 deaths are alleged to have been caused by the use of Propulsid (cisapride), a prescription drug used to treat symptoms of gastroesophageal reflux disease (GERD). Some 4,000 plaintiffs have been part of the MDL proceedings, and 12,000 more have unfiled claims that may be resolved through the case.

To me, the most remarkable thing about the Propulsid case is how little one might say Judge Fallon had to work with when he started. “All” he had were the current, unamended Federal Rules of Civil Procedure, a determination to manage the case well, his own considerable experience as a judge, and counsel on both sides who were professionals and acted accordingly. Early on, working within the existing rules, Judge Fallon wrote a comprehensive order for handling the electronic discovery. Under that order, over 7 million pages of documents were eventually produced, as well as numerous electronic databases, and over 13,000 pages of email messages and attachments.

According to the court’s website, the case is now virtually settled, if not completely settled, with well over \$100 million committed to compensate plaintiffs, pay attorney fees, and fund the administration of claim resolution.

*Zubulake.* The second case I’m thinking of is a sex discrimination case that is by now well-known to everybody who has heard of electronic discovery. It is a decision written by another of our faculty members, Judge Shira Scheindlin, and it is often called informally “*Zubulake I.*”<sup>21</sup> This is a perfect example of a case in which, when the issues are properly considered, and where the court works actively to review and manage the discovery requests, reasonable discovery can be obtained. A careful judicial analysis like this will help to get the facts out to see if the plaintiff can prove the case. At the same time it will both prevent excessive cost to the producing party and avoid “chilling” the plaintiff’s cause of action.

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19 MDL-1355 Propulsid Product Liability Litigation, U.S. Dist. Ct., E.D. La.

20 <http://propulsid.laed.uscourts.gov>.

21 *Zubulake v. UBS Warburg LLC et al.*, 217 F.R.D. 309 (S.D.N.Y. 2003), 91 Fair Empl.Prac.Cas. (BNA) 1574.

In *Zubulake I* the defendants had produced about 100 pages of email messages. The plaintiff demonstrated that it was highly likely that there were many more, although they might be on backup media that were already required by the SEC to be kept for compliance purposes. The defendants claimed that production would cost \$175,000, not counting attorney review time, and they requested cost-shifting. The court required the defendant to pay for production of the data that were kept in an accessible format (i.e. the usual rules of discovery applied to that). Instead of requiring the defendant to restore and produce all responsive documents, a small test sample was used and the cost-shifting decision was reserved, to be made after consideration of seven-factors now often called the “*Zubulake* factors.” In order of importance or weight, the factors are (1) the extent to which the request is tailored to discover relevant data; (2) availability of that data from other sources; (3) total cost of production, relative to the amount in controversy; (4) total cost of production, relative to the resources available to each party; (5) relative ability and incentive for each party to control its own costs; (6) importance of the issues at stake in the litigation; and (7) the relative benefits to the parties in obtaining that data.

In a later decision (*Zubulake III* <sup>22</sup>) after production had been completed, the court analyzed the seven factors it previously drew up and concluded that the balance was slightly against cost shifting; that requiring the requesting party to bear 25% of the costs would be fair; but that the producing party should bear all costs of attorney review of the data.

*Xpedior*.<sup>23</sup> Judge Scheindlin is not the only judge whose decisions I like, but this case, too, is a good example of what can be done by judges who make use of what they have in the rule book *right now*. Outwardly *Xpedior* was a breach of contract case between two businesses. In reality, though, it involved about a thousand consolidated cases prompted by the failure of a number of Initial Public Offerings (IPOs) when the “dot-com” bubble burst a few years ago. Judge Scheindlin talked about it a bit at the CCJ’s Civil Justice Roundtable last fall, and I have a note of how she said the problems were handled. She said the lawyers for the various parties all got together and wrote a document called “Plaintiffs’ and Underwriter Defendants’ Proposed Document Retention Questionnaire” that was the key to resolving the case. The lawyers did it themselves, and Judge Scheindlin considers it to be a model of what can be accomplished when lawyers cooperate with the court and with each other.

These just three examples of what can be achieved by honest, professional counsel who are dedicated both to their clients and to their responsibilities as officers of the court and an experienced, “take-charge” judge to resolve issues that arise with electronic discovery. As long as we can point to cases like these, I would much rather depend on the parties and the judge to deal with electronic discovery than I would on any number of rules. In that regard, I don’t believe anyone has put it any better than Judge Fallon did in one of his very early orders in the Propulsid litigation. He wrote,

Prominent in [the *Manual for Complex Litigation 3d*] at Section 20.21 is the following reference to courtesy and professionalism:

The added demands and burdens of complex litigation place a premium on professionalism. An attitude by counsel of cooperation, professional courtesy, and acceptance of the obligations owed as officers of the court is critical to the successful management of the litigation.

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<sup>22</sup> *Zubulake v. UBS Warburg LLC*, 216 F.R.D. 280 (S.D.N.Y. 2003).

<sup>23</sup> *Xpedior Credit Trust v. Credit Suisse First Boston (USA)*, 2003 WL 22283835 (S.D.N.Y. 2003).

The Court expects, indeed insists, that these two words—"Courtesy" and "Professionalism"—permeate this proceeding from now until this litigation is concluded. The Court record should never be the repository of ill chosen words arising out of a sense of frustration over real or imagined issues. Because of the high level of competence and experience displayed by the attorneys who attended the initial conference the Court is confident that this objective will be achieved without judicial intervention. *We believe that cooperation, professionalism, and good management have never been created by court rule. Judges can and do insist on them routinely.*<sup>24</sup>

## V. IDEAS FOR IMPROVEMENTS

By now, the reader of this little paper may be thinking, "Don't those consumer lawyers [OK, "plaintiff" lawyers, if you will] ever agree to any changes in the justice system?"

Well, yes. If you take a look on Ken Withers's website at the detailed letter Mary Alexander sent to the Advisory Committee on Civil Rules,<sup>25</sup> you'll see that there are several things short of rulemaking that the consumer bar can support to address emerging issues in electronic discovery.

One approach is *educational programs for both lawyers and judges*. The Federal Judicial Center offers such programs, and other organizations do also. In fact, I believe various defense bar organizations are taking their wisdom on this subject on the road in various parts of the country. Even though I don't agree that electronic discovery is fundamentally different from paper discovery, we can all use some help getting up to speed with the technical side of this area, with the new developments that occur constantly.

Another area is *research*, and there the FJC of course makes extremely valuable contributions. We just can't learn too much about this field, including what problems judges see arising, how they are dealt with, whether judges think there should be new rules, etc.

Another approach would use the "*practice manual*" model. We already have the *Manual for Complex Litigation* published by the Federal Judicial Center. I'm not at all sure that we need a whole new manual just for electronic discovery, especially since we have a number of judges who have been showing us that these issues can be handled under the existing rules. But I do think it would be valuable to compile those lessons learned and make them widely available to both federal and state judges. There has also been a recent effort by the ABA Section of Litigation in this area, and their product may be useful.<sup>26</sup>

The same goes for *disseminating the emerging case law and scholarship* on electronic discovery, and Ken Withers at the FJC has already done a remarkable job on that front through his website. But encyclopedia-size publications aren't necessary for the judiciary and the bar to stay abreast of the cases in this field. A comparatively small number of decisions will go a long way, and a number of opinions that can guide us are already available. After all, if we need to know what the U.S. Supreme Court says about the right to jury trial we don't have to start reading opinions written by John Marshall. A half dozen well-reasoned, widely-disseminated decisions will probably give us most of the answers we need.

<sup>24</sup> Pretrial Order No. 2, Oct. 2, 2000, at <http://propulsid.laed.uscourts.gov>. (Emphasis added.)

<sup>25</sup> *Supra* n. 8.

<sup>26</sup> American Bar Association, Section of Litigation, *Electronic Discovery Standards—Draft Amendments to ABA Civil Discovery Standards*, Nov. 13, 2003, available at <http://www.abanet.org/litigation/taskforces/electronic/document.pdf>

That having been said, I don't think we are anywhere close to a situation where new rules for electronic discovery are advisable or possible, let alone necessary.

## VI. CONCLUSION

Someone once said that “but” is the most important single word in the English language. Unfortunately, the consumer bar *does* have to spend a lot of time saying “but” to this and “but” to that. We have had to work very hard to protect the rights of our clients: our present clients, our future clients, and even our clients who haven't been born yet. We've had to oppose many questionable claims of “complexity” in the civil justice system and other kinds of claims about it—including some claims about it that don't even rise to the level of questionable.<sup>27</sup>

The mere fact that one often stands in opposition to something, though, doesn't mean the opposing person is always wrong. We all operate in an adversary system, and that's one of the very first lessons that experience teaches us. There are lawyers all over the southeastern United States who are opposed to my cases, and I'm opposed to their opposition—but we can usually get along anyway. I hope the rest of the attendees at the conference will understand why we on the consumer side feel we have to be in opposition a lot of the time, defending our clients, defending the courts, defending the judges, and working to preserve the system in which we all work.

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<sup>27</sup> See, e.g., the recent full-page advertisements purchased by the U.S. Chamber of Commerce that criticize the U.S. civil justice system (“It destroys your jobs. It raises your taxes. It takes your money. *And it's all legal!*”), WALL STREET JOURNAL, March 10, 2004 at B14, available at [www.legalreformnow.com/pdfs/National%20Ad.pdf](http://www.legalreformnow.com/pdfs/National%20Ad.pdf) (visited March 12, 2004). But see ABA president Dennis W. Archer's March 11, 2004, open letter to Chamber of Commerce president Thomas J. Donohue, [www.abanet.org/media/statementsletters/chamberopenletter.pdf](http://www.abanet.org/media/statementsletters/chamberopenletter.pdf); and contemporaneous op-ed article, [www.abanet.org/media/releases/opedchamber.html](http://www.abanet.org/media/releases/opedchamber.html) (challenging factual claims made in the ad; condemning the ad campaign as an attack on the judiciary; and finding the Chamber's campaign lacking in “truth and honor”).



**ATTACHMENT A****PROPOSED MODEL RULE REGARDING PRODUCTION;  
COST-SHIFTING AND SAFE HARBOR****[Electronic Discovery; Provisions for]**

(a) General. To obtain discovery of data or information that exists in electronic, digital or magnetic form, a requesting party must specifically request production of such data or information and specify the form in which it should be produced. The responding party must produce the data or information 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.

(b) Cost-Shifting For Extraordinary Steps. A court may order, upon showing of substantial need, production of data or information that is otherwise subject to production but is not reasonably available in the ordinary course of business. If the court orders production of such data or information in the requested or other form, the court may also order that the requesting party pay the reasonable expenses of any extraordinary steps required to retrieve and produce the information.

(c) Safe-Harbor; Sanctions. Nothing in these rules shall require the responding party to suspend or alter the operation in good faith of electronic backup or other routine disaster recovery or document retention systems absent a preservation order issued upon good cause shown, which shall not issue unless the standards applicable to obtaining injunctive relief are met. No sanctions or other relief predicated upon a failure to maintain or preserve documents or data shall be entered in the absence of a discovery request or preservation order that describes with particularity the specific documents or data requested and evidence that the party upon whom the request or order 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 with obligations under such discovery requests or preservation orders.

[This proposed model rule was advanced in a Dec. 9, 2002, comment letter from Thomas Y. Allman, General Counsel of BASF Corporation, to Peter McCabe, secretary of the Committee on Rules of Practice and Procedure, Judicial Conference of the United States. The text is downloaded from <http://www.kenwithers.com/rulemaking/index.html>.]



# SAFE HARBORS AND PRESERVATION: A RESPONSE

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My colleague Richard Middleton has graciously suggested that I might wish to respond to his criticism of an answer I gave at Fordham as to how my<sup>1</sup> proposed “safe harbor” rule might work where certain executives “deleted thousands of e-mail messages they should have kept ...” For starters, if those were the only facts – that is to say that if executives, knowing of their preservation obligations, nonetheless deliberately deleted material information relevant to discovery, one would expect the opposing parties to seek and secure sanctions. Nothing in the several versions of the “safe harbor” in Rule 37 that I have advocated would apply to that conduct nor should it.<sup>2</sup> However, the full quote from the *Legal Times* cited by Richard can also be read to imply that the deletions occurred solely because the active e-mail accounts of employees were “purged” every three weeks. That case might invoke a “safe harbor.” If the deletion of e-mails took place before the executives were aware of the dispute (or otherwise had notice of the duty to preserve) and were the result of a normal procedure which the corporation uniformly followed, it seems appropriate to me that no sanctions should be applied to them or their employer. If the court concludes that in that particular case the automatic purging system was “adopted and maintained in good faith,” it seems fair to allow the process to continue until a “litigation hold” is entered. Producing parties should have the right to continue to operate their businesses processes where it is accomplished in a reasonable manner and in good faith.

I also responded to a related question about the costs of retrieval of the e-mails in question from less accessible sources than the active e-mail accounts. One of the unique characteristics of electronic information that helps justify providing a “safe harbor” is that multiple sources of the same information almost always exist. Presumably, the hard drives of PCs used by the individuals or the backup tapes for the e-mail servers (if they still exist) could be searched for the deleted information. The information would not be considered to be readily available and the requesting party might have to pay for its reconstruction and production. The necessity to make the effort required and the potential outcome of such a cost-shifting request would be determined by the familiar factors listed by Judge Scheindlin and others in recent cases. This might require the requesting party to share some of the costs.

The key point to me, however, is that a “safe harbor” provisions cannot be “gamed” or “designed” to cover up or prevent preservation or production of information. As in the examples cited of the abuse of document retention policies, Courts and parties are well equipped to see through misuse of otherwise neutral policies and practices.

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1 While my proposals for a “safe harbor” in the Federal Rules were formulated while serving as the BASF Corporation General Counsel, the suggestions are mine alone, not those of BASF or of Mayer Brown Rowe & Maw.

2 My current formulation (March 11, 2004) applies only to failures which “resulted from the normal operation of a disaster recovery or other routine business system, adopted and maintained in good faith, which deletes or discards electronic information incidental to its operation and not specifically covered by a prior order entered after a showing of good cause.” I also suggest that sanctions for failures of preservation or production should not be imposed unless the party sought to be charged acted “willfully or recklessly.”



# U.S. DISCOVERY OF ELECTRONIC DOCUMENTS IN EUROPE

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This paper explores some of the special issues that may arise when U.S. litigation requires the discovery of electronic documents in Europe. The first section discusses European law with respect to discovery procedures, attorney-client privilege, privacy requirements and the Hague Convention. The second section discusses the challenges that arise for U.S. litigators as a result of European law on these topics, and strategies for overcoming these challenges.

## I. DIFFERENCES BETWEEN U.S. AND EUROPEAN LAW

### A. Discovery Procedures

Discovery procedures in Europe differ widely across countries. In England, for example, discovery (called disclosure) is relatively straightforward compared to the U.S. Cases primarily involve standard disclosure, pursuant to which a party is required to disclose only those documents on which he relies and those which adversely affect his own case, adversely affect another party's case or support another party's case. Each party provides the other party with a formal List of Documents that cover these categories, and the other party is then entitled to inspect the documents and make copies of them (at their own expense). Moreover, while parties are required to make a reasonable search for documents falling within these categories, they may limit their initial search on the grounds that an extensive search would be disproportionately costly. It is only if a party does not comply with discovery that the opposing party is allowed to apply for more specific, or more extensive, discovery; a court may order a party to produce specific documents if a requesting party can convince the court that the party is hiding evidence. The court will then order the party to disclose specific documents or classes of documents, carry out a search based on specific criteria, and disclose any documents located as a result of that search. English courts have adopted these rules as a method of managing cases by reducing costs and delay in litigation.

Like U.S. law, English law is gradually becoming cognizant of electronic documents. Electronic documents, including backup tapes, are discloseable under English law, although subject, again, to such disclosure being proportionate.

### B. Attorney-Client Privilege – Determining What is Discoverable

Another primary way in which European law differs from U.S. law in the context of discovery is in defining what documents are protected by attorney-client privilege. Under U.S. law, of course, confidential communications conducted with a lawyer, even an in-house lawyer, are protected by attorney-client privilege. This means that, if an email containing advice from an attorney is stored on a company's computer system, that email is generally

protected by attorney-client privilege and not discloseable. These same rules are generally in force in common law states like England. For other European states, however, the production of documents memorializing attorney-client communication are only protected where those documents are in the possession of a lawyer.<sup>1</sup> In addition, attorney-client communications in European countries (other than England) are generally only recognized where the lawyer is an independent attorney and not in-house counsel; in-house counsel in these countries are not considered members of the bar because they are not regarded as independent.<sup>2</sup> In Germany, attorney-client privilege does extend to in-house counsel if the in-house attorney maintains a separate private office and is acting in his or her capacity as an attorney.<sup>3</sup>

### C. Privacy Requirements

A major difference between U.S. and European discovery rules, and a difference that can create problems in U.S. litigation, are strict European privacy laws. European Directive 95/46/EC relating to the processing of personal data (“the Directive”) and national implementing legislation in EU Member States such as the Data Protection Act of 1998 (“DPA”) in the UK have implications for the transfer of “personal data” in the course of data collection and review for U.S. litigation. The DPA and Article 25 of the Directive set out eight principles that must be observed in processing personal data. The eighth principle states that personal data must not be transferred to a country or territory outside the European economic area (“EEA”) unless that country or territory ensures an “adequate level of protection” for individuals in relation to processing of personal data. The United States is not currently accepted by the European Commission as providing an adequate level of protection. As a result, under these rules, data cannot be transmitted to the United States if it constitutes personal data, unless a recognized exception to this rule applies, or another means is used to achieve adequacy of protection of the data.

Personal data is defined as data that relates to a living individual who can be identified from that data alone or in conjunction with other information in the possession of the data controller. In the United Kingdom, the Court of Appeal has recently given a restrictive interpretation to that definition, so that information will only constitute personal data if it “relates” to the individual in a strict sense, i.e., it has the individual as its focus or is biographical in nature. As a result, some documents that name or refer to individuals and that might be relevant in the context of litigation will no longer be considered to constitute personal data in the United Kingdom, but Courts in other Member States might take a wider view of the meaning of personal data.

It is important to note as well that the DPA only applies to information that is either processed electronically or recorded as part of a structured filing system such that particular information relating to an individual is readily accessible. Information collected for disclosure electronically will meet these criteria, but paper documents may not.

There are a few major exceptions to the DPA and the Directive, which should also reduce concerns about these privacy rules for corporations trying to comply with United States discovery obligations. The most relevant, set out in Article 26(d) of the Directive

<sup>1</sup> See, e.g., Case No. 155/79, *A.M. & S. Europe Ltd. v. Commission*, 1982 E.C.R. 1575. This case may also be authority for the proposition that in-house lawyers do not enjoy privilege with respect to communications with their client where the client is a party to an investigation into possible breaches of what were Articles 85 and 86 of the Treaty of Rome, an exception to the privilege enjoyed by in-house lawyers under English law.

<sup>2</sup> Laurel S. Terry, *An Introduction to the European Community's Legal Ethics Code Part I: An Analysis of the CCEB Code of Conduct*, 7 *Geo. J. Legal Ethics* 1, 4 (Summer 1993).

<sup>3</sup> See *id.*

<sup>4</sup> *FSA v. Durant*, [2003], EWCA Civ 1746, Court of Appeal.

(implemented by paragraph 5 of Schedule 4 of the DPA), provides that the eighth data protection principle does not apply where the transfer is “necessary or legally required for . . . the establishment, exercise or defence of legal claims.” The drafting of the equivalent provision in the DPA is more detailed than in the Directive, and also expressly allows the transfer of data where necessary for the purpose of obtaining legal advice or in connection with any legal proceedings, or is otherwise necessary for the purpose of establishing, exercising or defending legal rights. This exception is embodied in the Directive, but is subject to implementation by national law in each country individually. It is possible that the implementation in other EU Member States such as Germany may be more restrictive than in the United Kingdom, but ultimately the scope would be subject to determination by the European Court of Justice.

There has been some discussion in academic literature about the meaning of the word “necessary” in this context, and the precise scope of this exception, but to date we are aware of no courts that have reached decisions on this point. The exception is not limited to proceedings or claims to which the data subject is a party. It is likely, then, although courts have not yet directly ruled on this issue, that where transfer of information is legally required for the purpose of U.S. proceedings, the transfer will be recognized as an exception to the DPA and the Directive. However, a wholesale transfer of information in order to enable assessment of information to take place in the United States could contravene the eighth principle. In other words, a corporation who sends vast amounts of data to the United States in order to review the data to determine if it is subject to U.S. discovery rules might be violating the DPA and the Directive. For that reason, it might be appropriate to arrange for prior relevance review of documents likely to contain personal data to take place within the European Union prior to any transfer.

Additionally, the DPA and the Directive include an exception for information that the data subject has given his consent to be transferred, but in most cases this is unlikely to be practicable in the context of litigation, unless the data concerns an employee of the company, in which case it may be possible to obtain consent prior to transfer, provided the consent is genuine and freely given.

Where the legal proceedings exception does not apply, or the transfer is made on too large a scale to benefit entirely from the exception, there are other methods by which compliance with the eighth data principle might be achieved. One possible approach might be to use one of the sets of model clauses approved by the European Commission for use by organizations that wish to transfer personal data out of the EU.<sup>5</sup> There are two sets of model clauses that may be used, depending on whether the recipient organization will act as a “data controller” or “data processor” as defined in the Directive. Consideration would need to be given to the appropriate parties to the agreement and form of clause to be used, depending on the nature and purpose of the transfer. The use of the clauses would place the parties under various obligations with respect to the use of the data. For example, individual data subjects must be notified if certain sensitive or special categories of data are to be transferred, data may only be used for the purpose for which it is transferred, and there are restrictions on further onward transmission of information. No prior approval would be required for transfer from the United Kingdom based on these clauses, but the transferring organization would need to be able to demonstrate that the clauses had been used properly in the event of any challenge. In some EU countries the transfer would need to be approved

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5 Commission Decisions 2001/497/EC and 2002/16/EC, available online at [http://europa.eu.int/comm/internal\\_market/privacy/modelcontracts/en.htm](http://europa.eu.int/comm/internal_market/privacy/modelcontracts/en.htm).

by a national authority, which (other than in exceptional circumstances) would be required to accept the standard clause as offering adequate protection.

Alternatively, transfer may be permitted if the recipient in the U.S. has committed to observe the “safe harbor” principles agreed between the U.S. Department of Trade and Commerce and the EU Commission,<sup>6</sup> but U.S. companies may be reluctant to do this, and it may well be inappropriate to do so in the context of information transferred for the purpose of litigation

#### D. The Hague Convention

The Hague Convention of March 18, 1970 on the Taking of Evidence Abroad in Civil or Commercial Matters (the “Hague Convention”) provides rules that member states (which include the United States, Germany, the United Kingdom, and France) must follow in obtaining evidence for use in proceedings. Chapter I of the Convention provides for letters of request addressed by the U.S. court requesting discovery to a central authority in the state from which it is requesting discovery. The party requesting discovery must then comply with the discovery rules applicable in the state in which it is requesting documents or other discovery. Chapter II of the Convention provides for evidence gathering by diplomatic officers appointed by the requesting state. These diplomatic officers, in gathering documents, must also follow the rules of civil procedure in the state in which they are gathering documents, and lack the power to compel the production of documents. The United States Supreme Court, however, has held, in *Societe Nationale Industrielle Aerospatiale v. United States District Court*, 484 U.S. 522 (1987) that U.S. courts did not necessarily have to comply with the Hague Convention when subjecting foreign companies to discovery procedures. For this reason, where a European company is a party to U.S. litigation, it may not be able to rely on the Hague Convention as a method of avoiding U.S. discovery obligations, especially if there is a possibility of a finding of personal jurisdiction in the U.S. over the European company.<sup>7</sup>

## II. CHALLENGES AND STRATEGIES

Despite the increasing uniformity of international business and, to a lesser extent, the increasing uniformity of international litigation, attorneys working with European corporate clients in complying with U.S. discovery rules may still experience a disconnect between what their clients expect the U.S. discovery process to entail and what it will actually involve. In addition, continuing language and technological barriers may present difficulties in carrying out document review processes that U.S. discovery compliance has come to require. This section discusses some of the problems attorneys face in helping European clients respond to U.S. discovery requests and explores some strategies for minimizing them.

#### A. Privacy Laws and Logistical Problems in Analyzing Data

The strict nature of European privacy laws creates difficulties for European corporations seeking to comply with both U.S. discovery obligations and European rules governing the privacy of personal data. Although personal data concerns will not arise in every case, they are increasingly common, and out of an abundance of caution corporations

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<sup>6</sup> Commission Decision 520/2000/EC of 26 July 2000, available online at [http://europa.eu.int/comm/internal\\_market/privacy/adequacy\\_en.htm](http://europa.eu.int/comm/internal_market/privacy/adequacy_en.htm).  
<sup>7</sup> For a discussion of the Hague Convention and its effect on discovery in U.S. courts, see James Chalmers, *The Hague Evidence Convention and Discovery Inter Partes: Trial Court Decisions Post-Aerospatiale*, 8 *Tulane Journal of International and Comparative Law*, 189 (Spring 2000).



may want to broadly interpret their privacy obligations. Because of the broad exception for information produced pursuant to legal obligations, European companies should have little problem in producing relevant documents to the United States, but problems may arise during the review process itself. Because documents sent outside Europe to be reviewed for potential relevance and production in U.S. litigation may be interpreted as violating privacy laws, a feasible strategy may be to process and review documents on-site or within the relevant country, and to produce to the United States only those documents that will be disclosed to the other side. For large-scale litigation, this may entail bringing U.S. counsel and document production consultants to Europe to manage the discovery process.

#### B. Foreign Language Data

Although technology is continuously becoming more advanced, and English is increasingly becoming a common language for even internal business communications in Europe, language barriers continue to be a problem for U.S. discovery compliance. The legal team reviewing documents for relevance must include reviewers who are fluent in languages other than English, and search tools must be able to handle searches in other languages, including languages that use different character sets than English.

#### C. Different Conceptions of Backup Tapes

While European discovery processes can require the production of backup tapes, the production of backup tapes for U.S. litigation purposes may be a problem for European companies. Most European companies that use backup tapes think of these tapes as primarily for disaster recovery and not for litigation purposes. Some European companies never planned on freezing the contents of backup tapes, or retaining them for longer than their policies on retention of materials, so orders requiring preservation, or orders to produce, may come as a shock and may pose substantial technical problems.

#### D. Unfamiliarity with Large-Scale Discovery

Despite the increasing frequency of European corporate involvement in U.S. litigation, many European companies are unprepared for the large-scale nature of U.S. litigation. This is in large part because of the limited nature of most European discovery. Large-scale litigation of the type increasingly common in the United States is still a rarity in Europe, so the kind of large-scale document production that litigation has come to require in the United States may be a challenge to even the most international of European companies. Corporate culture in many European companies may also be different – many executives, for instance, may find it extremely invasive for an attorney to review their personal correspondence or files and to produce those documents to the other party in U.S. litigation. For this reason, U.S. attorneys advising European companies on U.S. discovery requirements should be prepared to explain in a clear way what U.S. courts require and work with their clients to meet these requirements in an efficient way.



# COST SHIFTING IN ELECTRONIC DISCOVERY

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## I. INTRODUCTION<sup>1</sup>

Although the Federal Rules of Civil Procedure nowhere explicitly speak of “cost shifting,” there is no doubt that the courts may require a party propounding discovery to pay the costs that will be incurred by the responding party in providing that discovery. This is implicit in the protective order provisions of Rule 26(c), which authorizes “any order which justice requires to protect a party or person from . . . undue burden or expense . . .” See also *Advisory Committee Notes to 1970 Amendments to Rule 34*. (“The courts have ample power under Rule 26(c) to protect respondent against undue burden or expense, either by restricting discovery or requiring that the discovering party pay costs.”) Cost shifting is not, however, a blanket means of “legitimizing” otherwise overbroad or unduly burdensome discovery. It is one tool available to the courts to protect a party from undue burden or expense.

While cost shifting has not historically received great judicial attention, this seems destined to change as electronic discovery becomes pervasive. As is increasingly well appreciated, the ability of modern technology to store vast amounts of records and information (a large portion of which is never reduced to a paper record, and some of which can be dauntingly expensive to recover and produce) presents increasingly critical issues for discovery. This has begun to sharpen the courts’ focus on the issue of who pays for such discovery to a degree not seen in the halcyon days of purely paper discovery. These issues can arise in myriad ways, by no means all of which have yet been addressed significantly by the courts. The most common scenarios involve discovery directed to disaster recovery tapes as sources of subsequently deleted emails; see, e.g., *Zubulake v. UBS-Warburg LLC*, 216 F.R.D. 280 (S.D.N.Y. 2003) (*Zubulake III*), mirror imaging hard drives for similar purposes (among others); see, e.g., *Fennell v. First Steps Designs, Ltd.*, 83 F.3d 526 (1<sup>st</sup> Cir. 1996), and the need to modify software or write new software to identify and recover records or data from electronic storage. See 7 *Moore’s Federal Practice* ¶ 37A.32[3][b][iii] (3d ed. 2003).

This topic has been the subject of considerable scholarly commentary. See, e.g., *The Sedona Principles* (Pike & Fischer 2004); Redish, *Electronic Discovery And The Litigation Matrix*, 51 Duke L. J. 561 (2001); Scheindlin & Rabkin, *Electronic Discovery In Federal Civil Litigation: Is Rule 34 Up To The Task?*, 41 B. C. L. Rev. 327 (March 2000); Artinyan, *Legal Impediments To Discovery And Destruction Of E-Mail*, 2 J. Legal Advoc. & Prac. 95 (2000); Note, *Allocating Discovery Costs In The Computer Age: Deciding Who Should Bear The Costs Of Discovery Of Electronically Stored Data*, 57 Wash. & Lee L. Rev. (Winter 2000); Note, *Electronic Media Discovery: The Economic Benefit Of Pay-Per-View*, 21 Cardozo L. Rev. 1379 (February 2000). While judicial consideration of the issues is growing rapidly, it has not, however, yet been the subject of widespread judicial analysis, and there is relatively little

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<sup>1</sup> All emphasis in quoted material is added.

guidance from the appellate level. See, *Xpedior Creditor Trust v. Credit Suisse First Boston (USA), Inc.*, 2003 WL 22283835 (S.D.N.Y., October 1, 2003); *Zubulake v. UBS-Warburg LLC* (“*Zubulake I*”), 217 F.R.D. 309 (S.D.N.Y. 2003); *Zubulake v. UBS-Warburg LLC* (“*Zubulake III*”), 216 F.R.D. 280 (S.D.N.Y. 2003); *Zubulake v. UBS-Warburg LLC* (“*Zubulake IV*”), 2003 WL 22410619 (S.D.N.Y. 2003); *Zubulake v. UBS-Warburg LLC* 2004 WL 1620866 (S.D.N.Y. July 20, 2004) (“*Zubulake V*”); *Medtronic Sofamor Danek, Inc. v. Michelson*, 2003 U. S. Dist. LEXIS 8587 (W. D. Tenn. 2003); *McPeck v. Ashcroft*, 202 F.R.D. 31 (D.D.C. 2001); *McPeck v. Ashcroft*, 212 F.R.D. 33 (D.D.C. 2003); *Murphy Oil USA v. Fluor Daniel, Inc.*, 2002 U.S. Dist. LEXIS 3196 (E.D. La. 2002); *Rowe Entertainment, Inc. v. The William Morris Agency, Inc.*, 205 F.R.D. 521 (S.D.N.Y. 2002); *Simon Property Group L.P. v. mySimon, Inc.*, 194 F.R.D. 639 (S.D. Ind. 2000).

Because of the potential for electronic discovery to impose substantial burden and expense on the responding party, the role of Rules 26(b) and (c) merits heightened judicial attention. While the potential magnitude of electronic data demands particularized attention, an increased focus on the cost of discovery generally has been part of the mantra of the Federal Rules Advisory Committee for the last twenty years. Indeed the purpose of the 1983 amendments to Rule 26(b), which has formed the analytical basis for some of the most frequently cited cost-shifting cases involving electronic discovery, was “to encourage judges to be more aggressive in identifying and discouraging discovery overuse” and “to enable the court to keep tighter rein on the extent of discovery.” *Koch v. Koch Industries, Inc.*, 203 F.3d 1202, 1238(10<sup>th</sup> Cir. 2000), quoting *Advisory Committee Notes to 1983 Amendments to Rule 26(b)*. That amendment, particularly subdivision (b)(2)(iii), explicitly introduced the “proportionality” test, which asks whether “the burden or expense of the proposed discovery outweighs its likely benefit.”

Of course, the “computerization” of records also potentially renders discovery more effective when prudently used. Drafts of important documents such as contracts, which may include “redlining” and embedded comments, may never have been “printed out,” but exist solely in electronic form. These sorts of electronic records may, for example, shed important light on the parties’ intentions concerning vital contract terms or impeach one party’s contention as to its intent.

But, to date no form of electronic record rivals the common e-mail as the focus of electronic discovery. To a far greater degree than was ever the case with letters or other paper documents, email has supplanted the telephone call, and even the face to face meeting, as a means of business communications. People seem prone to say things in “dashed off” emails that they would not say in other written communications. Many people seem not even to think of email as creating a lasting record. To the extent it has a historic analogue, email is most like the informal phone call or face-to-face conversation, but with at least two vital differences: First, it leaves a *record* of the *exact* words used, but divorced from the context of the “conversation.” Second, email effectively becomes a “transcript” of the sort of conversations that previously existed (if at all) only in human memories of oral communications, discoverable only by deposition, with all the vagaries that entailed.

This aspect of emails, coupled with discovery of the occasional, sensationalized “smoking gun” email in a few high profile cases, understandably may pose an intuitive challenge for many jurists faced with deciding who should bear the costs of recovering emails no longer easily or inexpensively recovered because they are “deleted but are not gone.” While some courts have made admirable efforts to fashion a scholarly, analytical approach to those issues, in the end they come down to subjective, human judgments that can be sensitive to the notion that the sheer magnitude of theoretically available electronic

information may mean that “there just might be gold” somewhere in it. It is this same magnitude of information, however, and the time, effort and expense often involved in providing it, that poses the prospect of imposing great burden and expense on the producing party.

## II. STRUCTURE OF THE RULES

The rules of discovery recognize that “cost matters,” and that not every stone must always be turned in the search for probative evidence. Thus, Rule 26(b)(1), which articulates the “Discovery Scope and Limits” under the Federal Rules, makes clear that not all discovery that meets the test of being “reasonably calculated to lead to admissible evidence” may be permitted. See *Advisory Committee Notes to 1983 Amendments, supra* (“The objective is to guard against redundant or disproportionate discovery by giving the court authority to reduce the amount of discovery that may be directed to matters that are otherwise proper subjects of inquiry.”). Rule 26(b) does not seem to treat the limitations it imposes in subdivision (b)(2) as aberrations or “exceptions,” but as intrinsic limits on the appropriate scope of discovery in the first place. Thus Rule 26(b)(1) declares that “All discovery is subject to the limitations imposed by Rule 26(b)(2)(i), (ii), and (iii)”.

In fact, the Year 2000 amendments to Rule 26(b), which specifically added the just quoted phrase, were

added [to] call[ ] attention to the limitations of subdivision (b)(2)(i), (ii), and (iii). These limitations apply to discovery that is otherwise within the scope of subdivision (b)(1). The Committee has been told repeatedly that the courts have not implemented these limitations with the vigor that was contemplated. This otherwise redundant cross-reference has been added to emphasize the need for active judicial use of subdivision (b)(2) to control excessive discovery.

### *Advisory Committee Notes to 2000 Amendments to Rule 26.*

Rule 26(b)(2) also directs that “[t]he frequency *or extent* of use of the discovery methods otherwise permitted under these rules . . . shall be limited by the court if it determines that” any of the “limitations” set out in (b)(2)(i) through (iii) are present. “[T]his sub-section was added ‘to encourage judges to be more aggressive in identifying and discouraging discovery overuse’ and ‘to enable the court to keep tighter rein on the extent of discovery.’” *Koch Industries, supra, quoting Advisory Committee Notes to 1983 Amendments To Rule 26(b)*.

Rule 26(b)(2)(iii) contains a common sense guiding principle for limiting discovery. Discovery of information that meets the “relevance” standard of Rule 26(b)(1) may nevertheless be prohibited where “the burden or expense of the proposed discovery outweighs its likely benefit . . . .” While the primary inquiry is whether the “burden or expense of the proposed discovery outweighs its likely benefit,” the rule also directs that the court “tak[e] into account the needs of the case, the amount in controversy, the parties’ resources, the importance of the issues at stake in the litigation, and the importance of the proposed discovery in resolving the issues.” The text of the rule suggests that the additional matters the court is to “tak[e] into account” are to inform its decision as to the key proportionality inquiry, but are not independent, additional and equally weighted tests in and of themselves. The overall test imposed by the Rule 26(b)(2) factors comprises the “proportionality” test. See, e.g., *Zubulake v. UBS-Warburg LLC*, 217 F.R.D. 309 (S.D.N.Y. 2003); *G-69 v. Degnan*, 139 F.R.D. 326 (D. N. J. 1990).

Rule 26 does not provide an express bridge between (a) the directive in Rule 26(b)(2) that the court “shall” limit discovery if it finds that any of the “limitations” set out in Rule 26(b)(2)(i) through (iii) are present, and (b) the protective order provisions of Rule 26(c), which require a showing of “good cause” by the moving party before protection (including cost shifting) is granted. In addition, the traditional “presumption” has been that the party responding to discovery must bear the cost of doing so. *Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340 (1978). In practice, the “burden” or “presumption” aspect of the cost shifting analysis has not generally appeared to be a significant factor, with the courts analyzing the situation and finding that cost shifting is or is not justified without relying heavily on the burden or presumption to be a “tie breaker.” See, e.g., *See Medtronic Sofamor Danek, Inc. v. Michelson*, 2003 U. S. Dist. LEXIS 8587 (W. D. Tenn. 2003); *McPeck v. Ashcroft*, 202 F.R.D. 31 (D.D.C. 2001); *McPeck v. Ashcroft*, 212 F.R.D. 33 (D.D.C. 2003); *Murphy Oil USA v. Fluor Daniel, Inc.*, 2002 U.S. Dist. LEXIS 3196 (E.D. La. 2002); *Rowe Entertainment, Inc. v. The William Morris Agency, Inc.*, 205 F.R.D. 521 (S.D.N.Y. 2002). *Zubulake III*, however, seemed to make more of the traditional presumption in various aspects of its analysis.

The focus of the relative handful of decided cases to date dealing with cost shifting in electronic discovery has primarily been on recovering deleted email from “backup tapes.” Because most businesses create such tapes only for use in the unlikely event of a catastrophic loss of their computer “system,” they preserve large, temporary “snapshots” of whatever electronic records exist on the backed up server or servers at the time the snapshot is taken, and they are usable for litigation discovery only at considerable cost and effort. Emails (and other records) on such backup tapes are not “stored” with the practical expectation of having to restore or search them in the normal course of business. Indeed, the general expectation is that they will be used only under catastrophic circumstances where the cost of restoration is vastly less than the cost to the organization of losing all of it electronic records.

They are not, therefore, analogous to “closed files” or paper document repositories whose purpose is to make it possible to locate and review stored paper records with relative ease. Such paper records are generally organized and indexed to be selectively retrieved for that purpose, and they are typically accessed with some frequency in the conduct of normal business.<sup>2</sup>

### III. RECENT JUDICIAL TREATMENT OF COST SHIFTING

Early in the evolution of the law in this area, judges and commentators confronting the often enormous costs associated with electronic discovery proposed blanket rules that placed the burden on either the producing or requesting party. The implications of such blanket rules were vividly described in the first *McPeck* decision:

[M]aking the producing party pay for all costs of restoration as a cost of its “choice” to use computers creates a disincentive for the requesting party to demand anything less than all of the tapes. American lawyers engaged in discovery have never been accused of asking for too little. To the contrary, like the Rolling Stones, they hope that if they ask for what they want, they will get what they need. They hardly need any more encouragement to demand as much as they can from their opponent.

<sup>2</sup> The above description of backup tapes is a generalization, similar to that used in several reported decisions. Not all organizations’ backup systems work the same, however. That is, not all organizations back up the entire contents of all servers. For example, some may not back up emails at all. They may route emails to a single server containing only emails, which server is not backed up. Where emails are not backed up, the way to locate deleted emails (not otherwise discovered in hard copy form) would be to search individual hard drives, which would involve another set of burden and expense issues. Moreover, as technology advances, the degree of burden and expense in restoring and searching backup tapes is changing and will presumably continue to do so.

The converse solution is to make the party seeking the restoration of the backup tapes pay for them, so that the requesting party literally gets what it pays for. Those who favor a “market” economic approach to the law would argue that charging the requesting party would guarantee that the requesting party would only demand what it needs. Under that rationale, shifting the cost of production solves the problem....

A fairer approach borrows, by analogy, from the economic principle of “marginal utility.” The more likely it is that the backup tape contains information that is relevant to a claim or defense, the fairer it is that the government agency search at its own expense. The less likely it is, the more unjust it would be to make the agency search at its own expense. The difference is “at the margin.”

Finally, economic considerations have to be pertinent if the court is to remain faithful to its responsibility to prevent “undue burden or expense.” Fed. R. Civ. P. 26(c). If the likelihood of finding something was the only criterion, there is a risk that someone will have to spend hundreds of thousands of dollars to produce a single email. That is an awfully expensive needle to justify searching a haystack. It must be recalled that ordering the producing party to restore backup tapes upon a showing of likelihood that they will contain relevant information in every case gives the plaintiff a gigantic club with which to beat his opponent into settlement. No corporate president in her right mind would fail to settle a lawsuit for \$100,000 if the restoration of backup tapes would cost \$300,000. While that scenario might warm the cockles of certain lawyers’ hearts, no one would accuse it of being just.<sup>3</sup>

*McPeck* also set forth another partial solution to the often enormous costs of electronic discovery by ordering a “test run” (sampling) procedure. The test run procedure was ordered by the court to garner a better understanding of the material likely to be found on contested e-mail back-up tapes and to determine if the results would be worth the expense of production. After ordering the defendant to produce back-up tapes for one computer for one targeted year, the test led the court to order production of one additional back-up tape while foreclosing discovery of the rest.

As more cases in this area are being litigated, there is an emerging trend toward a balancing test that calls upon litigators to understand the technology issues and meaningfully translate the burdens, costs, and needs involved in the arguments for and against cost shifting. Two cases (*Rowe* and *Zubulake*) represent the seminal decisions to date and are addressed in depth on the following pages.

#### A. The *Rowe* Factors

In January of 2002, Magistrate Judge Francis of the Southern District of New York issued a decision in *Rowe* setting forth a multi-factor approach to cost shifting. In *Rowe*, minority concert promoters claimed that the discriminatory and anti-competitive practices of booking agencies and other promoters prevented the plaintiffs from promoting certain concert events. The plaintiffs sought e-mails from defendants’ back-up tapes and hard drives.

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<sup>3</sup> *McPeck*, 202 F.R.D. at 33-34.

The Magistrate Judge examined and rejected “bright line” tests employed by other courts and instead outlined the following factors in evaluating the proposed discovery:

1. *Specificity of discovery requests.* The court found that this factor favored placing the cost burden on the requesting party. The discovery requests as framed were broad, and the requesting party had the power to narrow them. “The less specific the requesting party’s discovery demands, the more appropriate it is to shift the costs of production to that party.”
2. *Likelihood of a successful search.* While it was likely that the broad search of e-mails would yield relevant evidence, the marginal utility of searching the e-mails was “modest at best.” The requesting party had not shown that the e-mails would “be a gold mine,” so this factor also weighed in favor of placing the burden on the requesting party.
3. *Availability from other sources.* The producing parties claimed that any relevant e-mails would have been printed and maintained in the proper hard copy file. However, the producing parties were unable to prove that important e-mails would have been retained (by showing, for example, a company policy requiring this) or that the information was available or accessible in a different format at a lower expense, so this factor suggested the burden should be borne by the producing parties.
4. *Purposes of retention.* “[A] party that happens to retain vestigial data for no current business purposes, but only in case of an emergency or simply because it has neglected to discard it, should not be put to the expense of producing it.” Since there was no showing that the producing parties accessed their back-up tapes or the e-mails in the normal course of business, this factor tipped toward imposing costs on the requesting party.
5. *Benefit to the parties.* Because the e-mails would not be relevant to any issue on which the producing parties had the burden of proof, the producing parties would not benefit from the production of the e-mails, suggesting that the costs should be placed on the requesting party.
6. *Total costs.* Both sides agreed that substantial expense would be incurred through restoration and production of e-mails. This factor favored having the requesting party bear the costs.
7. *Ability and incentive to control costs.* Each side presented its own estimates about the costs, and the requesting party believed it would be much less expensive than the producing parties did. Further, the requesting party was in a better position to limit or control the costs by tailoring its requests.
8. *Parties’ resources.* Both sides had equal abilities to bear the costs.

Based upon a review of all eight factors, the Magistrate Judge in *Rowe* found that the costs should be borne by the requesting party. The court further stated that, if the producing parties wished to conduct a pre-production privilege review (notwithstanding the



existence of a protective order stating that inadvertent production was not a waiver of privilege and that the documents were to be seen only by the attorneys), the privilege review must be conducted at the producing parties' own expense.

On appeal to the district court from the Magistrate's ruling, Judge Robert Patterson affirmed Magistrate Judge Francis' decision on each of the eight factors.<sup>4</sup> Notably, Judge Patterson:

- Upheld the marginal utility analysis used to determine the likelihood of a successful search.
- Found that generalization about potential responsiveness based solely upon volume calculation is insufficient to justify burdensome discovery efforts.
- Determined the plaintiffs had never set forth a specific, concrete proposal narrowing their discovery requests, so the specificity of the requests factor properly placed the burden on the requesting parties.
- Noted that no single factor should be used as a bright-line test, instead stating that the requesting parties' argument about the total costs involved was insufficient, because of the other factors.

To date, the *Rowe* test has been applied in several reported cases.<sup>5</sup>

## B. *Zubulake*

Most recently, in *Zubulake*, a former employee asserting gender discrimination and retaliation claims sought allegedly relevant e-mails that had been deleted and resided only on back-up disk media (disaster recovery tapes). The defendant asserted that the request was unduly burdensome as it would require expensive restoration of back-up e-mail tapes and also unnecessary as approximately 100 pages of e-mails had previously been produced.

In its May 13, 2003 decision ("*Zubulake I*"), the court initially reviewed existing law regarding discovery and declared that "[t]he Supreme Court has instructed that 'the presumption is that the responding party must bear the expense of complying with discovery requests.'" In light of this instruction, the *Zubulake* court noted that "[a]ny principled approach to electronic evidence must respect this presumption."

After dispatching defendant's relevance arguments, the court addressed the defendant's claim of undue burden, determining that "whether production of documents is unduly burdensome or expensive turns primarily on whether [documents are] kept in an accessible or inaccessible format." The court outlined five categories of data: (1) active, online data, (2) near-line data, (3) offline storage/archives, (4) back-up tapes, and (5) erased, fragmented or damaged data. "Of these, the first three categories are typically identified as accessible, and the latter two as inaccessible." Judge Scheindlin announced that "a court should consider cost-shifting only when electronic data is relatively inaccessible."

<sup>4</sup> *Rowe Entm't, Inc. v. William Morris Agency, Inc.*, No. 98 Civ. 8272 (RPP), 2002 WL 975713 (S.D.N.Y. May 9, 2002).

<sup>5</sup> See *Medtronic Sofamor Danek, Inc. v. Michelson*, No. 01-2373-M1V, 2003 WL 21212601 (W.D. Tenn. May 13, 2003); *Computer Associates Intern, Inc. v. Quest Software, Inc.*, No. 02 C 4721, 2003 WL 21277129 (N.D. Ill. June 3, 2003); *In re Livent, Inc. Noteholders Sec. Litig.*, No. 98 Civ. 7161, 2003 WL 23254 at \*3 (S.D.N.Y. Jan. 2, 2003); *Antioch Co. v. Scrapbook Borders, Inc.*, 210 F.R.D. 645 (D. Minn. 2002); *In re Bristol-Myers Squibb Sec. Litig.*, 205 F.R.D. 437, 443 (D.N.J. 2002); *Byers v. Illinois State Police*, No. 99C 8105, 2002 WL 1264004 (N.D. Ill. June 3, 2002); *Murphy Oil USA, Inc. v. Fluor Daniel, Inc.*, No. 99-3564, 2002 WL 246439 (E.D. La. Feb. 19, 2002).

Since the allegedly relevant e-mails resided on the defendant's inaccessible back-up tapes, Judge Scheindlin found it appropriate to consider cost shifting.

The court found that the *Rowe* test was inadequate under Rule 26(b)(2):

In order to maintain the presumption that the responding party pays, the cost-shifting analysis must be neutral; close calls should be resolved in favor of the presumption. The *Rowe* factors, as applied, undercut that presumption for three reasons. *First*, the *Rowe* test is incomplete. *Second*, courts have given equal weight to all of the factors, when certain factors should predominate. *Third*, courts applying the *Rowe* test have not always developed a full factual record.

Judge Scheindlin proposed that some factors be added to improve the test. Specifically, she noted that Rule 26 “requires consideration of ‘the amount in controversy, the parties’ resources, the importance of the issues at stake in the litigation, and the importance of the proposed discovery in resolving the issues,’” yet *Rowe* omitted these rule-based factors in its balancing test.

Judge Scheindlin also proposed that two *Rowe* factors be deleted. First, she noted that “the specificity of the discovery request” was already inherent in the second and sixth *Rowe* factors (addressing relevance and cost), and the concept could be adequately captured within one factor. Second, the court found that the fourth *Rowe* factor, “the purposes for which the responding party maintains the requested data” is unimportant because “[w]hether the data is kept for a business purpose or for disaster recovery does not affect its accessibility, which is the practical basis for calculating the cost of production.”

Taking into account the proposed additions, deletions and modifications, the *Zubulake* court announced its seven factor test:

1. *The extent to which the request is specifically tailored to discover relevant information.* This is essentially a combination of the first and second factors of *Rowe*. The request must be sufficiently tailored to identify a discrete set of data or type of information sought.
2. *The availability of such information from other sources.* This is the same as the third factor of *Rowe*. Here, the requesting party already had in her possession 450 pages of e-mails that were demonstrably relevant to her request, while the producing party claimed that its production of 100 pages of e-mails was complete. Based upon these facts, the court quickly concluded that the producing party could not represent that its production was sufficient.
3. *The total cost of production, compared to the amount in controversy.* This factor modifies the sixth *Rowe* factor. Whereas *Rowe* considered the total cost of production without taking into account the amount in controversy, in *Zubulake* the court found that Rule 26 requires a broader proportionality screening that looks at the stakes involved. By way of example, the court noted that “[a] response to [a] discovery request costing \$100,000 sounds (and is) costly, but in a case potentially worth millions of dollars, the cost of responding may not be unduly burdensome.”

4. *The total cost of production, compared to the resources available to each party.* This modifies the eighth *Rowe* factor, which only considered the wealth of each party independent of the circumstances of production. According to the *Zubulake* court, it is more important to look at the ability to pay in relation to the total cost. “Thus, discovery that would be too expensive for one defendant to bear would be a drop in the bucket for another.”
5. *The relative ability of each party to control costs and its incentive to do so.* This is the same as the seventh *Rowe* factor. Again, the requesting party has greater ability to control the costs by narrowing its requests.
6. *The importance of the issues at stake in the litigation.* This factor was added by the *Zubulake* court. The court noted that “[f]or example, if a case has the potential for broad public impact, then public policy weighs heavily in favor of permitting extensive discovery.” Several examples of such cases were provided by the court, including “toxic tort class actions, environmental actions, so-called ‘impact’ or social reform litigation, cases involving criminal conduct, or cases implicating important legal or constitutional questions.”
7. *The relative benefits to the parties of obtaining the information.* This is the same as the fifth *Rowe* factor. The *Zubulake* court maintained that discovery requests usually benefit the requesting party, but the court noted that “in the unusual case where production will also provide a tangible or strategic benefit to the responding party, that fact may weigh *against* shifting costs.” (Emphasis in original).

The court noted that the seven factors should not all be given equal weight, but rather should be weighted as follows:

- In referencing *McPeek v. Ashcroft*, the court made very clear that “the first two factors —compromising the marginal utility test — are the most important.” (Factors 1 and 2)
- Second in importance are the factors that address cost issues. (Factors 3, 4, and 5)
- Third in consideration is the importance of the litigation itself. (Factor 6) Though the importance of the litigation itself will rarely come into play, the court stated that factor six has the potential to override the other factors.
- Finally, the relative benefits of production receive the least weight due to the fact that discovery requests usually benefit the requesting party. (Factor 7)

Due to the fact-intensive nature of the cost shifting analysis, the court determined that it did not have sufficient information to render a decision concerning cost shifting as it related to the back-up tapes. Instead, the court ordered that a sampling procedure, much like what was done in *McPeek*, be implemented to better understand the potential relevance of data on the back-up tapes. In particular, the defendant was “ordered to produce, at its

expense, responsive e-mails from any *five* backup tapes selected by [plaintiff] Zubulake.” The court concluded that “[o]nce the court has tangible evidence of the restoration time and cost, along with a more accurate understanding of the material on the backup tapes, the appropriate cost-shifting analysis will be conducted.”

On July 24, 2003, the court issued its decision (“*Zubulake III*”) (2003 WL 21714957)<sup>6</sup> based upon the submissions required by the June 13, 2003 Order. In that decision, the court reports that Zubulake selected the back-up tapes corresponding to a UBS employee’s e-mails from May, June, July, August, and September 2001. UBS hired an outside vendor, Pinkerton Consulting & Investigations, to perform the restoration. Pinkerton restored each of the backup tapes, yielding a total of 8,344 e-mails (including duplicates).

Pinkerton then performed a search for e-mails containing (in either the e-mail’s text or its header information, such as the “subject” line) the terms “Laura,” “Zubulake,” or “LZ.” The searches yielded 1,075 unique (non-duplicate) e-mails. UBS deemed approximately 600 to be responsive to Zubulake’s document request, and they were produced. (4% (25 of 625) of the responsive documents were withheld on the basis of privilege).

Pinkerton billed UBS 31.5 hours for its restoration services at an hourly rate of \$245, six hours for the development, refinement and execution of a search script at \$245 per hour, and 101.5 hours of “CPU Bench Utilization” time for use of Pinkerton’s computer systems at a rate of \$18.50 per hour. Pinkerton also included a five percent “administrative overhead fee” of \$459.38. Thus, the total cost of restoration and search was \$11,524.63.

In addition, UBS reported that it incurred the following costs: \$4,633 in attorney time for the document review (11.3 hours at \$410 per hour) and \$2,845.80 in paralegal time for tasks related to document production (16.74 hours at \$170 per hour). The total cost of restoration and production from the five backup tapes was \$19,003.43.

UBS asked that the court order the cost of any further production — estimated to be \$273,649.39, based on the cost incurred in restoring five tapes and producing responsive documents from those tapes — be shifted to Zubulake. The total figure includes \$165,954.67 to restore and search the tapes and \$107,694.72 in attorney and paralegal review costs.

On these facts, the court then applied the seven factor test from *Zubulake I*.

#### *Factors One and Two*

The court reiterated that these first two factors together comprise the “marginal utility test” announced in *McPeck v. Ashcroft* and are weighed the most heavily.

Zubulake presented the court with sixty-eight e-mails (of the 600 she received) that she claimed were “highly relevant to the issues in this case.” 2003 WL 21714957 at \*4. UBS argued that the e-mails had very little, if any, relevance to the issues in the case. The court undertook a fairly extensive review of the proffered e-mails and concluded that “a review of these e-mails reveals that they are relevant. Taken together, they tell a compelling story of the dysfunctional atmosphere surrounding UBS’s U.S. Asian Equities Sales Desk (the “Desk”).

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<sup>6</sup> There is another decision in the case (issued on the same day as *Zubulake I*) that addresses the plaintiff’s reporting obligations but does not touch upon electronic discovery issues. That decision is known as “*Zubulake II*”: *Zubulake v. UBS Warburg, LLC*, No. 02 Civ. 1243, 2003 WL 21087136 (S.D.N.Y. May 13, 2003).

Presumably, these sixty-eight e-mails are reasonably representative of the seventy-seven backup tapes.” *Id.* at \*4. However, the court added that

[w]hile all of these e-mails are likely to have some “tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence,” none of them provide any direct evidence of discrimination.

*Id.* at \*5 (citation and footnote omitted).

The court then turned to the other half of the marginal utility test — the availability of the relevant data from other sources. Neither party identified how many of the 600 e-mails produced in response to the May 13 Order had been previously produced, but the court noted that UBS previously produced only 100 pages of e-mails yet now produced 853 pages (comprising the 600 responsive e-mails) from the five selected backup tapes alone. The court concluded that “these numbers lead to the unavoidable conclusion that there are a significant number of responsive e-mails that now exist only on backup tapes.” *Id.* at \*5 (citation and footnote omitted).<sup>7</sup>

The court concluded:

The sample restoration, which resulted in the production of relevant e-mail, has demonstrated that Zubulake’s discovery request was narrowly tailored to discover relevant information. And while the subject matter of some of those e-mails was addressed in other documents, these particular e-mails are only available from the backup tapes. Thus, direct evidence of discrimination may only be available through restoration. As a result, the marginal utility of this additional discovery may be quite high.

While restoration may be the only means for obtaining direct evidence of discrimination, the existence of that evidence is still speculative. The best that can be said is that Zubulake has demonstrated that the marginal utility is potentially high. All-in-all, because UBS bears the burden of proving that cost-shifting is warranted, the marginal utility test tips slightly against cost-shifting.

*Id.* at \*6 (citation and footnote omitted).

#### *Factors Three, Four and Five*

As noted by the *Zubulake III* court, “The second group of factors addresses cost issues: ‘How expensive will this production be?’ and, ‘Who can handle that expense?’” *Id.* at \*6 (citation and footnote omitted).

#### *The Total Cost of Production Compared to the Amount in Controversy*

The total cost of restoring the remaining seventy-two tapes was extrapolated to \$165,954.67 (\$2,304.93 per tape). The “amount in controversy” was calculated by plaintiff as being between \$15,271,361 and \$19,227,361, while UBS indicated that damages could be as high as \$1,265,000. *Id.* at \*6 (citation and footnote omitted).

<sup>7</sup> The court also noted that there was “some evidence that [a UBS employee] was concealing and deleting especially relevant e-mails” and that the potentially useful e-mail resided only on UBS’s backup tapes. *Id.* at \*5 (citation and footnote omitted).

The court noted that it could not reconcile the significant disparity, but that it was clear that the case was not a “nuisance value case, a small case or a frivolous case.” *Id.* at \*6 (citation and footnote omitted) (“If Zubulake prevails, her damages award undoubtedly will be higher than that of the vast majority of Title VII plaintiffs”). Thus, while “in an ordinary case, a responding party should not be required to pay for the restoration of inaccessible data if the cost of that restoration is significantly disproportionate to the value of the case,” the cost of restoration in Zubulake is not “significantly disproportionate” to the projected value of the case. *Id.* at \*7 (citation and footnote omitted). Accordingly, in the opinion of the court, this factor weighs against cost-shifting.

*The Total Cost of Production Compared to the Resources Available to Each Party*

The court found that UBS has exponentially more resources available to it than Zubulake. Yet the court noted that Zubulake is asserting a \$19 million claim against UBS. So while UBS’s resources clearly dwarf Zubulake’s, “she may have the financial wherewithal to cover at least some of the cost of restoration.” *Id.* at \*7 (citation and footnote omitted). The court also noted that “it is not unheard of for plaintiff’s firms to front huge expenses when multi-million dollar recoveries are in sight.” *Id.* at \*7 (citation and footnote omitted). The court found that “while this factor weighs against cost shifting, it does not rule it out.” *Id.* at \*7 (citation and footnote omitted).

*The Relative Ability of Each Party to Control Costs and Its Incentive to Do So*

The court found that although a less-expensive vendor could have been found, once that vendor is selected costs are not within the control of either party. Because the discovery requests were focused at this stage of the process, the court found that this factor is neutral.

*Factor Six: The Importance of the Issues at Stake in the Litigation*

The court referred back to *Zubulake I*, where it declared that this factor “will only rarely come into play,” *id.* at \*7 (citing *Zubulake I*, 2003 WL 21087884, at \*11) and found that “Although this case revolves around a weighty issue — discrimination in the workplace — it is hardly unique. Claims of discrimination are common, and while discrimination is an important problem, this litigation does not present a particularly novel issue.” *Id.* at \*7 (citation and footnote omitted). As a result, the court found this factor to be neutral.

*Factor Seven: The Relative Benefits to the Parties of Obtaining the Information*

The court found that there “can be no question that Zubulake stands to gain far more than does UBS” and thereafter held that “this factor weighs in favor of cost-shifting.” *Id.* at \*7 (citation and footnote omitted).

The court concluded its review of the seven factor analysis as follows:

Factors one through four tip against cost-shifting (although factor two only slightly so). Factors five and six are neutral, and factor seven favors cost-shifting. As noted in my earlier opinion in this case, however, a list of factors is not merely a matter of counting and adding; it is only a guide. Because some of the factors cut against cost shifting, but only slightly so — in particular, the possibility that the continued production will produce valuable new information — some cost-shifting is appropriate in this case, although UBS should pay the majority of the costs. There is

plainly relevant evidence that is only available on UBS's backup tapes. At the same time, Zubulake has not been able to show that there is indispensable evidence on those backup tapes (although the fact that [a UBS employee] apparently deleted certain e-mails indicates that such evidence may exist).

*Id.* at \*8 (citation and footnote omitted).

The court then moved to determine how much of the cost should be shifted, noting that "it is beyond cavil that the precise allocation is a matter of judgment and fairness rather than a mathematical consequence of the seven factors ...." Applying this standard, the court found that:

Because the seven factor test requires that UBS pay the lion's share, the percentage assigned to Zubulake must be less than fifty percent. A share that is too costly may chill the rights of litigants to pursue meritorious claims. However, because the success of this search is somewhat speculative, any cost that fairly can be assigned to Zubulake is appropriate and ensures that UBS's expenses will not be unduly burdensome. A twenty-five percent assignment to Zubulake meets these goals.

*Id.* at \*8 (citation and footnote omitted).

Finally, the court considered the question of whether the cost shifting should apply to the entire cost of the production or only to the cost of restoring the backup tapes, the difference being \$107,694.72. The court recited that "as a general rule, where cost-shifting is appropriate, only the costs of restoration and searching should be shifted" and that "the responding party should always bear the cost of reviewing and producing electronic data once it has been converted to an accessible form." *Id.* at \*8 (citation and footnote omitted). The court reached this conclusion based upon the fact that the reviewing party controls the variables that underlie the cost (*e.g.*, review protocol, staffing) and that, in the court's opinion, cost-shifting is only appropriate for inaccessible — but otherwise discoverable — data. *Id.*

The court concluded:

The costs of restoring any backup tapes are allocated between UBS and Zubulake seventy-five percent and twenty-five percent, respectively. All other costs are to be borne exclusively by UBS. Notwithstanding this ruling, UBS can potentially impose a shift of all of its costs, attorney's fees included, by making an offer to the plaintiff under Rule 68.

*Id.* at \*9 (citation and footnote omitted).

Only a relative handful of federal courts have addressed cost shifting in the context of electronic discovery. While the *McPeck*, *Rowe*, and *Zubulake* decisions, for example, make admirable efforts to establish a thoughtful, coherent analytical structure and are finding a following in other courts, it is too early to predict the degree to which those decisions will ultimately influence case law or rule amendments. *See, Computer Assocs. Int'l, Inc. v. Quest Software, Inc.*, No. 02 C 4721, 2003 WL 21277129, at \*1-2 (N.D. Ill. June 3, 2003) (reviewing eight *Rowe* factors and determining that none of the factors favored cost shifting even though defendant spent between \$28,000 and \$40,000 to remove privileged e-mails

from the backups and to produce a privilege log); *Murphy Oil USA, Inc. v. Fluor Daniel, Inc.*, No. 99-3564 T(1), 2002 U.S. Dist. LEXIS 3196 at \*9-28 (E.D. La., Feb. 19, 2002) (largely following *Rowe* and providing two alternative protocols, letting the parties select their preferred version); *Byers v. Illinois State Police*, No. 99 C 8105, 2002 WL 1264004, at \*12 (N.D. Ill. June 3, 2002) (following *Rowe* and requiring plaintiffs to pay to license defendant's old email program if they wish to search for archived emails); *Medtronic Sofamor Danek, Inc. v. Michelson*, No. 01-2373-M1V, 2003 U.S. Dist. LEXIS 8587, at \*10-31 (W.D. Tenn. May 13, 2003) (applying the *Rowe* factors and shifting some costs to party requesting restoration of backup tapes); *OpenTV v. Liberate Techs.*, 219 F.R.D. 474, 479 (N.D. Cal. 2003) (applying seven *Zubulake* factors and concluding that, "because the parties are similarly situated, they are to split equally the cost" of electronic discovery); *Xpeditior Creditor Trust v. Credit Suisse First Boston (USA), Inc.*, No. 02 Civ. 9149(SAS), 2003 WL 22283835, at \*5-6 (S.D.N.Y. Oct. 2, 2003) (applying *Zubulake* factors and denying defendant's motion to require plaintiff to share in the cost of restoring computer files).



*THE MULTIFACTOR ANALYSES*

It may be helpful to view in one place the elements articulated in the Federal Rules, *Rowe*, and *Zubulake* in considering cost shifting (keeping in mind that the rules do not actually speak of cost shifting). Such a chart appears below.

<i>F.R.C.P. 34(b), 26(b)(2)</i>	<i>Rowe</i>	<i>Zubulake</i>
<p>(1) Is the discovery sought unreasonably cumulative or duplicative, or obtainable from another less burdensome or expensive source? (26(b)(2));</p> <p>(2) The request for documents “shall . . . describe . . . with reasonable particularity” what is sought. (34(b));</p> <p>(3) The burden or expense of the proposed discovery outweighs its likely benefit, taking into account;</p> <p>(4) the needs of the case;</p> <p>(5) The amount in controversy;</p> <p>(6) The parties’ resources;</p> <p>(7) The importance of the issues at stake in the litigation;</p> <p>(8) The importance of the proposed discovery in resolving the issues.</p>	<p>(1) The specificity of the discovery requests;</p> <p>(2) The likelihood of discovering critical information;</p> <p>(3) The availability of such information from other sources;</p> <p>(4) The purposes for which the responding party maintains the requested data (eliminated by <i>Zubulake</i>);</p> <p>(5) The relative benefits to the parties of obtaining the information;</p> <p>(6) The total cost associated with production;</p> <p>(7) The relative ability of each party to control costs and its incentive to do so;</p> <p>(8) The resources available to each party.</p>	<p>Threshold inquiry: are records kept in “accessible or inaccessible format?” Information is “accessible” if “stored in a readily usable format,” and it is not necessary to restore or “manipulate” it to be usable.</p> <p>(1) The extent to which the request is specifically tailored to discover relevant information [combines <i>Rowe</i> Factors 1 and 2];</p> <p>(2) The availability of such information from other sources;</p> <p>(3) The total cost of production, compared to the amount in controversy;</p> <p>(4) The total cost of production, compared to the resources available to each party;</p> <p>(5) The relative ability of each party to control costs and its incentive to do so;</p> <p>(6) The importance of the issues at stake in the litigation;</p> <p>(7) The relative benefits to the parties of obtaining the information.</p>

Despite substantial analytical consistency, important differences exist between the *Zubulake* and *Rowe* approaches. For example, *Zubulake* criticized *Rowe* as unduly favoring cost shifting. (“There is little doubt that the *Rowe* factors generally favored cost shifting.”) *Zubulake* concluded that *Rowe*’s analysis failed to “maintain the presumption that the responding party pays” the costs of responding to discovery, and that “the cost shifting analysis must be neutral.” *Zubulake* apparently believed that *Rowe* effectively “double counted” essentially the same considerations in its first and second factors (the specificity of the discovery requests and the likelihood of discovering critical information). *Zubulake* “combined” those into a single factor examining “the extent to which the request is specifically tailored to discover relevant information.”

*Zubulake* also regarded *Rowe*’s fourth factor (the purposes for which the responding party maintains the requested data) as “typically unimportant.” (*Rowe* had been more or less followed in this regard by *Murphy Oil* and *Medtronic*.) *Zubulake*, however, reasoned that why a party has kept data has nothing to do with what *Zubulake* regarded as the threshold question — accessibility. (“[I]t is important to not conflate the purpose of retention with accessibility.”)

*Zubulake* concluded that the *Rowe*’s test was also under inclusive. Specifically, *Zubulake* reasoned that *Rowe* had failed to consider two factors that Rule 26 requires be considered. Those were (1) the amount in controversy, reasonably measured by “look[ing] beyond the (often inflated) value stated in the ad damnum clause of the complaint”; (2) the “importance of issues at stake in the litigation.” While this latter factor will “only rarely come into play,” when it does, it “has the potential to predominate over the others.”<sup>8</sup>

*Zubulake* also made clear that the factors are not weighted equally and divided the seven factors into three categories in descending order of importance.

Finally, *Zubulake* reasoned that the cost shifting analysis should not be based on “assumptions made concerning the likelihood that relevant information will be found,” but upon a “factual record.” According to *Zubulake*, “such proof will rarely exist in advance of obtaining the requested discovery,” so the “best solution” is to sample the information sought, without ordering all of the discovery requested, so that the marginal utility test “will not be an exercise in speculation” and the actual cost of responding can be better developed.

#### IV. ISSUES AND QUESTIONS

A non-exhaustive list of cost shifting issues posed by the courts’ treatment of the topic in electronic discovery disputes include the following. These are general but important issues.

1. Should There Be A “Threshold” Standard (Or Presumption) As To When Cost Shifting Should Be Considered At All (Such As “Accessibility”)? If So, What Should It Be?

Is there a practical need (and a sound basis) for erecting a threshold presumption of when a cost shifting analysis should even be undertaken for electronic records and data? The *Zubulake* cases could be read to require application of the proportionality test only to

<sup>8</sup> *Zubulake* also noted that, while *Rowe* “also contemplates ‘the resources available to each party’” as a factor, it was not the absolute wealth of the parties that was the relevant factor, but rather “the focus should be on the total cost of production as compared to the resources available to each party.” *Zubulake* indicated that this may, however, have been “implicit in the *Rowe* test.”

“inaccessible data” — essentially creating a rule that production of “accessible” data is, by definition, not “unduly burdensome or expensive.” The court, for example, found that as to active email files and emails stored on optical disks “it would be wholly inappropriate *to even consider* cost shifting.”

We submit this is, however, too narrow a reading of the *Zubulake* line of cases. In *Zubulake I*, Judge Scheindlin held that “cost shifting should be considered only when electronic discovery imposes ‘an undue burden or expense’ on the responding party. The burden or expense of discovery is, in turn, ‘undue,’ when it, ‘outweighs its likely benefit, taking into account the needs of the case, the amount in controversy, the parties’ resources, the importance of the issues at stake in the litigation, and the importance of the proposed discovery in resolving the issues.’” This, of course, is simply a restatement of Rule 26(b)(2).

The Court went on to say, “many courts automatically assume that an undue burden or expense may arise simply because electronic evidence is involved. This makes no sense. Electronic evidence is frequently cheaper and easier to produce than paper evidence because it can be searched automatically, key words can be run for privilege checks, and the production can be made in electronic form, obviating the need for mass photocopying. In fact, whether production of documents is unduly burdensome or expensive turns *primarily* on whether it is kept in an accessible or inaccessible format, a distinction that corresponds closely to the expense of production.” (emphasis added)

The central holding in this regard is that cost shifting is a possible remedy only after undue burden is found under Rule 26(b)(2). This leaves the proportionality test in full force. Thus, a more accurate reading of the cases is that *ordinarily* in the *e*-discovery context, if data is accessible, there is no undue burden and, therefore, no need to reach the cost shifting question. This does not take accessible data outside the proportionality test, it simply recognizes that it is typically inappropriate, under the rules themselves, to apply the proportionality test to accessible data.

## 2. Is It Appropriate To Exclude Consideration Of The Cost Of Counsel’s Review (For Privilege And Responsiveness) From The Consideration Of Whether Costs Should Be Shifted?

Using the example of backup tapes, much of the cost involved includes not the restoration of the tapes *per se*, but the searching of the restored information, including fees associated with counsel’s review for documents identified by the search for responsiveness, privilege, or trade secret information, redactions (for privilege, to exclude portions of multi-topic emails), and so on. The costs associated with such functions are a key component of the responding party’s burden and expense. These expenses can exceed the cost of restoring and searching the tapes.

*Zubulake* rejects these costs as a valid consideration in cost shifting, reasoning that “the responding party should always bear the cost of reviewing and producing electronic data once it has been converted into an accessible form.” *Zubulake* is not alone in this view. See, e.g., *Computer Associates International, inc. v. Quest Software, Inc.*, 2003 U. S. Dist. LEXIS 9198 (N.D. Ill. 2003). But, is this conclusion unassailable? Even if it is in accord with current law, should the law or the paradigm be changed? Is this an occasion in which the potential expansion of cost by electronic discovery in and of itself merits reconsideration of how far those historic approaches can be taken?

A dollar spent on attorney review is no less a burden of discovery than a dollar spent restoring backup tapes. While it is true that the traditional “American Rule” has been that each party bears its own attorney’s fees in litigation, does that beg the question in these circumstances? Such attorney review not only costs money, but it potentially affects the client’s representation by diverting valuable resources away from other endeavors more valuable to the client. The former is an “expense” of discovery, and the latter is arguably a “burden” of such discovery. The rules speak of both burden and expense, presumably treating them as different things, but both of which are to be considered under Rule 26.<sup>9</sup> See *In re General Instrument Corp. Sec. Litig.*, 1999 WL 1072507 (N.D. Ill. Nov. 18, 1999)(non-monetary costs properly considered in assessing burden imposed by discovery.)

Moreover, there is a fuzzy line between the court’s discretion to deny discovery outright due to undue burden and expense on the one hand and permitting discovery, with cost shifting, on the other. Can a court not deny discovery outright as unduly burdensome and expensive because of both the attendant attorney fees and the allocation of attorney *effort* to such tasks? And, if the court can thus deny such discovery, is it inappropriate for it to consider those same burdens and expenses as part of the cost shifting analysis and shift those costs?

### 3. On What Bases Should The Court Choose Between Cost Shifting And Outright Denial Of Electronic Discovery? Do Requesting Parties Get To “Buy” Discovery Whose Likely Benefit Appears To Outweigh Its Cost?

As just noted, the rules do not provide explicit guidance as to when a court should deny discovery because of undue burden or expense and when it should shift costs as a remedy for undue burden or expense. Rule 26(b)(2) seems to speak more in terms of limiting or prohibiting the discovery than in permitting it with cost shifting. (Indeed, the rules do not actually speak of cost shifting at all.) Yet, some recent decisions, such as *Zubulake* and *Rowe*, appear to proceed on the premise that as long as the requested discovery meets the liberal “discoverability” standards of Rule 26(b)(1), the requesting party is entitled to discovery and then poses the issue as one of cost shifting.

These issues present a legitimate question of how a court chooses between cost shifting and prohibiting discovery. It appears that the courts would not simply hold that a party may, via cost shifting, “buy” discovery that blatantly fails the proportionality test. But, should cost shifting really be equal in stature to, or even more favored than, simple discovery limitations or prohibitions? Doesn’t the very considerations that would justify shifting costs (lack of clear likelihood of discovering information that justifies its expense) indicate that the discovery is of dubious or speculative value in the first place? Moreover, just because costs are shifted does not mean that no overall harm is done to the litigation process. Such activity involves time, both attorney and judicial, and further diversion away from the prompt and efficient resolution of the case on its merits.

### 4. What Is The Proper Role Of The “Resources Of The Parties” Factor In The Cost Shifting Analysis? How Far Should This Tilt The Scales?

This question – cost shifting versus discovery prohibition – is obviously related to another question: What is the proper role of the “resources” of the parties in resolving these

<sup>9</sup> Many litigators are familiar with the tactic of seeking extensive discovery, necessitating lengthy privilege review, for the principle purpose not only of causing the opposing party expense, but to direct legal resources away from the defense or prosecution of the case and towards other matters that have little purpose other than to occupy one side with “busy work” not directly contributing to the resolution of the key issues in the case. Not all cases involve mammoth law firms with scores of associates and paralegals who can devote their time just to “privilege review” and the like. In many cases attorneys, including associates, and paralegals that would otherwise be devoting their time to the representation of the client in the central issues in the lawsuit may be diverted to discovery privilege review and the like with little benefit to their client.

issues? Clearly, Rule 26(b)(2)(iii) requires that the parties' resources be taken into account. How the courts should "take into account" the resources of the parties is a potentially critical consideration.

*Zubulake* and other decisions might be read to suggest that the less able the plaintiff is to bear the cost of discovery, the greater the burden that the producing party may be required to shoulder. *Zubulake* shifted 25 percent of the cost of production to the requesting party, observing, that "because the success of this search is somewhat speculative, any cost that fairly can be assigned to *Zubulake* is appropriate and ensures that UBS's expenses will not be unduly burdensome. A 25-percent assignment to *Zubulake* meets these goals." It is not clear why shifting 25 percent of the cost to the requesting party rendered the 75 percent borne by the respondent not unduly burdensome.

What precisely *Zubulake* did is not of overwhelming importance, of course, because each case will be decided as to particular percentages on its own facts. Rather, the issue is how far do the resources of the party seeking discovery take the analysis? Does the inability of a party to pay simply result in the responding party having to bear those costs, or should it result in the denial of discovery? Does requiring the requesting party to pay "what he can afford" have any true relation to the elimination of an undue burden? The intuitive answer would appear to be no.

Historically, while there has clearly been some solicitude for the financially weaker litigant in discovery matters, this consideration is not a compelling one and is not generally meant to sanction the discovery of marginal discovery whose expense outweighs its likely benefits. See 6 *Moore's Federal Practice* ¶ 26.60[5] (3d ed.); *Marker v. Union Fidelity Life Insurance Company*, 124 F.R.D. 121 (M.D.N.C. 1989). Is there any reason why electronic discovery, where the costs can be proportionally greater, should be any different?

Should therefore a party's resources matter primarily in "close calls" – when the discovery appears potentially worth undertaking, the burden on the responding party is not great, and the requesting party cannot obtain the discovery at all if he must bear the results of cost shifting? Even so, should he bear whatever he can "afford," since otherwise there is no incentive for the requesting party to be focused and restrained in seeking such discovery?

##### 5. Should The Overall Cost Of Discovery — Including Costs of Preservation — Be A Factor In Cost Shifting?

One question not addressed by recent decisions is, to what degree, if any, the overall costs of discovery should be considered in the context of an individualized discovery issue. Nothing in the rules appears to prohibit the court from taking into account the overall burden that discovery is imposing. Such a broader consideration is arguably implicit in those aspects of Rule 26(b) that examines the other sources of discovery that have been pursued or could have been pursued. Indeed, the discovery of electronic data can easily pose the risk that a responding party could die the proverbial "death of the thousands cuts" without any one cut having been deemed to be sufficient to justify cost shifting. This may also be a relevant consideration in determining whether discovery should be taken in phases, with potentially burdensome electronic discovery reserved until a better record of the benefits of overall discovery has been obtained. (See discussion *infra*.)

## 6. Does The Rule 34(b) Option To “Produce In The Regular Course Business” Indicate That Cost Shifting Should More Readily Be Ordered?

Federal Rule 34(b) provides that “a party who produces documents for inspection shall produce them as they are kept in the usual course of business or shall organize and label them to correspond with the categories in the request.” There is a split of authority among the courts as to whether the option to produce documents as kept in the ordinary course of business is an “absolute privilege” belonging to the party producing the documents, whether it belongs to the requesting party, or whether it is one for determination by the court. *See, Renda Marine, Inc. v. United States*, 2003 U.S. Claims, LEXIS 260 (Ct. Fed. Cl. 2003), and authorities cited therein; *In Re: G-I Holdings, Inc.* 2003 US Dist. LEXIS 13901 (D.N.J. July 17, 2003) (“The plain phrasing of Rule 34(b) reveals that the producing party has the option of presenting information in one of two ways.”); *C & T Associates, Inc. v. Township of Abington*, 1986 US Dist. LEXIS 16490 (E.D. Penn. 1986) (“Federal Rule of Civil Procedure 34(b) would appear to give the producing party the option . . . .”); *Board of Education v. Admiral Heating and Ventilating, Inc.*, 104 F.R.D. 23 (N.D. Ill. 1984) (“Rule should not be interpreted as giving sole choice to the producing party.”)

It appears, however, that the courts generally regard the rule as giving the producing party the option as to the form of production, subject to override if the court determines that the records have been maintained in “bad faith” or are “so disorganized that it is unreasonable” for the requesting party “to make its own review.” *Renda Marine, supra*, quoting *Natural Resources Defense Council, Inc. v. Fox*, 1996 WL 497024, \*5 n.3 (S.D.N.Y. 1996).

Since a party producing an electronic “data compilation” should have the same rights as a party producing paper documents under Rule 34(b), may a party acting under Rule 34(b) elect to “produce” (grant access to) the physical tapes or other media rather than restoring and searching them itself? If so, the party has essentially “shifted” the costs (other than privilege and trade secret review, discussed above) of restoration and search to the party seeking the discovery, consistent with a “cost shifting” principle built into Rule 34. It would seem that the information stored on the media being produced is, by definition, being produced as kept in the regular course of business and thus falls within the policy of the rule, unless the producing party has a materially superior or unique means of restoring and searching the data (which is not always the case). *See, Jicarilla Apache Nation v. United States*; 60 Fed. Cl. 413, 416 (2004) (protective order requires that responding party produce electronic documents in the format in which that party routinely uses or stores them, along with the available technical information necessary for access or use by the requesting party); *In re Honeywell Int'l Inc. Sec. Litig.*, No. M8-85, 2003 U.S. Dist. LEXIS 20602, at \*4-5 (S.D.N.Y. Nov. 18, 2003) (requiring non-party to produce electronic version of audit papers even though non-party had produced the documents in paper form because the workpapers were maintained in the usual course of business in electronic, not paper form); *Zhou v. Pittsburg State Univ.*, No. 01-2493, 2003 WL 1905988, at \*2 (D. Kan. Feb. 5, 2003) (finding plaintiff entitled to computerized data in addition to information already produced in hard copy form because the discovery rules require disclosure of “any back-up copies of files or archival tapes that will provide information about any ‘deleted’ electronic data”); *McNally Tunneling Corp. v. City of Evanston*, No. 00-C-979, 2001 WL 1568879, at \*4 (N.D. Ill. Dec. 10, 2001) (concluding that there is an “apparent split of authority on whether a party is entitled to both hard-copy and electronic versions of computer files” and holding that the requesting party had failed to demonstrate that it is entitled to both); *Zakre v. Norddeutsche Landesbank*, 2004 U.S. Dist. Lexis 6026 (S.D.N.Y. Apr. 6, 2004) (holding it sufficient to produce 204,000 emails in text-readable format without any further relevance

cut); *In re Lorazepam and Clorazepate Antitrust Litig.*, 300 F. Supp. 2d 43, 46 (D.D.C. 2004) (holding that no index was required where CD-ROMs were searchable); *N. Crossarm Co., Inc. v. Chem. Specialties, Inc.*, No. 03-C-415-C, 2004 U.S. Dist. LEXIS 5381, at \*3-5 (W.D. Wis. Mar. 3, 2004) (denying plaintiff's motion to compel production of e-mail files in electronic format after they were already produced in hard copy form, noting that a party may produce electronic information in hard copy form absent a request for the documents in specific electronic format); *cf. Jones v. Goord*, No. 95 Civ. 8026, 2002 WL 1007614, at \*10-12 (S.D.N.Y. May 16, 2002) (declining plaintiff's request for production of databases where plaintiff already had access to the information in hard copy).

Beyond this, however, does Rule 34(b) suggest anything about how the cost shifting analysis should be treated for electronic data under Rule 26? If Rule 34(b) anticipates that a responding party can effectively "shift" the cost of restoration and searching to its opponent by producing (or granting access *in situ*) the electronic storage records as they are kept in the usual course of business, but prudently does not do so because of reasonable privilege and security concerns, should at least the shifting of the cost of restoring and searching such media under Rule 26 be more favorably considered by the court? If the party could "shift" those costs without judicial approval under Rule 34(b), should the party be entitled to shift them under Rule 26?

#### 7. Does It Matter Why The Records Are Kept In An Inaccessible (Or Expensive To Retrieve) Fashion?

*Zubulake* treated as irrelevant ("typically unimportant") to the cost shifting analysis the fact that the records were stored on media not expected to be used for retrieval in the normal course of business. That is, it considered the fact that they were kept solely for disaster recovery and not for retrieving them in normal operations an immaterial consideration that unduly favored cost shifting. *Zubulake* reasoned that it "conflate[d] the purpose of retention with accessibility."

This is contrary to the approach taken in *Rowe* and *Medtronic*. *Medtronic* treated this inquiry as valuable because it suggested an answer to a relevant question: "Does the reason for maintaining the backup tapes indicate that the tapes are so likely to contain relevant information that the producing party should bear the cost of their production." *Id.* at \*22. *Rowe's* discussion focused more on the fact that the organization did not keep the data on backup tapes for any business purpose and had never used the tapes:

A party that happens to retain vestigial data for no current business purposes, but only in case of an emergency . . . should not be put to the expense of producing it. . . . There is no evidence that the defendants themselves ever search these tapes for information or even have a means for doing so.

*Rowe* at 432.

Considering why the records were kept in the fashion they were kept (i.e., on what storage media, such as backup tapes) seems relevant to the broad, subjective inquiry authorized by Rule 26. Indeed, the considerations listed in the rule are not meant to be exhaustive. While the reason the records were kept in a particular fashion is not an answer to whether they are accessible, does that necessarily mean the answer is unimportant? The fact that an organization does not maintain backup tapes for normal business access and use indicates that such media are not likely to be important sources of information over and

above its records that are stored for retrieval in the ordinary course of business. True, what an organization may regard as useful and what an opposing party in litigation would regard as useful are not always synonymous. However, absent evidence that the “inaccessible” storage media was deliberately chosen over a more accessible alternative *in order* to make litigation more difficult, should the rules of discovery be dramatically out of synch with normal business records keeping practices?

The rules of discovery themselves suggest otherwise. *See* Rule 34(b), which authorizes the production of documents as they are kept in the normal course of business. Is it unreasonable to treat why the organization stores the data the way it does as an indication of whether it is likely to contain material documents? A factual record (*see infra*) can be developed to indicate otherwise if that is the case, of course. The same would appear to be true, if not even more true, as to efforts to obtain data that is not even deliberately created for recovery, but created as a function of the operation of the computer system itself.

#### 8. Should “Sampling” Be A Standard Practice?

Both *Zubulake* and *McPeck* chose to authorize sampling of backup tapes. *Zubulake* apparently saw it as necessary to create an adequate factual record on which to make an informed cost shifting decision.

But is sampling always necessary? Should it be the “norm?” Are there other reasonable “factual bases” on which to make these judgments? In a “small” case would sampling itself be an undue burden?

#### 9. What Case Administration Procedures Might Assist In Developing Such A Record And Making The Subjective Decision On Cost Shifting?

The *Rowe* and *Zubulake* multifactor analyses are by their own description more “art” than science. The multifactor analyses represent an organized way of thinking that still comes down to subjective judgments about a number of things, including the weight to be given each factor and the likelihood of finding truly useful evidence.

Neither *Zubulake* nor *Rowe* suggests that the only way to approach cost shifting is to immediately leap into the “sampling” of inaccessible data. *Zubulake’s* insistence on a “factual record” to assess the cost shifting issues does not appear intended to suggest that the only appropriate factual record is sampling. What other sorts of factual records might be considered, and how cases might be managed where inaccessible electronic discovery may pose a substantial cost issue, will vary considerably. However, some such procedures might include the following:

(1) The entire analysis will be better informed by defining and formulating the important issues in the case early and before such discovery. The potential for extensive and potentially expensive electronic discovery argues in favor of more aggressive attempts by the parties and the courts in identifying the true factual issues in the case through Rule 26 and 16 conferences and hearings before such discovery begins. Most litigators are familiar with the unfortunate circumstance of both parties engaging in broad ranging discovery without having first analyzed and identified the true factual issues in the case, as well as any areas where factual issues might be mooted by rulings of law. While early intervention is unlikely to eliminate discovery disputes, the better crystallized the issues in the case, the more informed a judgment the court can make not only as to what subject matters of discovery are appropriate, but how potentially beneficial discovery of certain types may be. Such



efforts should carry at least as much importance as the requirement that the discovery request be specifically tailored to discover relevant information. The two go hand in hand.

(2) If issues can be narrowed by judicial rulings, the courts may (and generally should) stay potentially burdensome electronic (or other) discovery pending that resolution. *See, Chudasama v. Mazda Motor Corp.*, 123 F.3<sup>rd</sup> 1353 (11<sup>th</sup> Cir. 1997) (Court has power to stay discovery where discovery may be mooted by pending, potentially dispositive motions as to issues to which discovery is directed, or entire case.) For example, in a contract dispute where large amounts of emails are sought to develop parol evidence as to a party's claimed intentions, should the court not first resolve whether parol evidence will even be admissible?

(3) Has evidence been developed in discovery that relevant emails have been destroyed? Have witnesses testified that they recall emails, the substance of which are potentially highly probative, but which do not exist in paper form in any known file and are no longer on easily accessible electronic media? Similarly, do copies of some probative emails appear in some recipients' files but not at all in the sender's, indicating that the sender deleted probative emails and that not all recipients may have them all?

(4) If backup tapes are the issue, what is the vintage of the key events and issues compared to the periods covered by available backup tapes? If the events giving rise to the lawsuit occurred five years ago and the only available backup tapes are thirty days old, that is potentially very relevant to assessing the chances of finding useful emails on those media. On the other hand, is there a specific reason to believe that the deletions of emails years old occurred only recently so that they may be captured on existing tapes?

(5) Conversely, do procedures that require a party to conduct discovery in stages in order to develop factual basis for seeking significant electronic discovery put the cart before the horse? Might not electronic discovery lessen the ultimate, overall expense to both parties? Would finding any such electronic data later necessitate a second round of depositions, for example?

#### 10. Should The Responding Party Always Pay For The Sampling?

*Zubulake* ordered the responding party to bear the expense of the sampling. Should that always be the case? The amount of sampling that might be done in one case could equal or exceed the entire electronic production in a smaller case and can involve considerable potential burden and expense. By definition, the reason for sampling is often that the requesting party can demonstrate no non-speculative basis for believing the discovery will yield significant value. Is it appropriate for the party seeking discovery to bear the cost of demonstrating what existing discovery has not demonstrated (i.e., likely value from the discovery)? Even if it is appropriate for the responding party to bear some sampling costs, would it be inappropriate to require at least an equal division of the cost of sampling where the requesting party has no particular basis on which to otherwise demonstrate that the likely benefits needed to satisfy the inherent limitations imposed by Rule 26(b)(2)(iii) are present?

Moreover, how big should the sample be? How sophisticated should the design be? Should the sampling protocol be as specific as possible, rather than as broad as possible? Otherwise, is the sampling itself a fishing expedition?

11. By What Principles Should The Results Of The Sampling Be Judged? For Example, Should It Be Judged By Whether It Reveals That There Is Further “Discoverable” Evidence, By Whether It Indicates A Likelihood Of Highly Probative Evidence, Or Something Else?

How are the sampling results measured — whether they reveal that there is “discoverable” information to be found or whether there is truly probative evidence to be found? It seems appropriate to have some idea of how this assessment will be made when embarking on the sampling process. It informs how the sampling is designed. If discovery has already yielded a substantial amount of discovery of a certain type, does it then to follow that the only justification for seeking discovery of “inaccessible” material would not be to simply find more of the same? This would seem to fit the classic standard of cumulative evidence or discovery. Can and should the search be one that is narrowed using a more refined search that truly looks for probative evidence rather than searching as broadly as possible for anything broadly relating to the lawsuit?

To use an oversimplified example, if a gender discrimination case has already yielded significant documentary evidence that a particular supervisor disliked the plaintiff, but no direct evidence of gender based animosity, should the search be one that (again, oversimplified for illustrative purposes) searches for only emails involving the plaintiff’s name and a specific agreed form of reference to gender?

If the sampling results only in revealing the probability that there are other “discoverable” forms of information to be found on deleted material, but the sampling fails to yield any direct evidence of substantial probative value (i.e., yields cumulative information), how is permitting discovery to continue, or to continue without total or substantial cost shifting to the claimant, different from allowing a fishing expedition?

In addition, it may be that what is sampled may be chosen or largely dictated by the requesting party and thus will presumably reflect not simply an attempt to gain a “representative” sampling, but the requesting party’s judgment as to what tapes (or other things sampled) are most likely to yield “hot” documents. Whether the sampling was the result of substantial control by the requesting party therefore seems an appropriate consideration to take into account when assessing the results of that sampling.

12. Should At A Minimum Cost Sharing Be Presumed? How Does A Court Make This Allocation On A Principled Basis?

It seems likely that sampling will often yield simply inconclusive results – no “smoking gun,” but a general indication that some additional discoverable, but probably not highly probative, information exists on the media not yet restored and searched. In such circumstances it may be appropriate for the court to refuse the requested discovery outright, particularly when the requesting party cannot afford to bear its cost. If a court is not inclined to do that, however, as a general presumptive matter should it be prepared to require the requesting party to bear a substantial share, if not the majority, of the costs? Is it not fair that the requesting party at least significantly “invest” in the discovery it apparently believes to be potentially valuable?

## V. CONCLUSION

These are only a few of the issues that will confront jurists, advocates, clients, and rule makers in the months and years to come. As this paper is going to print, changes to The Federal Rules are under consideration to address some of the questions posed here. *See*, <http://www.kenwithers.com/rulemaking/index.html>. Given the constant evolution in technology and the explosive growth in the business and personal use of electronic data and communications, these issues inevitably will continue to challenge — and motivate — us all.



# *THE (2004) SEDONA PRINCIPLES:* BEST PRACTICES, RECOMMENDATIONS & PRINCIPLES FOR ADDRESSING ELECTRONIC DOCUMENT PRODUCTION

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*The Sedona Conference Working Group on  
Electronic Document Retention and Production  
Sedona, AZ*

**Editor's Note:** The March 2003 public comment draft of *The Sedona Principles* was included in Vol. 4 of this Journal. This is the 2004 post-public comment version. A brief discussion of the changes follows this reprinting of *The 2004 Sedona Principles*.

## I. INTRODUCTION

### Discovery in a World of Electronic Documents and Data

Discovery, and document production in particular, is a familiar aspect of litigation practice for many lawyers. The explosive growth and diversification of electronic methods of creating documents, communicating, and managing data has transformed the meaning of the term “document.” While 20 years ago PCs were a novelty and e-mail did not exist, today by some estimates more than 90 percent of all information is created in an electronic format.

For courts and lawyers, whose practices are steeped in tradition and precedent, the pace of technological and business change presents a particular challenge.<sup>1</sup> In recent years, courts and litigants have attempted to meet this challenge, sometimes by resorting to traditional approaches to discovery, sometimes by innovating. This paper seeks to synthesize the current and provide new, practical standards for a new form of discovery.

#### 1. What is Electronic Discovery?

Electronic discovery refers to the discovery of electronic documents and data. Electronic documents include e-mail, web pages, word processing files, computer databases, and virtually anything that is stored on a computer. Technically, documents and data are “electronic” if they exist in a medium that can only be read through the use of computers. Such media include cache memory, magnetic disks (such as computer hard drives or floppy disks), optical disks (such as DVDs or CDs), and magnetic tapes. Electronic discovery is often distinguished from “paper discovery,” which refers to the discovery of writings on paper that can be read without the aid of some devices.

For readers less familiar with technical terms relevant to electronic discovery, Appendix A contains a glossary of terms.

<sup>1</sup> “[I]t has become evident that computers are central to modern life and consequently also to much civil litigation. As one district court put it in 1985, “[c]omputers have become so commonplace that most court battles now involve discovery of some computer-stored information.” 8A CHARLES ALAN WRIGHT, ARTHUR R. MILLER, & RICHARD L. MARCUS, *FEDERAL PRACTICE & PROCEDURE*, Section 2218 at 449 (2d ed. 1994) (quoting *Bills v. Kennebec Corp.*, 108 F.R.D. 459, 462 (D. Utah 1985)). Similarly, the *Manual for Complex Litigation (Third)* recognizes that the benefits and problems associated with computerized data are substantial in the discovery process. *Manual for Complex Litigation (Third)*, Section 21.446 (Fed. Jud. Ctr. 1995).

## 2. What Rules Govern Electronic Document Production?

The same rules that govern paper discovery, such as Federal Rules of Civil Procedure 1, 26, and 34, govern electronic discovery. Federal Rule of Civil Procedure 34 permits the service by one party upon another of a request for documents of any type:

Any party may serve on any other party a request ... to produce and permit the party making the request, or someone acting on the requestor's behalf, to inspect and copy, any designated documents (including writings, drawings, graphs, charts, photographs, phonorecords, and other data compilations from which information can be obtained, translated, if necessary, by the respondent through detection devices into reasonably usable form), or to inspect and copy, test, or sample any tangible things which constitute or contain matters within the scope of Rule 26(b) and which are in the possession, custody or control of the party upon whom the request is served.

FED. R. CIV. P. 34(a). The Advisory Committee Notes for the 1970 amendments to the rule make clear that the added reference to "data compilations" served to include all forms of electronic data: "The inclusive description of 'documents' is revised to accord with changing technology. It makes clear that Rule 34 applies to electronics [sic] data compilations from which information can be obtained only with the use of detection devices." FED. R. CIV. P. 34, Advisory Committee Notes 1970.

Thus, it is now "black letter law that computerized data is discoverable if relevant." *Anti-Monopoly, Inc. v. Hasbro, Inc.*, No. 94 Civ. 2120, 1995 WL 649934, at \*2 (S.D.N.Y. Nov. 3, 1995); *see also Bills v. Kennecott Corp.*, 108 F.R.D. 459, 463-64 (D. Utah 1985) ("information stored in computers should be as freely discoverable as information not stored in computers"); *Simon Prop. Group L.P. v. mySimon, Inc.*, 194 F.R.D. 639, 640 (S.D. Ind. 2000) ("[C]omputer records ... are documents discoverable under FED. R. CIV. P. 34.").

For all discovery, of course, the Federal Rules protect parties from unduly burdensome, unnecessary, or inefficient discovery. Rule 26 requires that any requested discovery be relevant. Rule 1 provides that that the Federal Rules be "administered to secure the just, speedy, and inexpensive determination of every action." FED. R. CIV. P. 1. The most specific protections against burdensome, unnecessary, or inefficient discovery appear in Rules 26(b) and (c).

Rule 26(b) allows a court to weigh the potential relevance of requested documents against the burden on the party that would have to produce the documents. Rule 26(b)(2)(iii) provides for limiting discovery when "the burden or expense of the proposed discovery outweighs its likely benefit, taking into account the needs of the case, the amount in controversy, the parties' resources, the importance of the issues at stake in the litigation, and the importance of the proposed discovery in resolving the issues." Rule 26(b)(2)(i) provides that discovery may be limited if "the discovery sought is unreasonably cumulative or duplicative, or is obtainable from some other source that is more convenient, less burdensome, or less expensive."

Similarly, Rule 26(c) allows a court to enter a protective order against burdensome discovery.

Upon motion by a party or by the person from whom discovery is sought, accompanied by a certification that the movant has in good faith conferred

or attempted to confer with other affected parties in an effort to resolve the dispute without court action, and for good cause shown, the court in which the action is pending or alternatively, on matters relating to a deposition, the court in the district where the deposition is to be taken may make any order which justice requires to protect a party or person from annoyance, embarrassment, oppression, or undue burden or expense.

FED. R. CIV. P. 26(c).<sup>2</sup>

These broad powers enable a court to limit discovery of electronic documents or condition their production on cost-shifting if the court concludes that the burden of the discovery outweighs its ultimate benefit. The Advisory Committee Notes for the 1970 amendments to the Federal Rules specifically recognized that electronic discovery may generate a special need for such protections against oppressive discovery:

[W]hen ... data can as a practical matter be made usable by the discovering party only through respondent's devices, respondent may be required to use his devices to translate the data into usable form. In many instances, this means that respondent will have to supply a print-out of computer data. The burden thus placed on respondent will vary from case to case, *and the courts have ample power under Rule 26(c) to protect respondent against undue burden or expense, either by restricting discovery or requiring that the discovering party pay costs.* Similarly, if the discovering party needs to check the electronic source itself, the court may protect respondent with respect to preservation of his records, confidentiality of nondiscoverable matters, and costs.

FED. R. CIV. P. 34, Advisory Committee Notes 1970 (emphasis supplied).

These existing rules, however, do not fully address the distinct nature of electronic documents, and courts must take great care in applying the rules in the electronic context. For example, an inartfully worded order compelling production of electronic records could cause a litigant to incur costs that are multiples of the value of the case before discovery even begins. To fairly apply the Federal Rules to electronic discovery, one must understand the differences between electronic documents and paper documents.

### 3. How are Electronic Documents Different from Paper Documents?

If the same rules govern paper discovery and electronic discovery, why should electronic discovery be any different from paper discovery? *Byers v. Illinois State Police*, 53 Fed.R.Serv.3d 740, No. 99 C 8105, 2002 WL 1264004 (N.D. Ill. May 31, 2002), which presented a typical electronic discovery dispute, posed this very question:

The plaintiffs move the Court for an order compelling the defendants to produce archived e-mails that were authored by one of the individual defendants and relate to either plaintiff. The defendants argue that it would be unduly burdensome for them to search the backup tapes containing the archived e-mail. The plaintiffs respond that computer-based discovery is no different than paper-based discovery.

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<sup>2</sup> Local court rules often contain standards imposing limitations on all forms of discovery.

*Id.* at \*10.

The answer to this question—“why is electronic discovery different?”—lies in the subtle, but sometimes profound, ways in which electronic documents present unique opportunities and problems for document production. In *Byers*, Magistrate Judge Nolan reflected on some of these differences:

Computer files, including e-mails, are discoverable. However, the Court is not persuaded by the plaintiffs’ attempt to equate traditional paper-based discovery with the discovery of e-mail files. Chief among these differences is the sheer volume of electronic information. E-mails have replaced other forms of communication besides just paper-based communication. Many informal messages that were previously relayed by telephone or at the water cooler are now sent via e-mail. Additionally, computers have the ability to capture several copies (or drafts) of the same e-mail, thus multiplying the volume of documents. All of these e-mails must be scanned for both relevance and privilege. Also, unlike most paper-based discovery, archived e-mails typically lack a coherent filing system. Moreover, dated archival systems commonly store information on magnetic tapes which have become obsolete. Thus, parties incur additional costs in translating the data from the tapes into useable form.”

*Id.* at \*31-33. There are many ways in which producing electronic documents is qualitatively and quantitatively different from producing paper documents. They can be grouped into six broad categories of differences.

#### A. Volume and Duplicability

First and foremost, there are vastly more electronic documents than paper documents, and electronic documents are created at much greater rates than paper documents. As a result, the amount of information available for potential discovery has exponentially increased with the introduction of electronic data. For example, the use of e-mail has risen dramatically in recent years. In 1998, the U.S. Postal Service processed approximately 1.98 billion pieces of mail. During that year, there were approximately 47 million e-mail users in the United States who sent an estimated 500 million e-mail messages per day, for a total of approximately 182.5 billion e-mail messages per year—more than 90 times as many messages as the U.S. Postal Service handled the same year. In 2003, it is projected that there will be 105 million e-mail users in the United States, who will send over 1.5 billion e-mail messages a day (approximately 547.5 billion e-mail messages per year)—nearly as many messages in a day as the U.S. Postal Service handles in a year.

The dramatic increase in e-mail usage and electronic file generation poses special problems for large corporations. A single large corporation can generate and receive millions of e-mails and electronic files each day. At least 93 percent of information created today is first generated in digital format,<sup>3</sup> 70 percent of corporate records may be stored in electronic format,<sup>4</sup> and 30 percent of electronic information is never printed to paper.<sup>5</sup> Not surprisingly, the proliferation of the use of electronic data in corporations has resulted in vast accumulations. While a few thousand paper documents are enough to fill a file cabinet, a single computer tape or disk drive the size of a small book can hold the equivalent of

<sup>3</sup> Kenneth J. Withers, *The Real Cost of Virtual Discovery*, 7 FEDERAL DISCOVERY NEWS 3 (Feb. 2001).

<sup>4</sup> Lori Enos, *Digital Data Changing Legal Landscape*, E-Commerce Times, May 16, 2000.

<sup>5</sup> Richard L. Marcus, *Confronting the Future: Coping with Discovery of Electronic Material*, 64 Law & Contemp. Probs. 253, 280-81 (Spring/Summer 2001).



millions of printed pages. Organizations often accumulate thousands of such tapes as data is stored, transmitted, copied, replicated, backed up, and archived.

Partly responsible for this phenomenon is the fact that electronic documents are more easily duplicated than paper documents. Electronic information is subject to rapid and large scale user-created and automated replication without degradation of the data. E-mail provides a good example. E-mail users frequently send the same e-mail to many recipients. These recipients, in turn, often forward the message, and so on. At the same time, e-mail software and the systems that are used to transmit the messages automatically create multiple copies as the messages are sent and resent. Similarly, other business applications are designed to periodically and automatically make copies of data. Examples of these include web pages that are automatically saved as cache files and file data that is routinely backed up to protect against inadvertent deletion or system failure.<sup>6</sup>

### B. Persistence

Second, electronic documents are more difficult to dispose of than paper documents. A shredded paper document is essentially irretrievable.<sup>7</sup> Likewise, a paper document that has been discarded and taken off the premises is generally considered to be beyond recovery. Disposal of electronic documents is another matter altogether. “The term ‘deleted’ is sticky in the context of electronic data. ‘Deleting’ a file does not actually erase the data from the computer’s storage devices. Rather, it simply finds the data’s entry in the disk directory and changes it to a ‘not used’ status—thus permitting the computer to write over the ‘deleted’ data. Until the computer writes over the ‘deleted’ data, however, it may be recovered by searching the disk itself rather than the disk’s directory. Accordingly, many files are recoverable long after they have been deleted—even if neither the computer user nor the computer itself is aware of their existence.” *Zubulake v. UBS Warburg LLC*, 217 F.R.D. 309, 313 n.19 (S.D.N.Y. 2003) (“*Zubulake I*”) (internal quotation marks omitted). This persistence of electronic data compounds the rate at which electronic data and documents accumulate and creates an entire subset of electronic data that exists unknown to the individuals with ostensible custody over them. Indeed, because of the difficulty of effectively deleting electronic documents, software is sold that purports to completely erase or “wipe” the data by overwriting the data numerous times.

### C. Dynamic, Changeable Content

Third, computer information, unlike paper, has dynamic content that is designed to change over time even without human intervention. Examples include: workflow systems that automatically update files and transfer data from one location to another; tape backup applications that move data from one cartridge to another to function properly; web pages that are constantly updated with information fed from other applications; and e-mail systems that reorganize and remove data automatically. As a result, unlike paper documents, many electronic documents and collections are never fixed in a final form.

More generally, electronic documents are more changeable than paper documents. Documents in electronic form can be modified in numerous ways that are sometimes difficult to detect without computer forensic techniques. Moreover, the act of merely

<sup>6</sup> Neither the users who created the data nor information technology personnel are necessarily aware of the existence and locations of the replicant copies. For instance, a word processing file may reside concurrently on an individual’s hard drive, in a network-shared folder, as an attachment to an e-mail, on a backup tape, in an Internet cache, and on portable media such as a CD or floppy disk. Furthermore, the location of particular electronic files typically is determined not by their substantive content, but by the software with which they were created, making organized retention and review of those documents difficult.

<sup>7</sup> Modern technology, however, has made recovery at least a theoretical possibility. See Douglas Heingartner, *Back Together Again*, New York Times, July 17, 2003, at G1 (describing new technology that can reconstruct cross-shredded paper documents).

accessing or moving electronic data can change it. For example, booting up a computer can alter data contained on it. Simply moving a word processing file from one location to another can change creation or modification dates. In addition, drafts of documents may be retained without the user's knowledge or consent.

#### D. Metadata

Fourth, electronic documents, unlike paper, contain information that is known as "metadata." Metadata is information about the document or file that is recorded by the computer to assist the computer and often the user in storing and retrieving the document or file at a later date. The information may also be useful for system administration as it reflects data regarding the generation, handling, transfer, and storage of the data within the computer system. Much metadata is not normally accessible by the computer user.

There are many examples of metadata. Such information includes file designation, create and edit dates, authorship, comments, and edit history. Indeed, electronic files may contain hundreds or even thousands of pieces of such information. For instance, e-mail has its own metadata elements that may include, such information as the dates that mail was sent, received, replied to or forwarded, blind carbon copy ("bcc") information, and sender address book information.

Indeed, an e-mail message may routinely have over a thousand different metadata elements. Typical word processing documents have hidden codes that determine whether to indent a paragraph, change a font, and set line spacing. The ability to recall inadvertently deleted information is another familiar function, as is tracking of creation and modification dates. Similarly, electronically created spreadsheets may contain calculations that are not visible in a printed version or completely hidden columns that can only be viewed by accessing the spreadsheet in its native application. Internet documents contain hidden data that allow for the transmission of information between an Internet user's computer and the server on which the internet document is located. So-called "meta-tags" allow search engines to locate websites responsive to specified search criteria. "Cookies" are embedded codes that can be placed on a computer (without user knowledge) that can, among other things, track usage and transmit information back to the originator of the cookie.<sup>8</sup>

Metadata presents unique issues for the preservation and production of documents in litigation. On the one hand, it is easy to conceive of situations where metadata is necessary to authenticate a document, or establish facts material to a dispute, such as when a file was accessed in a suit involving theft of trade secrets. In most cases, however, the metadata will have no material evidentiary value—it does not matter when a document was printed, or who typed the revisions, or what edits were made before the document was circulated. And there is also the real danger that information recorded by the computer may be inaccurate. For example, when a new employee uses a word processing program to create a memorandum by using a memorandum template created by a former employee, the metadata for the new memorandum may incorrectly identify the former employee as the author.

Understanding when metadata needs to be specifically preserved and produced represents one of the biggest challenges in electronic document production.

#### E. Environment-Dependence and Obsolescence

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<sup>8</sup> An extensive discussion of the problems raised by metadata can be found in Jason R. Baron's article *Recordkeeping in the 21st Century*, 33 *Information Management Journal* 8 (July 1999) (available at [http://www.arma.org/pdf/journal/1999/7\\_99\\_02.pdf](http://www.arma.org/pdf/journal/1999/7_99_02.pdf)).

Fifth, electronic data, unlike paper data, may be incomprehensible when separated from its environment.<sup>9</sup> For example, as a structured set of data, the information in a database may be incomprehensible when removed from the structure in which it was created. If the raw data (without the underlying structure) in a database is produced, it will appear as merely a long list of undefined numbers. To make sense of the data, a viewer needs the context that includes labels, columns, report formats, and other information. Existing or customized “reports” based on queries of the database can be generated without producing the entire database.

Also, the frequent obsolescence of computer systems due to changing technology creates unique issues for recovering electronic documents that are not present in the recovery of paper documents. It is not unusual for an organization to undergo several migrations of data to different platforms within a few years. Moreover, because of the turnover in computer systems, neither the personnel familiar with the obsolete systems nor the technological infrastructure necessary to restore the out-of-date systems may be available when this “legacy” data needs to be accessed. In a perfect world, electronic records that have continuing value for business purposes or litigation are converted for use in successor systems, and all other data is discarded. In reality, though, such migrations are rarely flawless.

#### F. Dispersion and Searchability

Sixth, while an employee’s paper documents will often be consolidated in a handful of boxes or filing cabinets, the employee’s electronic documents could reside in numerous locations: desktop hard drives, laptop computers, network servers, floppy disks, and backup tapes. Many of these electronic documents may be identical backup copies. However, some documents may be earlier versions drafted by that employee or by other employees who can access those documents through a shared network.

Consequently, it may be more difficult to determine the provenance of electronic documents than paper documents. The ease of transmitting electronic data and the routine modification and multi-user editing process may obscure the origin of a document. Electronic files are often stored in shared network folders that may have departmental or functional designations rather than author information. In addition, there is growing use of collaborative software that allows for group editing of electronic data, rendering the determination of authorship far more difficult. Finally, while electronic documents may be stored on a single drive, it is likely that such documents may also be found on high-capacity, undifferentiated backup tapes, or on network servers—not under the custodianship of an individual who may have “created” the document.

Counterbalancing, to some extent, the dispersed nature of electronic documents is the fact that some forms of electronic documents and some forms of electronic media can be searched quickly and fairly accurately by automated methods. For these types of electronic documents, software may be able to search through far more documents than human beings could hope to review manually.

#### 4. Why Do Courts and Litigants Need Standards Tailored to Electronic Discovery?

The differences between electronic documents and paper documents make clear that document production will mean very different things in the electronic and the paper

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<sup>9</sup> In addition, passwords, encryption, and other security features can limit the ability of users to access electronic documents.

contexts. In practical terms, these differences mean that rules principally designed to govern paper documents do not always provide meaningful guidance for disputes involving the discovery of electronic documents.

For example, a preservation order to save “all records pertaining to the manufacture of X” could, if all documents were paper documents, be applied logically by a party, which could instruct employees to collect and preserve those records. In the electronic age, such a command could present intractable problems. Because electronic information is both dynamic and ubiquitous, a party would have to, unless it suspended operations, copy all electronic data, wherever located and in whatever form, for possible production. That process could be extraordinarily complex and expensive, depending upon the size of the data involved, since it is typically impossible to suspend destruction of only the information covered by the preservation order.<sup>10</sup>

The Working Group has first-hand experience of unreasonable and unfair burdens in producing electronic documents in litigation. These unfair burdens have included, among other things, spending millions of dollars to process and review large volumes of electronic documents that had little likelihood of being relevant to the case and preserving at great cost thousands of backup tapes that were subsequently not even sought by the opposing party later in discovery.

We believe that the unfair burdens would be minimized if standards were provided to parties and courts for addressing electronic document production. Without standards, parties are left to guess as to what their obligations are, with the threat of discovery violations for incorrect guesses. Indeed, a number of courts facing electronic discovery issues have noted the lack of principled guidance in the area. For example, the court in *McPeek v. Ashcroft* observed, in the context of evaluating the discovery of e-mail backup tapes:

[t]here is certainly no controlling authority for the proposition that restoring all backup tapes is necessary in every case. The Federal Rules do not require such a search, and the handful of cases are idiosyncratic and provide little guidance. The one judicial rationale that has emerged is that producing backup tapes is a cost of doing business in the computer age. *In re Brand Name Prescription Drugs*, Nos. 94 C 897, MDL 997, 1995 WL 360526 at \*3 (N.D. Ill., June 15, 1995). But, that assumes an alternative. It is impossible to walk ten feet into the office of a private business or government agency without seeing a network computer, which is on a server, which, in turn, is being backed up on tape (or some other media) on a daily, weekly or monthly basis. What alternative is there? Quill pens?

*McPeek v. Ashcroft*, 202 F.R.D. 31, 33 (D.D.C. 2001) (footnote omitted). The general lack of standards has been noted by other judges as well. *See, e.g.*, Shira A. Scheindlin & Jeffrey Rabkin, *Electronic Discovery in Federal Civil Litigation: Is Rule 34 Up to the Task?*, 41 B.C. L. Rev. 327, 361 (2000) (“[W]hile courts have managed to resolve motions that raise Rule 34 questions in the context of electronic discovery, they have generally approached these questions in a highly fact-specific manner, producing few general principles to aid in the resolution of similar disputes.”).<sup>11</sup>

<sup>10</sup> Indeed, at an extreme, such data might be interpreted to include machine or product line data that is collected only for milliseconds. Attempting to retain all such data would effectively shut down manufacturing operations because its retention would quickly outstrip the storage capacity.

<sup>11</sup> There are many examples of conflicting guidance in the case law. *Compare, e.g., McPeek v. Ashcroft*, 202 F.R.D. at 33 (restoring all backup tapes not necessary in every case) with *Linnen v. A.H. Robins Co.*, 10 Mass. L. Rptr 189, No. 97-2307, 1999 WL 462015, at \*9-10 (Mass. Super. June 16, 1999) (obligation imposed to cease recycling of backup tapes); *compare, e.g., In re Brand Name Prescription Drugs Antitrust Litig.*, Nos. 94 C 897, MDL 997, 1995 WL 360526, at \*2 (N.D. Ill. June 15, 1995) (holding that producing party must bear costs, as would be the case with paper documents, because the producing party chose to store the data electronically), with *Rowe Entm't, Inc. v. William Morris Agency, Inc.*, 205 F.R.D. 421, 421 (S.D.N.Y. Jan. 16, 2002) (adopting multiple factor test to address cost allocation of electronic discovery burden).

## 5. How Can Courts and Litigants Use Precedent from the Context of Paper Discovery in the Context of Electronic Documents?

Recognizing the differences between electronic and paper document production begs the crucial question: what to do with the great body of case law applying the Federal Rules in the context of paper discovery? How can courts and counsel use familiar applications of the Rules to guide discovery in the unique context of electronic documents?

To answer this question, one should consider the two obvious alternative approaches: a “similarity” paradigm that seeks guiding principles in precedent by searching for analogies to electronic discovery in the paper context and following the guidelines that would apply in the paper context; and a “difference” paradigm that emphasizes the differences between electronic and paper documents and rejects the guidance of paper discovery cases because of these differences. Both approaches offer useful insights, but neither approach will ultimately serve the interests of litigants or the courts.

### A. Sameness: Find an Analogy from Paper Discovery

There is a temptation in the face of new legal terrain to search for analogies to familiar cases that could provide guidance. Often such an exercise can be illuminating, and indeed many principles from paper discovery appear to be sound in the context of electronic document production.

*Illustration i.* Searches for relevant paper documents usually entail identifying the files of key individuals or files devoted to the individual, product, or conduct that is at issue in the litigation (such as the personnel file of a plaintiff who is suing for unlawful termination). There is no expectation that an organization search the filing cabinets of employees with no connection to the issues in the litigation. Thus, by analogy, there should be no expectation that an organization search the computer files of individuals with no connection to the litigation.

*Illustration ii.* The preservation obligation for paper documents does not require a party to keep multiple identical copies of each potentially relevant paper document. Thus, it makes no sense to require a party to preserve electronic documents on optical disks or hard drives as well as the copies of those same documents that might exist on backup tapes.

Drawing analogies from paper discovery, however, can lead to costly pitfalls. These pitfalls arise when parties fail to recognize the distinct capabilities or limitations of electronic documents.

*Illustration iii.* When reviewing paper documents before production, attorneys and paralegals commonly review each page of a potentially relevant paper file to see if the document mentions a person or event responsive to a document request. It has been common practice with respect to electronic documents to print out paper copies of all potentially responsive documents and then review them by hand. By doing so, however, the responding party foregoes the possibility of greatly reducing the time and cost of document review by using automated searches.

*Illustration iv.* In the world of paper discovery, a document preservation order requiring that a corporate party “freeze” all of its documents is burdensome, but normally would not force the party to shut down its business. Paper documents can be left in their files, or copied if they need to be marked up. Personnel can suspend their practice of throwing away old files. But in the electronic context, complying with such an order and freezing all electronic information (including shared or interactive databases) could be catastrophic to a business.

It may be literally impossible to “freeze” a company’s electronic documents without shutting down its entire computer system, because data are altered and overwritten constantly on all computer systems, often in ways that users cannot detect or control. For example, the mere act of accessing a document can alter it, and on any given system, thousands of temporary files are created and overwritten daily, hourly, or more frequently. Disk space that is no longer in use, but which may contain potentially relevant fragmented data, may also be overwritten.

#### B. Difference: Eschew Precedent from Paper Discovery

Appreciating the differences between electronic and paper documents can allow courts and parties to break from past practice in ways that serve the goals of the Federal Rules: “just, speedy, and inexpensive” resolution of litigation. For example, as noted above, automated searches may be faster and less expensive than a page-by-page manual review of electronic documents. And as noted by the *Byers* court, a 20-year-old box of papers and a 20-year-old backup tape are not comparable subjects of discovery. The paper documents may be yellowed, but still readable, while the electronic documents on the backup tape may be written in code that can only be read by software that no longer exists. *See Byers*, 2002 WL 1264004, at \*10. Yet it may not be advisable to do things differently simply because new technology makes it possible.

*Illustration v.* It may be easier to recover “destroyed” electronic documents than “destroyed” paper documents. Computer forensic techniques allow parties to recover or reconstruct deleted documents even, in some cases, documents that appear to have been permanently deleted. But this does not mean that parties responding to document requests should be required to produce deleted data or data fragments. The expense and disruption caused by such techniques would not justify such a production. Here, an analogy to paper is useful. Must a producing party produce papers that it threw away a year ago? Or must it reassemble and copy shredded documents in the garbage cans? *See Rowe Entm’t, Inc. v. The William Morris Agency, Inc.*, 205 F.R.D. 421, 431 (S.D.N.Y. 2002) (“Just as a party would not be required to sort through its trash to resurrect discarded paper documents, so it should not be obligated to pay the cost of retrieving deleted e-mails.”). Of course, whether in the paper or electronic context, if there is a serious question of document destruction, recovering destroyed documents may be justified. Even paper documents that have been shredded to confetti possibly can be reconstructed using new, sophisticated (but expensive) technology. *See Douglas Heingartner, Back Together Again*, *New York Times*, July 17, 2003, at G1 (describing technology that may be used to reconstruct documents shredded by the East German secret police).

*Illustration vi.* Because the cost of electronic document storage (*i.e.*, optical disks or magnetic tape) is relatively low, some have suggested preserving copies of electronic documents even when there is no business reason or legal obligation to do so. Yet this overlooks the fact that indiscriminate copying and retention of electronic files—even if cheaper than indiscriminate copying and retention of paper files—leads to the same or greater headaches in litigation: ballooning costs of review for responsiveness and privilege, large numbers of duplicate documents, and problems dealing with retrieving documents in obsolete formats that have been unnecessarily retained.

### C. Translation: Applying Media-Neutral Rules in a Context-Specific Way

The best approach to electronic discovery begins by recognizing how existing precedent and new technology interact. The rules governing discovery are, as noted above, broadly stated standards that require reasonableness in their application. As such, the rules governing discovery are *media neutral*, in that they apply to documents existing in all media—paper, electronic, or stone tablets. Due to their generality, however, the proper application of the rules only takes shape when one understands the specific context in which the rule is applied. For electronic discovery, this requires that the litigants and the courts understand how electronic documents work, and the costs and benefits of different approaches to discovery.

The result is a process of *translation*: precedent from the world of paper discovery provides a starting point, composed of the legal rule and the application in the specific facts of the case. One can translate that precedent to the world of electronic discovery by asking whether the factual differences between the paper context and the electronic context are relevant to the rule. If so, the precedent may not be a good model. If not, the paper-based precedent could be an adequate starting point for discovery in the electronic context.

For example, in illustration *i.* above, the controlling, media-neutral rule is that production is limited to relevant documents, and the specific application in the paper context is that employees not connected to the issues in the litigation need not search their files because in all likelihood they will not have any relevant documents. In translating from paper discovery to electronic discovery, the question is, “Does the existence of documents in electronic form make the files of such employees more relevant?” Since the answer is no, the guideline in the paper context translates well to the electronic context.

On the other hand, in illustration *iii.* above, the controlling, media-neutral rule is the obligation to produce documents responsive to a document request. The specific application in this illustration involves the most efficient way to identify responsive documents. In the paper context, paralegals and attorneys commonly conduct a page-by-page review of documents, looking for certain key words. In translating this best practice from paper discovery to electronic discovery, the question is, “Does the existence of documents in electronic form make another technique more efficient?” In this case the answer may be yes, if the electronic documents are in a searchable format. Importantly, correctly answering this question (“translating”) requires an understanding of the electronic documents at issue.

The Working Group has examined the issue of electronic document production closely, focusing both on its similarities to and differences from paper document production. The principles that follow reflect our efforts at translating the rules of discovery into the law of electronic document production.

## II. THE SEDONA PRINCIPLES FOR ELECTRONIC DOCUMENT PRODUCTION

1. Electronic data and documents are potentially discoverable under FED. R. CIV. P. 34 or its state law equivalents. Organizations must properly preserve electronic data and documents that can reasonably be anticipated to be relevant to litigation.
2. When balancing the cost, burden, and need for electronic data and documents, courts and parties should apply the balancing standard embodied in FED. R. CIV. P. 26(b)(2) and its state law equivalents, which require considering the technological feasibility and realistic costs of preserving, retrieving, producing, and reviewing electronic data, as well as the nature of the litigation and the amount in controversy.
3. Parties should confer early in discovery regarding the preservation and production of electronic data and documents when these matters are at issue in the litigation, and seek to agree on the scope of each party's rights and responsibilities.
4. Discovery requests should make as clear as possible what electronic documents and data are being asked for, while responses and objections to discovery should disclose the scope and limits of what is being produced.
5. The obligation to preserve electronic data and documents requires reasonable and good faith efforts to retain information that may be relevant to pending or threatened litigation. However, it is unreasonable to expect parties to take every conceivable step to preserve all potentially relevant data.
6. Responding parties are best situated to evaluate the procedures, methodologies, and technologies appropriate for preserving and producing their own electronic data and documents.
7. The requesting party has the burden on a motion to compel to show that the responding party's steps to preserve and produce relevant electronic data and documents were inadequate.
8. The primary source of electronic data and documents for production should be active data and information purposely stored in a manner that anticipates future business use and permits efficient searching and retrieval. Resort to disaster recovery backup tapes and other sources of data and documents requires the requesting party to demonstrate need and relevance that outweigh the cost, burden, and disruption of retrieving and processing the data from such sources.
9. Absent a showing of special need and relevance a responding party should not be required to preserve, review, or produce deleted, shadowed, fragmented, or residual data or documents.
10. A responding party should follow reasonable procedures to protect privileges and objections to production of electronic data and documents.
11. A responding party may satisfy its good faith obligation to preserve and produce potentially responsive electronic data and documents by using electronic tools and processes, such as data sampling, searching, or the use of selection criteria, to identify data most likely to contain responsive information.



12. Unless it is material to resolving the dispute, there is no obligation to preserve and produce metadata absent agreement of the parties or order of the court.
13. Absent a specific objection, agreement of the parties or order of the court, the reasonable costs of retrieving and reviewing electronic information for production should be borne by the responding party, unless the information sought is not reasonably available to the responding party in the ordinary course of business. If the data or formatting of the information sought is not reasonably available to the responding party in the ordinary course of business, then, absent special circumstances, the costs of retrieving and reviewing such electronic information should be shifted to the requesting party.
14. Sanctions, including spoliation findings, should only be considered by the court if, upon a showing of a clear duty to preserve, the court finds that there was an intentional or reckless failure to preserve and produce relevant electronic data and that there is a reasonable probability that the loss of the evidence has materially prejudiced the adverse party.

### III. PRINCIPLES & COMMENTS

1. *Electronic data and documents are potentially discoverable under FED. R. CIV. P. 34 or its state law equivalents. Organizations must properly preserve electronic data and documents that can reasonably be anticipated to be relevant to litigation.*

#### Comment 1.a. The Importance of Proper Document Management Policies

Organizations should adopt policies that provide rational and defensible guidelines on the treatment of electronic documents. These guidelines should be created after considering the business, regulatory, and tax needs of the organization, including the need to conserve electronic storage space on e-mail and other servers. Thus, a company that determines it only needs to retain e-mail with business record significance could set forth these guidelines in its document retention policy. Employees would then be responsible for implementing the policy and neither destroying documents prematurely nor retaining documents beyond their useful life. Any such system should include provisions for litigation holds to preserve documents related to ongoing or reasonably anticipated litigation, governmental investigations, or audits. The existence and reasonable effectiveness of such a program should be a significant consideration in any spoliation analysis.<sup>12</sup>

The advantages of an effective document retention program are particularly pronounced with respect to distributed data and disaster recovery backup tapes. An effective document retention program, combined with a preservation approach triggered by the reasonable anticipation of litigation, would establish the principal source of discovery material, thus reducing the need to routinely access and review multiple sources of likely duplicative data, including backup tapes. An appropriate electronic document preservation program would involve most or all of the following:

- Establishing a thorough but practical records management program and training individuals to manage and retain business records created or received in the ordinary course of business;

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<sup>12</sup> Of course, no organization can ensure 100% percent compliance with its records management program, but this limitation inheres in all document retention, whether paper or electronic.

- Helping business units establish practices and customs, tailored to the needs of their businesses, to identify the business records they need to retain;
- Implementing a system of presumptive limits (based on time or quantity) on the retention of e-mail and other communications, such as instant messaging and voice-mail, to the extent their content does not merit treatment as business records, and developing communications policies that promote the appropriate use of company systems;
- Determining the recycle time applicable to backup tapes based on disaster recovery needs;
- Developing and implementing appropriate procedures to identify and notify relevant individuals and business units of the need to preserve electronic and other records for reasonably anticipated or pending litigation; and
- Establishing and maintaining awareness of the importance of preserving potential evidence in the case of threatened litigation, and training lawyers and business people on when and how to carry out their responsibilities.

Implementing policies with features such as those described above can provide a solid basis to plan for the treatment of electronic documents during discovery. By following an objective, preexisting policy, an organization can formulate its responses to electronic discovery not by expediency, but by reasoned consideration.<sup>13</sup> Under such an approach, a responding party may be able to limit its discovery responses to producing only those materials that are reasonably available to it in the ordinary course of business.

#### Comment 1.b. The Benefits of Written Records Management Policies

A written records management policy can enable an organization to ensure that it is retaining all records necessary to the business, regulatory, and legal needs of the organization. Indeed, the Code of Federal Regulations “has over 1500 references to reporting and record keeping requirements.” J. Edwin Dietel, *Designing an Effective Records Retention Compliance Program* Section 1:26 (2002). While not all of these regulations will apply to any one organization, any organization that does business in the United States will be subject to at least some of these regulations.

A written records management policy can also provide guidance on how to properly dispose of documents—both written and electronic—that are without use to the organization. Under such programs, an organization can demonstrate that it has legitimately destroyed documents by following reasonable and objective standards. Indeed, at least one court has held that the existence of a reasonable records management policy, instituted and applied in good faith, should be considered in determining whether to apply sanctions based on the destruction of evidence. See *Lewy v. Remington Arms Co.*, 836 F.2d 1104, 1112 (8th Cir. 1988) (“[I]f the trial court is called upon to again instruct the jury regarding the failure to produce evidence, ... [f]irst, the courts should determine whether Remington’s record management policy is reasonable considering the facts and circumstances surrounding the relevant document. ... Second, in making this determination the court may also consider

<sup>13</sup> Doing so will help protect against a possible spoliation claim. For example, in *Lewy v. Remington Arms Co.*, 836 F.2d 1104, 1112 (8th Cir. 1988), the United States Court of Appeals for the Eighth Circuit held that, before giving a jury instruction regarding failure to produce evidence, a court should consider whether the party alleged to have destroyed evidence had a records retention policy that was “reasonable considering the facts and circumstances surrounding the relevant documents[.] ... whether lawsuits concerning the complaint or related complaints have been filed, the frequency of such complaints, [ ] the magnitude of the complaints[, and] whether the retention policy was instituted in bad faith.”

whether lawsuits concerning the complaint or related complaints have been filed, the frequency of such complaints, and the magnitude of the complaints. Finally, the court should determine whether the document retention policy was instituted in bad faith.”); *see also Willard v. Caterpillar, Inc.*, 40 Cal. App. 4th 892, 921 (Cal. 1995) (The “good faith disposal pursuant to a bona fide consistent and reasonable document retention policy could justify a failure to produce documents in discovery.”). If an organization implements a clearly defined written records management policy that establishes parameters for what records need to be kept, then destruction of records not meeting these retention guidelines is defensible. However, an organization cannot employ a records management policy designed to obstruct discovery. *See Stevenson v. Union Pac. R.R. Co.*, \_\_\_ F.3d \_\_\_ 2003 WL 23104550, at \*8 (8th Cir. Jan. 5, 2004) (after receipt of specific request for documents, company “cannot rely on its routine document retention policy as a shield” for destruction of evidence); *Kozlowski v. Sears, Roebuck & Co.*, 73 F.R.D. 73 (D. Mass. 1976) (cannot use policies to thwart discovery obligations).

#### Comment 1.c. Written Records Management Policies Should Account for Records in Both Paper and Electronic Form

An organization can benefit from creating a records management policy designed to ensure that all information needed to conduct the business of the organization, fulfill its legal and financial recordkeeping requirements, and preserve its institutional memory is maintained and accessible while providing for the appropriate disposition of other documents. Because a modern organization’s records are created and exist in both paper and electronic form, an organization’s records management policy should address both paper and electronic documents. Such policies can enable organizations to maximize the value of their accumulated information, including electronically stored information, and appropriately view records as assets in which the organization has invested substantial capital. *See generally Pub. Citizen v. Carlin*, 2 F. Supp.2d 1 (D.D.C. 1997) (noting that “computers have now become a significant part of the way the federal government conducts its business” and therefore “[t]he federal government must adapt its electronic recordkeeping capabilities to reflect that reality.”), *rev’d on other grounds*, 184 F.3d 900 (D.C. Cir. 1999), *cert. denied*, 529 U.S. 1003 (2000).

In some instances, an organization can address electronic and paper records with a single set of policies that require identical treatment of paper and electronic materials. In other instances, however, appropriate treatment of both paper and electronic materials will require records management policies that differentiate between paper and electronic materials.

#### Comment 1.d. Preservation in the Context of Litigation

An organization’s document retention policies should focus on the business needs of the organization and the budgetary constraints on its use of technology. An organization also must retain documents that may be relevant to current or reasonably anticipated litigation. *See Principle 5 and associated commentary.* Further, most organizations are subject to statutory and regulatory regimes that require the preservation of particular documents for specified periods of time. For example, the Sarbanes-Oxley Act of 2002, 116 Stat. 745 (2002), contains a number of document preservation requirements applicable to many publicly traded companies.

Beyond satisfying these legal duties, however, it is neither feasible nor reasonable for organizations to take extraordinary measures to preserve documents if there is no business or regulatory need to retain such documents and there is no reasonable anticipation

of litigation to which those documents may be relevant. For example, some commentators have observed that organizations should consider routinely making mirror image copies of employee disk drives when an employee leaves an organization or when computer equipment is recycled or discarded. While there may be unusual circumstances when that is advisable, as a general rule it would be wasteful and wholly unnecessary to accumulate such massive quantities of unused data just because it is technically possible to do so. Rather, in accordance with existing records management principles, it is more rational to establish a procedure by which selected items of value can be identified and retained as necessary to meet the organization's legal and business needs during changes in personnel or hardware.

*2. When balancing the cost, burden, and need for electronic data and documents, courts and parties should apply the balancing standard embodied in FED. R. CIV. P. 26(b)(2) and its state law equivalents, which requires considering the technological feasibility and realistic costs of preserving, retrieving, producing, and reviewing electronic data, as well as the nature of the litigation and the amount in controversy.*

#### Comment 2.a. Scope of Reasonable Inquiries

The traditional approach to preserving and producing paper documents has been to identify and inform appropriate individuals of the specific need to preserve reasonably available information that may be relevant to the dispute at issue. This is followed by reasonable steps to gather and produce documents, after review for privilege, trade secrets, or other appropriate bases for non-production.

A similar approach is also proper to identify, preserve, and produce relevant information in electronic format. The Federal Rules did not intend to place a new, different, and greater discovery obligation upon litigants with relevant electronic information merely because of the increased volume of potential materials involved. Instead, litigants should start with these traditional foundations for good faith compliance with discovery obligations and employ the unique capabilities of computer tools to assist in identifying, locating, retrieving, preserving, reviewing, and producing relevant electronic data and documents.

#### Comment 2.b. Balancing Need and Cost of Electronic Discovery

The standard of Rule 26(b), requiring a balancing of the need for discovery with the burdens imposed, is particularly applicable to discovery of electronic documents and data. Among the factors that must be addressed in electronic discovery are: (a) large volumes of data, (b) data being stored in multiple repositories, (c) complex internal structures of collections of data and the relationships of one document to another, (d) data in different formats and coding schemes that may need to be converted into text to be understood by humans, and (e) frequent changes in information technology. In this context, the need to accurately balance Rule 26(b) factors becomes particularly acute.

Electronic discovery burdens must be proportional to the amount in controversy and nature of the case. Otherwise, transaction costs due to electronic discovery will overwhelm the ability to resolve disputes fairly in litigation. *See, e.g., Alexander v. FBI*, 188 F.R.D. 111, 117 (D.D.C. 1998) (limiting discovery to “targeted and appropriately worded searches of backed-up and archived e-mail and deleted hard-drives for a limited number of individuals”); *Zonaras v. General Motors Corp.*, No. C-3-94-161, 1996 WL 1671236, at \*4 (S.D. Ohio Oct. 17, 1996) (relying on proportionality test of Federal Rules to determine that benefits of discovery outweigh expense).

Costs cannot be calculated solely in terms of the expense of computer technicians to retrieve the data, but must factor in other litigation costs. For instance, the court in *In re General Instrument Corporation Securities Litigation* noted that, while retrieval of the requested documents from backup tapes was not unduly expensive, the implications of a production order requiring that act were broader:

[T]he technical matter of retrieving the documents from the backup tapes would be just the start of the process. Defense counsel would then have to read each e-mail, assess whether the e-mail was responsive, and then determine whether the e-mail contained privileged information. Given that the volume of e-mail at issue here is potentially very large, the court finds that the burden of reviewing the requested documents would be heavy.

*In re Gen. Instr. Corp. Sec. Litig.*, No. 96 C 1129, 1999 WL 1072507, at \*6 (N.D. Ill. Nov. 18, 1999). In addition, the non-monetary costs (such as the invasion of privacy of business data, and the risks to business and legal confidences and privileges) and secondary economic costs (including the burdens on information technology personnel and the resources required to review documents) should be considered in any calculus of whether to allow discovery.

#### Comment 2.c. Need to Coordinate Internal Efforts

Decisions regarding preserving electronic documents and data are typically a team effort, involving counsel (inside and outside), information systems professionals, end-user representatives, records management personnel, and, potentially, other individuals with knowledge of the relevant computer systems and how data is used, such as information security personnel. Parties may use outside consultants, and include them in some of the team activities when consistent with the need for privileged communications.

The team approach permits each team member's relevant expertise to be applied regarding preservation issues. Furthermore, maintaining a team allows the organization to build a knowledge base about its systems and how they are used. The organization may identify a person or persons who will act as the organization's spokesperson or witness on issues relating to the scope of electronic document production. Of course, the size and responsibilities of any team will likely vary greatly depending upon the size of the organization and the scope of litigation. Coordination of information and effort is essential. *See Keir v. UnumProvident Corp.*, No. 02 Civ. 8781, 2003 WL 21997747, at \*5-9 (S.D.N.Y. Aug. 22, 2003) (vague directions and lack of coordination led to loss of data subject to preservation order).

#### Comment 2.d. Communications with the Court Regarding Electronic Data Collection and the Need to Develop an Adequate Factual Record

Organizations should take reasonable positions when arguing electronic data collection issues in court. The organization must clearly demonstrate that it will fulfill its responsibility to preserve and produce relevant data. Overstated or excessive cost estimates will reduce the organization's credibility. Where feasible, the organization should promptly implement a fair and reasonable plan for collecting and producing data, rather than leaving the court to rule on competing plans. When an organization does not present the court with a reasonable plan, the court will usually err on the side of protecting the integrity of the data collection process and require preservation exceeding what may be reasonably necessary.

In preparing for court conferences, counsel needs to adequately consult with their clients' information technology departments and vendors regarding the technical issues involved in data preservation. *See Keir v. UnumProvident Corp.*, No. 02 Civ. 8781, 2003 WL 21997747, at \*12 (S.D.N.Y. Aug. 22, 2003) (specifically noting counsel's failure to inform court of burdens and technological issues regarding preservation order); *see also Landmark Legal Foundation v. EPA*, 272 F. Supp.2d 70, 77-79 (D.D.C. 2003) (reciting failures of agency's attorneys to properly communicate preservation order to agency and holding that agency committed contempt of court by reformatting hard drives and erasing e-mail backup tapes after it received notice of the order). When providing affidavits or testimony to the court on these issues, the organization should recognize that judges may lack technical background. Resources should be directed to develop presentations that make complex technical issues comprehensible to the court.

3. *Parties should confer early in discovery regarding the preservation and production of electronic data and documents when these matters are at issue in the litigation and seek to agree on the scope of each party's rights and responsibilities.*

Comment 3.a. Parties Should Include Electronic Discovery Issues in Their Rule 26 Disclosures and Conferences

Federal Rule of Civil Procedure 26(f) requires parties to confer early in litigation to attempt to develop a discovery plan. *See In re Bristol-Myers Squibb Sec. Litig.*, 205 F.R.D. 437, 441 (D.N.J. 2002) (where party possesses relevant information in electronic format, it is obligated to advise adversary under mandatory disclosure rules); *Kleiner v. Burns*, No. 00-2160, 2000 WL 1909470, at \*4 (D. Kan. Dec. 15, 2000) (holding that Rule 26 requires disclosure of nature and location of relevant electronic documents).

The Rule 26(f) conference is an important tool that can avoid disputes over discovery of electronic documents. In fact, several United States District Courts have, via local rule, mandated that such conferences explicitly include discussion of electronic discovery issues. *See* U.S. Dist. Ct. Ark. L. R. 26.1 ("The FED. R. CIV. P. 26(f) report filed with the court must contain the parties' views and proposals regarding ... [w]hether any party will likely be requested to disclose or produce information from electronic or computer-based media. If so [the report must also specify details on the anticipated electronic discovery ]."); U.S. Dist. Ct. N.J. L. R. 26.1(d) ("During the FED. R. CIV. P. 26(f) conference, the parties shall confer and attempt to agree on computer-based and other digital discovery matters."); U.S. Dist. Ct. Wyo. L. R. 26.1(d)(3)(B) ("The parties shall meet and confer regarding the following matters during the FED. R. CIV. P. 26(f) conference: (i) Computer-based information (in general) ... (ii) E-mail information ... (iii) Deleted information ... and (iv) Back-up data.").

By early discussion of issues such as which computer systems will be subject to preservation and discovery, the relevant time period, and the identities of particular individuals likely to have relevant electronic documents, litigants can identify and attempt to resolve disputes before they create collateral litigation. *See, e.g., In re Bristol-Myers Squibb Sec. Litig.*, 205 F.R.D. at 444 ("counsel should take advantage of the required Rule 26(f) meeting to discuss issues associated with electronic discovery").

Creating checklists of key issues to consider during an electronic discovery conference can guide the parties and minimize the likelihood of post-discovery spoliation

disputes.<sup>14</sup> Counsel should also be prepared to discuss electronic discovery issues during the Rule 16(b) pretrial conference with the court, whether required by local rule or not.

*Illustration i.* A party seeking production of e-mails requests that all backup tapes, hard drives, laptops, PDAs, and other computer systems in the organization be preserved. The request makes no provision for ongoing operation of computer systems and does not narrow the request to reasonable persons, subjects and types of devices covered. After informal consultations, the parties are able to agree upon resolution of the issues (such as which databases contain records that will be preserved) and their agreement is embodied in a letter.

*Illustration ii.* Plaintiffs in a lawsuit involving allegations of securities fraud against multiple defendants seeking extensive damages request preservation of electronic documents by all defendants. The defendants, most of whom are large investment banks and other financial institutions, respond that preservation obligations need to be tailored so that they are defined, manageable, and cost-effective while also preserving evidence that is truly needed for the resolution of the dispute. The parties meet and confer upon a protocol for preserving existing data, including preserving select (not all) backup tapes, certain archived data, select legacy systems, distributing retention notices (and updates), creating a limited number of mirror images of select computer hard drives, undertaking measures to collect potentially relevant data, and distributing a questionnaire regarding electronic data systems. The defendants assess the costs and burdens involved in the various proposed steps and reach agreement on the scope and limitations of the obligations. The protocol averts motion practice and provides certainty as to the expected preservation efforts. *Cf.* Case Management Order Relating to Preservation of Electronic Data, *In Re Initial Public Offering Sec. Litig.*, 21 MC 92 (SAS) (S.D.N.Y. Dec. 19, 2002) (adopting parties' proposed Protocol for the Preservation of Electronic Data).

### Comment 3.b. Privilege Logs for Voluminous Electronic Documents

Federal Rule of Civil Procedure 26(b)(5) states that:

[w]hen a party withholds information otherwise discoverable under these rules by claiming that it is privileged or subject to protection as trial preparation material, the party shall make the claim expressly and shall describe the nature of the documents, communications, or things not produced or disclosed in a manner that, without revealing information itself privileged or protected, will enable other parties to assess the applicability of the privilege or protection.

Traditionally, parties have complied with this rule by producing a privilege log with separate entries for each document that contains objective information about the document (such as author, addressee and Bates number) as well as a field that describes the basis for the privilege claim. Even if there are few documents, preparing a privilege log is often extremely

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<sup>14</sup> See, e.g., Kenneth J. Withers, Computer-Based Discovery in Federal Civil Litigation, 2000 Fed. Cts. L. Rev. 2, at Appendix A (<http://www.fclr.org/2000fedctslrev2.htm>). In addition, the November 17, 2003 draft amendments to the *ABA Civil Discovery Standards* have proposed another checklist of issues for consideration. See Nov. 17, 2003 ABA draft at Standard 13 ("Effective Use of Discovery Conferences").

time consuming. Even with the best efforts of counsel it often results in a privilege log that is of marginal utility at best. See *Mitchell v. Nat'l R.R. Passenger Corp.*, 208 F.R.D. 455, 461 (D.D.C. 2002) (“While FED. R. CIV. P. 26(b)(5) requires what lawyers call a ‘privilege log,’ I have held that such logs are nearly always useless. Instead, defendants will now be required to submit all documents as to which a privilege is claimed, to chambers for an *in camera* review.”); see also *Avery Dennison Corp. v. Four Pillars*, 190 F.R.D. 1, 2 (D.D.C. 1999) (noting that “counsel rarely provides more than minimal information in the logs they submit”). The immense volume of electronic documents now being poured into the litigation process exacerbates this unavoidable problem.

One solution that parties should consider at the outset is to agree to accept privilege logs that will initially classify categories or groups of withheld documents, while providing that any ultimate adjudication of privilege claims if challenged will be made on the basis of a document-by-document review. The basis for this approach is the 1993 rules amendment comment to Rule 26(b)(5), which states:

The rule does not attempt to define for each case what information must be provided when a party asserts a claim of privilege or work product protection. Details concerning time, persons, general subject matter, etc., may be appropriate if only a few items are withheld, but may be unduly burdensome when voluminous documents are claimed to be privileged or protected, particularly if the items can be described by categories.

FED. R. CIV. P. 26, Advisory Committee Notes 1993. An agreement at the outset of litigation to log privileged documents by category that provides for a fair and full defense of individual privilege claims if challenged, will reduce motion practice regarding log deficiencies and other procedural challenges that are becoming more common given the huge volume of documents at issue.

### Comment 3.c. Preservation of Expert Witness Drafts and Materials

The obligation to preserve and produce electronic data may apply to expert witness testimony. The 1993 amendments to Rule 26(a)(2)(B) require the disclosure of all “information considered by the [expert] in forming the [expert’s] opinion.” Under this standard, courts have held that the failure to preserve data and information could lead to sanctions and exclusion of testimony. See, e.g., *Trigon Ins. Co. v. United States*, 204 F.R.D. 277, 282-84, 289-91 (E.D. Va. 2001) (finding that government had duty to preserve correspondence between experts and consultants, including drafts of expert reports; that the destruction of such evidence was intentional, warranting sanctions for spoliation of evidence; and that an adverse inference against the experts’ testimony and their credibility in general was warranted). It is not hard to imagine that litigants will quickly adapt the electronic spoliation disputes of document discovery to the realm of expert witness disclosures (for example, requests for all of the electronic copies of expert witness reports, for access to the expert’s hard drive to search for deleted data, or requests for access to all e-mail accounts of the expert).

Because of this potential for dispute, and recognizing that the issue will almost always affect both parties, the best course for the parties is to discuss, early in the case, the issue of which expert witness materials need to be preserved and exchanged in accordance with Rule 26(a)(2)(B). If an agreement cannot be reached, it is far preferable to approach the court with a sensible solution early in a disputed motion than to face accusations of evidence spoliation later.



4. *Discovery requests should make as clear as possible what electronic documents and data are being asked for, while responses and objections to discovery should disclose the scope and limits of what is being produced.*

#### Comment 4.a. Requests for Production Should Clearly Specify What Documents are Being Requested

A requesting party that believes in good faith that particular electronic documents should be reviewed by the producing party in responding to document requests should request those documents clearly and with particularity.

Such discovery requests should go beyond boilerplate definitions seeking all e-mail, databases, word processing files, or whatever other electronic documents the requesting party can generally describe. Instead, the request should target particular electronic data that the requesting party contends is important to resolve the case. By identifying relevant documents, parties can avoid the sort of blanket, burdensome requests for electronic documents that invite blanket objections and judicial intervention.

The requesting party should also identify the form in which it wishes the data to be produced. *See* TEX. R. CIV. P. 196.4 (“To obtain discovery of data or information that exists in electronic or magnetic form, the requesting party must specifically request production of electronic or magnetic data and specify the form in which the requesting party wants it produced.”).

#### Comment 4.b. Rule 34 Responses and Objections

Rule 34 responses and objections should indicate that reasonable steps have been taken to produce responsive electronic data and documents. If production has not been made from all reasonably available sources of electronic documents and data, a respondent should tender appropriate objections based upon existing production efforts, cost, burden, overbreadth of the request, and/or other factors.

It is neither reasonable, feasible, nor required under Rule 34 to produce every file or message that might potentially be relevant to every issue in the litigation. It should be reasonable, for example, to limit searches for messages to the e-mail accounts of key witnesses in the litigation, for the same reasons that it has been regarded as reasonable to limit searches for paper documents to the paper files of key individuals. Likewise, it should be appropriate, absent unusual circumstances, to limit review for production to those sources most likely to contain unique, relevant data and information (such as active files or removable media used by key employees). The better practice is to specify such limitations in the responses so that any disputes can be addressed and resolved early.

#### Comment 4.c. Disclosure of Collection Parameters

It is usually not feasible, and may not even be possible, for most business litigants to collect and review all data from their computer systems in connection with discovery. The extraordinary effort that would be required to do so could cripple many businesses. Yet, without appropriate guidelines, if any data is omitted from a production, an organization may be accused of withholding data that should have been produced. Unnecessary controversy over peripheral discovery issues can often be avoided at the outset by discussion by the parties of the potential scope and related costs of collecting relevant data.

5. *The obligation to preserve electronic data and documents requires reasonable and good faith efforts to retain information that may be relevant to pending or threatened litigation. However, it is unreasonable to expect parties to take every conceivable step to preserve all potentially relevant data.*

#### Comment 5.a. Scope of Preservation Obligation

The common law duty to preserve evidence clearly extends to electronic documents. Indeed, the vast majority of information upon which businesses operate today is generated electronically, and much of this information is never printed to paper. Therefore, organizations must take reasonable steps to preserve electronic documents for litigation, whether pending or reasonably anticipated.

The preservation obligation necessarily involves two related questions: (1) when does the duty to preserve attach, and (2) what evidence must be preserved. *Zubulake v. UBS Warburg LLC*, No. 02 Civ. 1243, 2003 WL 22410619, at \*2 (S.D.N.Y. Oct. 22, 2003) (“*Zubulake IV*”). The first inquiry remains unchanged in the world of electronic data and documents, although the need to recognize when a duty arises may be more important in light of the volatility of certain data.

The second inquiry is a much greater challenge regarding electronic data and documents. The obligation to preserve relevant evidence is generally understood to require that the producing party make reasonable efforts to identify and manage the relevant information readily available to it. Satisfying this obligation must be balanced against the right of a party to continue to manage its electronic information in the best interest of the enterprise, even though some electronic information is necessarily overwritten on a routine basis by various computer systems. If such overwriting is incidental to the operation of the systems—as opposed to a deliberate attempt to destroy evidence in anticipation of or in connection with an investigation or litigation—it should be permitted to continue after the commencement of litigation. See Martin H. Redish, *Electronic Discovery and the Litigation Matrix*, 51 Duke L.J. 561, 621 (2001) (“(1) Electronic evidence destruction, if done routinely in the ordinary course of business, does not automatically give rise to an inference of knowledge of specific documents’ destruction, much less intent to destroy those documents for litigation-related reasons, and (2) to prohibit such routine destruction could impose substantial costs and disruptive burdens on commercial enterprises.”); see also *Concord Boat Corp. v. Brunswick Corp.*, No. LR-C-95-781, 1997 WL 33352759, at \*4 (E.D. Ark. Aug. 29, 1997) (“[T]o hold that a corporation is under a duty to preserve all e-mail potentially relevant to any future litigation would be tantamount to holding that the corporation must preserve all e-mail.”). But see 7 MOORE’S FEDERAL PRACTICE Section 37A.12[5][e] (Matthew Bender 3d ed.) (“The routine recycling of magnetic tapes that may contain relevant evidence should be immediately halted on commencement of litigation.”).

At a minimum, organizations need not preserve every shred of paper, every e-mail or electronic document, and every backup tape. See *Zubulake IV* at \*3. To declare otherwise would “cripple large corporations” who are almost always involved in litigation. Id. A reasonable balance must be struck between (1) an organization’s duty to preserve relevant data, and (2) an organization’s need, in good faith, to continue operations.

*Illustration i.* L Corporation (“L Corp.”) routinely backs up its e-mail system every day and recycles the backup tapes after two weeks. Discovery is served relating to a product liability claim brought against L Corp. arising out of the design of products sold one year ago. L Corp. promptly

and appropriately notifies all employees involved in the design, manufacture, and sale of the product to save all documents, including e-mails relating to the issues in the litigation, and the legal department takes reasonable steps to ensure that all relevant evidence has, in fact, been preserved. L Corp. continues its policy of recycling backup tapes while the litigation is pending. Absent awareness of a reasonable likelihood that specific unique and relevant information is contained only on a backup tape, there is no violation of preservation obligations, because the corporation has an appropriate policy in place and the backup tapes are reasonably considered to be redundant of the data saved by other means.

#### Comment 5.b. Organizations Must Prepare for Electronic Discovery to Reduce Cost and Risk

The main purpose of an organization's computer system is to assist the organization in its business activities. Nonetheless, the need to respond to discovery in litigation is a fact of life for many organizations.

The costs of responding to requests for discovery of information contained in computer systems can be best controlled if the organization takes steps ahead of time to prepare computer systems, and users of these systems, for the potential demands of litigation.

Such steps include instituting defined, orderly procedures for preserving and producing potentially relevant documents and data, and establishing processes to identify, locate, retrieve, preserve, review, and produce data that may be responsive to discovery requests or required for initial mandatory disclosures. Preparing for electronic discovery can also help the corporation accurately present the cost and burden of specific discovery requests to the court, control the costs of reasonable steps to produce data, and avoid the risk of failing to preserve or produce evidence from computer systems.

*Illustration i.* Med Corporation ("Med") is a manufacturer of pharmaceutical products. Med has established a three-week rotation for system backups. One of Med's products, LIT, is observed to cause serious adverse reactions in a number of patients, and the FDA orders it withdrawn from the market. Anticipating the potential for claims relating to LIT, Med's litigation department collects all potentially relevant information from employees. The litigation response system helps Med identify and quickly move to preserve all potentially relevant data, including e-mail, user files, corporate databases, shared network areas, public folders, and other repositories. The process results in relevant data being collected on a special litigation database server that is independent of normal system operations and backups.

Eight months later, a class action is filed against Med for LIT injuries. Plaintiff's counsel obtains an *ex parte* order requiring Med to save all of its backup tapes, to refrain from using any auto-deletion functions on e-mail and other data, pending discovery, or to reformat or reassign hard drives from employees involved in any way with LIT. Med's Information Systems department estimates that the order would cost at least \$150,000 per month to comply with, including the cost of new tapes, reconfiguration of backup procedures and tape storage, purchase and installation of additional hard drive space for accumulating e-mail and file

data, and special processing of hard drives when computers are upgraded or employees leave the company or are transferred.

Med promptly moves for relief from the order, demonstrating through its documented data collection process that the relevant data has been preserved, and that the requested modifications of its systems are unnecessary due to the preservation efforts already in place. The court withdraws its order and Med is able to defend the litigation without impact on normal operations of its computer systems or excessive electronic discovery costs.

#### Comment 5.c. Corporate Response Regarding Litigation Preservation

Ordinarily, organizations should identify and define preservation obligations at the outset of litigation. Due to the dynamic nature of electronic data, delay in taking preservation steps may increase the danger of claims that evidence was not preserved. Early preservation steps can also prevent unnecessary disputes over retention issues.

The duty to comply with a preservation obligation is an affirmative duty. The scope of what is necessary will, of course, vary widely between and even within organizations depending upon the nature of the claims and information at issue. *See Zubulake v. UBS Warburg LLC*, No. 02 Civ. 1243, 2003 WL 22410619, at \*3 (S.D.N.Y. Oct. 22, 2003) (“In recognition of the fact that there are many ways to manage electronic data, litigants are free to choose how this task [of retaining relevant documents] is accomplished.”). That said, organizations addressing preservation issues should carefully consider the future discovery demands for relevant data to avoid needless repetitive steps to capture data again in the future. *See In re Amsted Industries, Inc. “Erisa” Litig.*, 2002 WL 31844956, at \*2 (N.D. Ill. Dec. 18, 2002) (requiring defendants to “research their tapes under the broader subject matter and time period” ordered by the court).

Ideally, an effective means of retaining documents reasonably subject to the preservation obligation should be established as soon as practicable. An appropriate notice should be effectively communicated to an appropriate list of affected persons. (*See* Cmt. 5.d, *infra*.) Senior management or legal advisors may need to be involved in the retention decisions and processes, depending upon the particular circumstances. *Cf. In re Prudential Ins. Co. of Am. Sales Practices Litig.*, 169 F.R.D. 598, 615 (D.N.J. 1997) (court noted that “obligation to preserve documents that are potentially discoverable materials is an affirmative one that rests squarely on the shoulders of senior corporate officers” and found that particular nature of litigation and repeated failure of efforts to preserve documents warranted sanctions); *see also Danis v. USN Communications, Inc.*, No. 98 C 7482, 2000 WL 1694325, at \*38-41 (N.D. Ill. Oct. 20, 2002) (circumstances of case indicated insufficient involvement of management in proper oversight and delegation of preservation responsibilities).

#### Comment 5.d. Notice to Affected Persons

Upon determining that litigation or an investigation is threatened or pending and has triggered a preservation obligation, the organization should take reasonable steps to communicate to affected persons the need for and scope of preserving relevant records (both electronic and hard copy). The form, content and distribution of the notice will vary widely between and among organizations depending upon the circumstances, and there is no talisman.

The notice need not be a detailed catalog of information types to be retained. Instead, it should sufficiently describe the kinds of information that must be preserved so the affected custodians of data can segregate and preserve identified files and data. *See Wiginton v. CB Richard Ellis, Inc.*, No. 02 C 6832, 2003 WL 22439865, at \*5 (N.D. Ill. Oct. 27, 2003) (defendant was faulted for being too narrow when preservation communication to employees only instructed employees to save documents that “pertain to” the named plaintiff in a putative class action although various other employees and offices were identified in the complaint).

The notice should state that electronic as well as paper documents must be preserved. The notice might need to specifically address preservation of data in multiple locations (*e.g.*, network, workstation, laptop or other devices), depending upon the circumstances of the organization and the dispute. The notice need not demand preservation of all documents—only those affected by the preservation obligation.

Additionally, the preservation obligation, except in extreme circumstances, should not require the complete suspension of normal document management policies, including the routine destruction and deletion of records. The notice does not need to reach all employees, only those reasonably likely to maintain documents relevant to the litigation or investigation. In many cases, the notice should be sent to a person or persons responsible for the maintaining and operating computer systems or files that have no particular custodian or owner but may fall within the scope of the preservation obligation. *See id.* at \*2 (among other problems with preservation notice sent to employees was the defendant’s failure “to inform its director of network services that any electronic information should be retained”).

Communications should be accomplished in a manner reasonably designed to provide prominent notice to the recipients. Depending upon the scope and duration of the litigation, it may be advisable to repeat the notice periodically in at least one form or location. When preservation obligations apply to documents and data spanning a significant or continuing time period, organizations should analyze whether special steps are needed to deal with hardware that might be retired if it contains unique relevant documents.

*Illustration i.* Pursuant to its procedures for litigation response, upon receipt of notice of the claim, the organization reasonably identifies the departments and employees involved in the dispute. Those individuals whose files are reasonably likely to contain relevant documents and information are notified via e-mail of the dispute and are asked to take steps to retain documents (including electronic communications, data and records) that may be relevant to the litigation, which is described in the notice. The notice identifies a contact person who can address questions regarding preservation duties. The notice is also distributed to the identified Information Technology liaison, who works with management and legal counsel to identify any systems files or data that may be subject to the preservation obligation.

Parties also should consider whether notice must be sent to third parties, such as contractors and vendors who provide information technology services. This concern arises out of FED. R. CIV. P. 34, which frames a party’s obligation in terms of the possession, custody or control of documents. The responding party should set forth any objections to producing a document in the possession of third parties so that any disputes can be resolved early in the litigation.

### Comment 5.e. Preservation Obligation Not Ordinarily Heroic

Preservation orders should not impose heroic or unduly burdensome requirements on organizations with electronic documents.<sup>15</sup> A party may request, and a court can compel, the exercise of extraordinary efforts to preserve or produce electronic material that is not readily available in the ordinary course of business. However, this power to order extraordinary efforts should be exercised only where there is a substantial likelihood that the information exists in the form sought, that it would not remain in existence absent intervention, and that its preservation or production is likely to materially advance the interests of justice in the individual case. *See* FED. R. CIV. P. 26(b)(2) (“The frequency or extent of use of the discovery methods otherwise permitted under these rules and by any local rule shall be limited by the court if it determines that ... the burden or expense of the proposed discovery outweighs its likely benefit, taking into account the needs of the case, the amount in controversy, the parties’ resources, the importance of the issues at stake in the litigation, and the importance of the proposed discovery in resolving the issues.”).

*Illustration i.* A requesting party seeks an order, over objection, that backup tapes created during a relevant period should be preserved and restored. It develops sufficient proof to raise the likelihood that substantial amounts of deleted but relevant information existed in the time frame covered by the backup tapes. Before ruling on the merits of the request, the court should consider having the producing party restore and search a sample of the tapes to determine the likelihood that relevant and discoverable material, not otherwise available, can be recovered and that it is worthwhile to do so. If recovery of information from the backup tapes is ordered, the court should consider whether further use of sampling techniques would minimize the burdens on the producing party.

### Comment 5.f. Preservation Orders

In general, courts should not issue a preservation order unless the party requesting such an order demonstrates at a hearing the necessity of such an order. Because all litigants are obligated to preserve relevant documents in their possession, custody, or control, a party seeking a preservation order must first demonstrate a real danger of document destruction, the lack of any other available remedy, and that a preservation order is an appropriate exercise of the court’s discretion. *See Adobe Sys., Inc. v. Sun South Prods., Inc.*, 187 F.R.D. 636, 642-43 (S.D. Cal. 1999) (denying motion for temporary restraining order to permit immediate examination of defendant’s computers because of the technical difficulties of permanently destroying electronic documents); *Gorgen Co. v. Brecht*, No. C2-01-1715, 2002 WL 977467, at \*2-3 (Minn. Ct. App. May 14, 2002) (overturning temporary restraining order barring defendants from destroying or altering paper or electronic documents because plaintiff failed to demonstrate risk of irreparable harm).

Preservation orders may in certain circumstances aid the discovery process by defining the specific contours of the parties’ preservation obligations. In those circumstances, before a preservation order is issued, the parties should attempt to work out the scope and parameters of the preservation obligation through the meet and confer process. Preservation orders should be tailored to require preservation of documents and data that are potentially

<sup>15</sup> The 1999 ABA Civil Discovery Standards echo this conclusion, although the November 17, 2003 proposed amendments to this Standard omit this guidance entirely. *Compare ABA Civil Discovery Standards*, Standard 29(a)(iii) (1999) (“[A] party does not ordinarily have a duty to take steps to try to restore electronic information that has been deleted or discarded in the regular course of business ....”) with Nov. 17, 2003 proposed draft amendments to *ABA Civil Discovery Standards*.

relevant to the case, and should not unduly interfere with the normal functioning of the affected computer systems.

*Ex parte* preservation orders should be discouraged. Such orders violate the principle that responding parties are responsible for preserving and producing their own electronic documents and data. See Principle 6, *infra*. More generally, preservation orders should be issued rarely, and only in cases in which the standards for injunctive relief have been met. See *In re Potash Antitrust Litig.*, No. 3-93-197, MDL No. 981, 1994 WL 1108312, at \*7-8 (D. Minn. Dec. 5, 1994) (applying standard for injunctive relief to request for a preservation order); *Humble Oil & Refining Co. v. Harang*, 262 F. Supp. 39, 42-43 (E.D. La. 1966) (same). This is particularly important when dealing with electronic data that may be transitory and not susceptible to reasonable preservation measures. See *Dodge, Warren & Peters Ins. Servs., Inc. v. Riley*, 105 Cal. App. 4th 1414, 1418, 130 Cal. Rptr. 2d 385 (2003) (applying standards for injunctive relief to request to “freeze” defendants’ electronically stored data.)

Usually, neither the party seeking a preservation order nor the court will have a thorough understanding of the other parties’ computer system, the electronic data that is available, or the mechanisms in place to preserve that electronic data. For example, courts sometimes believe that backup tapes are inexpensive and that preservation of tapes is not burdensome. However, backup systems vary a great deal in this regard, and without information regarding the specifics of the backup system in use, it is difficult to tell what steps may be appropriate or inappropriate for data preservation purposes.

#### Comment 5.g. All Data Does Not Need to be “Frozen”

A party’s preservation obligation does not require freezing of all electronic documents and data, including e-mail. See *Zubulake v. UBS Warburg LLC*, No. 02 Civ. 1243, 2003 WL 22410619, at \*2 (S.D.N.Y. Oct. 22, 2003) (organizations need not preserve “every shred of paper, every e-mail or electronic document, and every back-up tape.”); see also *Wiginton v. CB Richard Ellis, Inc.*, No. 02 C 6832, 2003 WL 22439865, at \*4 (“A party does not have to go to extraordinary measures” to preserve all potential evidence ... [i]t does not have to preserve every single scrap of paper in its business.”) (citing *China Ocean Shipping (Group) Co. v. Simone Metals Inc.*, No. 97 C 2694, 1999 WL 966443, at \*3 (N.D. Ill. Sept. 30, 1999) and *Danis v. USN Communications, Inc.*, No. 98 C 7482, 2000 WL 1694325, at \*32 (N.D. Ill. Oct. 20, 2000)).

Civil litigation should not create the aura of a crime scene with forensic investigation employed at every opportunity. Theoretically, a party could preserve the contents of waste baskets and trash bins for evidence of statements or conduct. Yet, the burdens and costs of those acts are apparent and no one would typically argue that this is required. There should be a similar application of reasonableness to preservation of electronic documents and data.

Even though it may be technically possible to capture vast amounts of data during preservation efforts, this usually can be done only at massive cost. Data is maintained in a wide variety of formats, locations and structures. Many copies of the same data may exist in active storage, backup, or archives. Computer systems manage data dynamically, meaning that the data is constantly being cached, rewritten, moved and copied. For example, a word processing program will usually save a backup copy of an open document into a temporary file every few minutes, overwriting the previous backup copy. In this context, imposing an absolute requirement to preserve all information would require shutting down computer

systems and making copies of data on each fixed disk drive, as well as other media that are normally used by the system. Costs of litigation would routinely approach or exceed the amount in controversy in most lawsuits. In the ordinary course, therefore, the preservation obligation should be limited to those steps reasonably necessary to secure evidence for the fair and just resolution of the matter in dispute.

*Illustration i.* In a Freedom of Information Act (“FOIA”) action, the district court enters a preliminary injunction that the agency believes requires it to freeze all computers that could potentially contain documents subject to the FOIA dispute. In implementing the order, the agency determines that the categorical freeze on all agency hard drives requires the purchase of new equipment with each personnel change and wherever there are certain types of equipment malfunctions. The agency should approach the court for implementation of a more limited order so that only those computers that contain responsive records will be preserved and all others can be released for reuse. *See* July 10, 2002 Notice of Supplemental Instructions Regarding Preservation of Electronic Information, *Landmark Legal Foundation v. EPA*, No. 00-2338 (RCL) (D.D.C. July 10, 2002).

#### Comment 5.h. Disaster Recovery Backup Tapes

Absent specific circumstances, preservation obligations should not extend to disaster recovery backup tapes created in the ordinary course of business. *See McPeck v. Ashcroft*, 202 F.R.D. 31, 33 (D.D.C. 2001) (“There is certainly no controlling authority for the proposition that restoring all backup tapes is necessary in every case. The Federal Rules do not require such a search, and the handful of cases are idiosyncratic and provide little guidance.”).

When backup tapes exist to restore electronic files that are lost due to system failures or through disasters such as fires or tornadoes, their contents are, by definition, duplicative of the contents of active computer systems at a specific point in time. Thus, employing proper preservation procedures with respect to the active system should render preservation of backup tapes on a going-forward basis redundant. Further, because backup tapes generally are not retained for substantial periods, but are instead periodically overwritten when new backups are made, preserving backup tapes would require the time-consuming and costly process of reprogramming backup systems, manually exchanging backup tapes, and purchasing new tapes or hardware.

In some organizations, however, the concepts of backup and archive are not clearly separated, and backup tapes are retained for a relatively long period of time to provide for retention of files that may need to be accessed in the future. Backup tapes may also be retained for long periods of time out of concern for compliance with record retention laws. Under these circumstances, there is a possibility that the stored backup tapes contain the only remaining copy of data or documents that may be relevant in a case.

Organizations that use backup tapes for archival purposes should be aware that this practice is likely to cause substantially higher costs for evidence preservation and production in connection with litigation. *Compare Rowe Entm’t, Inc. v. The William Morris Agency, Inc.*, 205 F.R.D. 421, 429-30 (S.D.N.Y. 2002) (in determining whether to shift costs, considering “the purposes for which the responding party maintains the requested data,” because “[i]f a party maintains electronic data for the purpose of utilizing it in connection



with current activities, it may be expected to respond to discovery requests at its own expense”); *with Zubulake v. UBS Warburg LLC*, 217 F.R.D. 309, 321 (S.D.N.Y. 2003) (concluding that “the purposes for which the responding party maintains the requested data are typically unimportant,” which suggests that using backup tapes for archival purposes may not adversely affect the cost-shifting analysis).

Organizations seeking to preserve data for business purposes or litigation should, if possible, consider employing means other than traditional disaster recovery backup tapes. *Cf.* 26 C.F.R. 1234.24(c) (“[B]ackup tapes should not be used for recordkeeping purposes.”).

*Illustration i.* Pursuant to an information technology management plan, once each day a producing party routinely copies all electronic information on its systems and retains, for a short period of time, the resulting backup tape for the purpose of reconstruction in the event of an accidental erasure, disaster or system malfunction. A requesting party seeks an order requiring the producing party to preserve, and to cease reuse of, all existing backup tapes pending discovery in the case. Complying with the requested order would impose large expenses and burdens on the producing party, which are documented in factual submissions. No credible evidence is shown establishing the likelihood that, absent the requested order, the producing party will not produce all relevant information during discovery. The producing party should be permitted to continue the routine recycling of backup tapes in light of the expense, burden and potential complexity of restoration and search of the backup tapes.

Finally, if it is unclear whether there is a reasonable likelihood that unique, relevant data is contained on backup tapes, the parties and or the court may consider the use of sampling to better understand the data at issue. *See McPeck v. Ashcroft*, 212 F.R.D. 33, 36 (D.D.C. 2003) (declining to order searches of backup tapes where plaintiff had not demonstrated a likelihood of obtaining relevant information after review of sample; *cf. Zubulake v. UBS Warburg LLC*, 216 F.R.D. 280 (S.D.N.Y. 2003) (using sampling to determine that other backup tapes likely contained relevant data that should be produced)). Depending on the circumstances of the case, sampling may establish that there are few, if any, unique documents on the tapes and that there is no need for the tapes to be retained or restored. Similarly, sampling techniques may establish that it is reasonable to retain and restore only certain intervals of available tapes (such as every tenth tape) to satisfy the party’s good faith compliance with its preservation and production obligations. *See* Cmt. 11.c, *infra*.

#### Comment 5.i. Potential Preservation of Shared Data

An organization’s networks or intranet may contain shared areas (such as public folders, discussion databases and shared network folders) that are not regarded as belonging to any specific employee. Such areas containing potentially relevant data should be identified promptly and appropriate steps taken to preserve shared data that is relevant.

If an organization maintains archival data on tape or other offline media not accessible to end users of computer systems, steps should promptly be taken to preserve those archival media that are reasonably likely to contain relevant information not present as active data on the organization’s systems. These steps may include notifying persons responsible for managing archival systems to retain tapes or other media as appropriate.

6. *Responding parties are best situated to evaluate the procedures, methodologies and technologies appropriate for preserving and producing their own electronic data and documents.*

Comment 6.a. The Producing Party Should Determine the Best and Most Reasonable Way to Locate and Produce Relevant Documents in Discovery

It is the responsibility of the producing party to determine what is responsive to discovery demands and to make adequate arrangements to preserve and produce relevant information. See *Zubulake v. UBS Warburg LLC*, No. 02 Civ. 1243, 2003 WL 22410619, at \*3 (S.D.N.Y. Oct. 22, 2003) (noting there are various ways to manage electronic documents and thus many ways in which a party may comply with its obligations); cf. *In re Ford Motor Co.*, 345 F.3d 1315 (11th Cir. 2003) (stating that the producing party's choice to review database and only produce those relevant portions was adequate discovery response absent specific evidence to the contrary). Failure to do so in an organized and methodical fashion has led some courts to impose penalties upon the top officers responsible. See *Danis v. USN Communications, Inc.*, No. 98 C 7482, 2000 WL 1694325, at \*37 (N.D. Ill. Oct. 20, 2000) (listing elements of notification of discovery obligations not put into place).

Typically, the producing party identifies and informs the key individuals likely to have relevant information of the specific need to preserve all available relevant information. (This instruction is sometimes referred to as a "litigation hold order."). See Cmt. 5.d, *supra*. Thereafter, reasonable steps are taken to facilitate production of documents, after review for privilege, trade secrets, or other appropriate bases for non-production.

There is no principled reason to require more intrusive efforts merely because the party seeking discovery is suspicious of the efforts undertaken by the producing party. See *McCurdy Group, LLC v. American Biomedical Group, Inc.*, 9 Fed. Appx. 822, 831 (10th Cir. 2001) (affirming denial of motion to compel production of hard drives based on that party's expression of skepticism that all relevant and non-privileged documents had been produced).

Comment 6.b. Scope of Electronic Data Collection

When responding to discovery requests, organizations should define the scope of the data needed to appropriately and fairly address the issues in the case and to avoid unreasonable overbreadth, burden, and cost. Important steps in achieving the goal of reasonably limiting discovery may include collecting data from repositories used by key players rather than generally searching through the entire corporate computer system; defining the set of data to be collected by applying reasonable selection criteria, including search terms, date restrictions, or folder designations; and avoiding collection efforts that are out of proportion to or are inappropriate in the context of a particular litigation.

Discovery should not be permitted to continue indefinitely merely because a discovering party can point to undiscovered documents when there is no evidence that those documents are relevant to the case. See *Fennell v. First Step Designs, Ltd.*, 83 F.3d 526, 532-33 (1st Cir. 1996) (affirming order denying electronic discovery where that discovery would be a "fishing expedition"); *Stallings-Daniel v. Northern Trust Co.*, No. 01 C 2290, 2002 WL 385566, at \*1 (N.D. Ill. Mar. 12, 2002) (refusing to reconsider denial of a request by plaintiff for an order permitting an expert to conduct an intrusive and detailed examination of discovery of defendant's e-mail system where the bases for the claims were "speculations").

*Illustration i.* A party seeking access to e-mail relevant to the case demands that it be permitted to copy and inspect the active e-mail accounts of all users. The request should be denied. The producing party is in the best position to determine how to comply with its discovery obligations. Electronic information that is not deemed relevant should not be subject to inspection by the requesting party. The Rules do not create the right to a fishing expedition merely because the information sought is in electronic form. The concept of relevance is no broader—or narrower—in the electronic context than in the paper context.

#### Comment 6.c. Rule 34 Inspections

Rule 34 inspections should be the exception and not the rule for discovery of electronic data. Usually, the issues in litigation relate to the informational content of the data held on computer systems, not the actual operations of the systems. Therefore, in most cases, if the producing party provides the informational content of the data, there is no need or justification for direct inspection of the respondent's computer systems. A Rule 34 inspection presents possible concerns such as:

- a) invading trade secrets;
- b) revealing other highly confidential information, such as personnel evaluations and payroll information, properly private to individual employees;
- c) encroaching upon confidential attorney-client communications and other confidential material prepared and organized by the party's attorneys;
- d) massively disrupting the ongoing business; and
- e) endangering the stability of operating systems, software applications, and electronic files if certain procedures or software are used inappropriately.

Further, Rule 34 inspections of electronic data are likely to be particularly ineffective. The standard form of production—in which the producing party identifies and produces responsive documents—allows the party with the greatest knowledge of the computer systems to search and utilize the systems to produce responsive documents. A Rule 34 inspection, in contrast, requires persons unfamiliar with the party's recordkeeping systems, hardware, and software to attempt to manipulate the systems.

Not only is such a process disruptive, it is less likely to be fruitful. Producing parties will most often be able to argue persuasively that their production of relevant information from computer systems and databases will be sufficient to discharge discovery obligations. *See In re Ford Motor Co.*, 345 F.3d 1315 (11th Cir. 2003) (vacating order allowing plaintiff direct access to defendant's databases).

To justify the onsite inspection of respondent's computer systems, a party should be required to demonstrate that there is a substantial need to discover information about the computer system and programs used (as opposed to the data stored on that system) and that there is no reasonable alternative to an onsite inspection. Any inspection procedure should be documented in an agreed upon (and/or court ordered) protocol and should be narrowly restricted to protect confidential information and system integrity and to avoid giving the discovering party access to data unrelated to the litigation.

Additionally, no inspection should be permitted to proceed until the producing party has had a fair opportunity to review the data subject to inspection. Where the requesting party makes the required showing to justify inspection of the other party's

systems, the data subject to inspection should be dealt with in a way to preserve the producing party's rights, for example, through the use of "neutral" court appointed consultants. *See* Cmt. 6.d and Illustration 9.b.ii, *infra*.

#### Comment 6.d. Use and Role of Consultants and Vendors

Responding parties may consider retaining consultants and vendors to assist them in preserving and producing their electronic data and documents. Due to the complexity of electronic discovery, many organizations rely on consultants to provide a variety of services, including helping plan discovery, performing specialized data processing, and engaging in forensic work. Such consultants can be of great assistance to parties and courts in providing technical expertise and experience with the collection, review, and production of electronic documents and data. *See also* Cmt. 10.c (Use of Special Masters and Court-Appointed Experts to Preserve Privilege).

However, standards for experts and consultants in this field have not yet fully developed. Parties and courts should carefully consider the experience and expertise of a potential consultant before his or her selection. Vendors offer a variety of software and services to assist with the electronic discovery process. Considerations in evaluating vendor software and services include the defensibility of the process in the litigation context, the cost, and the experience of the vendor.

At all times, counsel, clients, and vendors must understand the role of each in the discovery process. Thus, even if a vendor is retained to serve in a non-testifying role, everyone should be aware of the potential need for testimony if forensic or other technical expertise is applied to data to prepare it for review or production. Care should be taken to ensure that the vendor does not assume the role of a legal advisor, and all persons involved should understand which communications are protected under the attorney-client privilege, and which documents may be protected under a claim of attorney work product.

#### Comment 6.e. Documentation and Validation of Data Collection Procedures

In developing data collection procedures, organizations should consider the appropriate scope of the collection, the cost, burden and disruption of normal activities, and the defensibility of the process. All collection processes should be accompanied by documentation and validation appropriate to the needs of the particular case. Well-documented data collection and production procedures enable an organization to respond to challenges to the collection process and to avoid unintentionally collecting data that is not needed or overlooking data that should be collected.

The documentation should describe what is being collected, the procedures used and any steps used to validate the collection. This documentation should not be static but should be revised as the organization uses new or different technology.

Similarly, notice and instructions to end-users regarding collection of data should include clear descriptions of the information being sought; a reminder that the collection includes many types of electronic data; direction regarding where users should look for data; and the steps to follow in retrieving the data. Specifics will depend upon the organization's systems and the nature of the litigation.

7. *The requesting party has the burden on a motion to compel to show that the responding party's steps to preserve and produce relevant electronic data and documents were inadequate.*

Comment 7.a. Rule 37 Sets Forth Guidelines for Resolving Discovery Disputes

A party that receives a request for production of electronic documents may object to some or all of the request. If such objections are filed and the requesting party opts not to accept the objections, the requesting party must file a motion to compel pursuant to Rule 37. *See, e.g., GFI Computer Indus., Inc. v. Fry*, 476 F.2d 1, 3 (5th Cir. 1973) (“Plaintiffs’ remedy for incomplete or otherwise objectionable answers to interrogatories, and for failure to produce pursuant to a Rule 34 request, was to file a motion under Rule 37(a) for an order requiring defendant to answer and to produce documents for inspection.”).

In such a proceeding, the moving party has the burden of demonstrating that the responding party’s response to the discovery request, including its steps to preserve and produce electronic data and documents, was incomplete, and that additional efforts are warranted.

Comment 7.b. Discovery Against Third Parties Under Rule 45

The requesting party sometimes requests the same or similar materials from third parties under Rule 45 of the Federal Rules. In such cases, courts should balance the cost, burden, and need for imposing discovery burdens on third parties who may possess copies of such documents. *See Braxton v. Farmer’s Ins. Group*, 209 F.R.D. 651, 653 (N.D. Ala. 2002) (court quashed non-party subpoena for all documents, including e-mail and electronic documents, from insurance agents where insurance company defendant alleged it was able to produce materials (including e-mails) it had sent to agents and the discovering party failed to make a showing that the insurer’s production would be inadequate).

Requesting parties should be sensitive to the burdens that third-party discovery places on third-parties. Excessively broad electronic document production requests on third parties can lead to sanctions and liability under federal statutes protecting the privacy of electronic communications. *See Theofel v. Farey-Jones*, 341 F.3d 978 (9th Cir. 2003) (service of an overbroad, “patently unlawful” subpoena on a party’s ISP, which led to the disclosure of private and privileged communications, violated the Stored Communications Act, 18 U.S.C. Section 2701 *et seq.*, and the Computer Fraud and Abuse Act, 18 U.S.C. Section 1030).

8. *The primary source of electronic data and documents for production should be active data and information purposely stored in a manner that anticipates future business use and permits efficient searching and retrieval. Resort to disaster recovery backup tapes and other sources of data and documents requires the requesting party to demonstrate need and relevance that outweigh the cost, burden, and disruption of retrieving and processing the data from such sources.*

Comment 8.a. Scope of Search for Active and Purposely Stored Data

The scope of a search for relevant electronic data and documents must be reasonable. For example, potentially relevant information may be found in local and network computers, laptop computers, handheld storage devices (such as PDAs and flash memory drives), archive and backup data tapes, cellular phones, voice mail systems and closed-circuit television monitoring systems.

However, it is neither feasible nor reasonable to require that litigants immediately or always canvass all potential reservoirs of data in responding to preservation obligations and discovery requests. Many of the locations will contain redundant data, and many others may contain massive amounts of information not relevant to the claims and defenses in the case.

Accordingly, litigants and courts must exercise judgment, made upon reasonable inquiry and in good faith, regarding the active and purposely stored data locations that should be subject to preservation efforts. If the producing party is aware (or reasonably should be aware) that specific relevant information can only be obtained from a particular source, that data should be preserved for possible production absent agreement of the parties or order of the Court.

If potentially relevant documents exist in sources that are not in a “readily usable” format, cost-shifting may be most appropriate. See *Zubulake v. UBS Warburg LLC*, 217 F.R.D. 309, 319-20 (S.D.N.Y. 2003); Principle 13, *infra*.

#### Comment 8.b. Forensic Data Collection

Discovery should be limited to electronic data and documents that are relevant to the claims and defenses in the case. A requesting party should not be permitted to discover electronic data and documents that do not meet this standard, regardless of the technical feasibility of broader access.

Forensic data collection should not be required unless exceptional circumstances warrant the extraordinary cost and burden of such an approach. See *McPeck v. Ashcroft*, 212 F.R.D. 33, 36 (D.D.C. 2003) (declining to order searches of backup tapes where plaintiff had not demonstrated a likelihood of obtaining relevant information). However, a party could choose to meet certain preservation obligations by making or retaining copies of backup tapes. Cf. *Zubulake v. UBS Warburg LLC*, No. 02 Civ. 1243, 2003 WL 22410619, at \*3 (S.D.N.Y. Oct. 22, 2003) (noting possible use of “mirror-image” copies in conjunction with other steps to meet preservation obligations). In some cases, such copies may best preserve all possibly relevant data.<sup>16</sup> In any event, making forensic image backups of computers is only the first step of an expensive, complex, and difficult process of data analysis that can divert litigation into side issues involving the interpretation of ambiguous forensic evidence.

#### Comment 8.c. Outsourcing Vendors and Third Party Custodians of Data

Many organizations outsource all or part of their information technology systems or share data with third parties for processing or for other business purposes. In contracting for such services, organizations should consider how they will comply with their obligations to preserve and collect electronic data for litigation. If such activities are not within the scope of contractual agreements, costs may escalate and necessary services may be unavailable when needed. Parties also need to consider whether notice should be sent to third parties, such as contractors and vendors. This concern arises out of FED. R. CIV. P. 34, which allows discovery of documents in the possession, custody or control of a party.

*9. Absent a showing of special need and relevance, a responding party should not be required to preserve, review, or produce deleted, shadowed, fragmented, or residual data or documents.*

#### Comment 9.a. The Scope of Document Discovery under the Federal Rules

Although FED. R. CIV. P. 34 was amended in 1970 to add “data compilations” to the list of discoverable documents, there was no suggestion that “data compilations” was intended to turn *all* forms of “data” into a Rule 34 “document.” Cf. Shira A. Scheindlin &

<sup>16</sup> For example, forensic copies of hard drives may be useful where key employees leave employment under suspicious circumstances, or if theft or misappropriation of trade secrets or confidential information may be involved.

Jeffrey Rabkin, *Electronic Discovery In Federal Civil Litigation: Is Rule 34 Up To The Task?*, 41 B.C. L. Rev. 327, 372 (2000) (“Embedded data, Web caches, history, temporary, cookie and backup files—all of which are forms of electronically stored information automatically created by computer programs rather than by computer users—do not obviously fall within the scope of the term ‘documents.’”).

The best approach to understanding what is a document is to examine what information is readily available to the computer user in the ordinary course of business. If the employee can view the information, it should be treated as the equivalent of a paper “document.” Data that can be readily compiled into viewable information, whether presented on the screen or printed on paper, is also a “document” under Rule 34. However, data used by a computer system but hidden and never revealed to the user in the ordinary course of business should not be presumptively treated as a part of the “document,” although there are circumstances in which the data may be relevant and should be preserved and produced. *See* Cmt. 12.a, *infra*. Nor should data, such as deleted or residual data, that is not accessible except through forensic means be presumed to be a document that is discoverable in all circumstances. Such data may be discoverable under Rule 34, but the evaluation of the need for and relevance of such discovery should be separately analyzed on a case-by-case basis. *See, e.g., McPeck v. Ashcroft*, 202 F.R.D. 31, 33 (D.D.C. 2001) (court rejected notion that there is an absolute obligation to pursue potentially relevant data on backup tapes); *McPeck v. Ashcroft*, 212 F.R.D. 33, 35-37 (D.D.C. 2003) (rejecting 15 out of 16 of plaintiff’s demands for additional searches of backup tapes). At least one state court system—that of Texas—has adopted this viewpoint and created a presumption that heroic efforts to produce data are not ordinarily required. *See* Texas R. Civ. P. 196.4 (“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 its 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.”); Cmt. 5.e, *supra*.

*Illustration i.* A party demands that responsive documents, “whether in hard copy or electronic format,” be produced. The producing party objects to producing the documents in electronic format and states that production will be made through PDF or TIF images on CD-ROMs. The producing party assembles copies of the relevant hard copy memoranda, prints out copies of relevant e-mails and electronic memoranda, and produces them in a PDF or TIF format that does not include metadata. Absent a special request for metadata (or any reasonable basis to conclude the metadata was relevant to the claims and defenses in the litigation), and a prior order of the court based on a showing of need, this production of documents complies with the ordinary meaning of Rule 34.

*Illustration ii.* Plaintiff claims that he is entitled to a commission on a transaction, based upon an e-mail allegedly sent by the president of defendant corporation agreeing to the commission. Defendant asserts that there is no record of the e-mail being sent in its e-mail system or the logs of its Internet activity, and that the e-mail is not authentic. In these circumstances, it is appropriate to require production of not only the content of the questioned e-mail, but also of the e-mail header information and metadata, which can play a crucial role in determining whether the questioned message is authentic.

*Illustration iii.* Plaintiff alleges that the defendant engaged in a fraud regarding software development. The plaintiff shows that the computer program sold by defendant appears to incorporate plaintiff's source code. Plaintiff presents two copies of a letter allegedly sent on the same day to plaintiff, but the letters differ in a material manner. In this case, discovery of the source code data may be appropriate, as well as targeted discovery of any electronic drafts or metadata concerning the suspect letter.

#### Comment 9.b. Deleted Data and Residual Data

Absent specific circumstances, organizations should not have to preserve deleted or residual data. While most computer systems will have a plethora of data that could be "mined," there should not be routine authorization for such forensic recovery. If, as usual, deleted and residual data are not accessed by employees in the ordinary course of business, there is no reason to require the routine preservation of such data. The relevance of the data will be marginal at best in most cases, while the burdens involved will usually be great. In exceptional cases, however, there may be good cause for targeted preservation of deleted and residual data.<sup>17</sup>

Deleted and residual data, like papers discarded in the trash, may be subject to discovery and may even properly be described as a document under Rule 34. See *Antioch Co. v. Scrapbook Borders, Inc.*, 210 F.R.D. 645, 652 (D. Minn. 2002) ("[I]t is a well accepted proposition that deleted computer files, whether they be e-mails or otherwise, are discoverable."); *Rowe Entm't, Inc. v. The William Morris Agency, Inc.*, 205 F.R.D. 421, 428 (S.D.N.Y. 2002) (stating that "[e]lectronic documents are no less subject to disclosure than paper records"); *Simon Prop. Group L.P. v. mySimon, Inc.*, 194 F.R.D. 639, 640 (S.D. Ind. 2000) ("[C]omputer records, including records that have been 'deleted', are documents discoverable under FED. R. CIV. P. 34."). Thus, even if production of deleted or residual data is unwarranted, parties should communicate early about the possible relevance of deleted data in order to avoid costly and unnecessary preservation of deleted or residual data, on one hand, or claims of spoliation, on the other.

However, only exceptional cases will turn on "deleted" or "discarded" information (whether paper or electronic). Discovery efforts, agreements, and orders of the courts should reflect this fact. See *Concord Boat Corp. v. Brunswick Corp.*, No. LR-C-95-781, 1997 WL 33352759, at \*9 (E.D. Ark. Aug. 29, 1997) ("Fourteen days worth of e-mail, which might contain a few deleted e-mails, seems to hardly justify the expense necessary to obtain it. Similarly, even if earlier back up tapes containing 'snapshots' of the system were in existence, the potential limited gains from a search of such tapes would be outweighed by the substantial burden and expense of conducting the search. Accordingly, the Court finds that Defendant will not be required to restore and search any available back up tapes which might contain deleted [ ] e-mail."). But see *Munshani v. Signal Lake Venture Fund II, LP*, 13 Mass. L. Rptr. 732, No. 005529BLS, 2001 WL 1526954, at \*3-4 (Mass. Super. Ct. Oct. 9, 2001) (allowing use of court-appointed forensic consultant and determining that plaintiff had fabricated electronic documents based on testimony of that expert).

*Illustration i.* A party seeking relevant e-mails demands a search of inactive accounts, backup tapes, and hard drives for deleted materials. No showing

<sup>17</sup> Deleted data may at one time have been a "useful" document generated in the ordinary course of business that had value to the organization, although that value may have expired. However, this historic fact alone does not justify the retrieval and review of deleted or residual data. Absent specific evidence to the contrary, a presumption of regularity should apply that allows employees and organizations to properly and routinely delete or destroy documents that no longer have business value, so long as the documents are not subject to regulatory, investigatory or litigation preservation obligations.



of special need or justification is made for the extraordinary search. The request should be denied. Parties are not typically required to sequester and search the trash bin outside an office building after commencement of litigation; neither should they be required to preserve and produce deleted electronic information in the normal case.

*Illustration ii.* After a key employee leaves X Company (“X Co.,”) to work for a competitor, a suspiciously similar competitive product suddenly emerges from the new company. X Co. produces credible testimony that the former employee bragged about sending confidential design specifications to his new company computer, copying the data to a CD, and deleting the data so that the evidence would never be found. The court properly orders that, given the circumstances of the case, the requesting party has demonstrated the need for the computer to be produced for mirror image copying of its hard drive. If the defendant is not willing to undertake the expense of hiring its own reputable data recovery expert to produce all available relevant data, inspection of the computer’s contents by an expert working on behalf of X Co. may be justified, subject to appropriate orders to preserve privacy, to protect data, and to prevent production of unrelated or privileged material. Under a showing of special need, with appropriate orders of protection, extraordinary efforts to restore electronic information could also be ordered.

10. *A responding party should follow reasonable procedures to protect privileges and objections to production of electronic data and documents.*

Comment 10.a. Potential Waiver of Confidentiality and Privilege in Production

Because of the large volumes of documents and data typically involved when electronic data is produced, courts should consider entering orders protecting the parties against any waiver of privileges or protections due to the inadvertent production of documents and data.

Counsel should discuss the need for such a provision at the outset of litigation and should approach the court for entry of an appropriate non-waiver order.<sup>18</sup> Such an order should provide that the inadvertent disclosure of a privileged document does not constitute a waiver of privilege, that the privileged document should be returned (or there will be a certification that it has been deleted), and that any notes or copies will be destroyed or deleted.<sup>19</sup> Ideally, an agreement or order should be obtained before any production.

<sup>18</sup> The recently issued proposed amendments to the ABA Civil Discovery Standards reflect this recommendation. See Nov. 17, 2003 proposed *ABA Civil Discovery Standards* at Section 32(b).

<sup>19</sup> An example is in the Bridgestone/Firestone/Ford multi-district litigation from the Southern District of Indiana. The pertinent provision of the Case Management Order states:

In the event that a privileged document is inadvertently produced by any party to this proceeding, the party may request that the document be returned. In the event that such a request is made, all parties to the litigation and their counsel shall promptly return all copies of the document in their possession, custody, or control to the producing party and shall not retain or make any [copies]. Such inadvertent disclosure of a privileged document shall not be deemed a waiver with respect to that document or other documents involving similar subject matter.

*In re Bridgestone/Firestone, Inc., ATX, ATX II, and Wilderness Tires Prods. Liab. Litig.*, 129 F. Supp. 2d 1207, 1219 (S.D. Ind. 2001). Other courts prefer that such orders include a temporal qualification on the right to assert a claim of inadvertent production (*i.e.*, within a “reasonable time” or a “date certain” from production) as well as a qualification that the producing party must state that it employed good faith efforts to detect and prevent production of privileged or protected materials and that the document in question was inadvertently produced notwithstanding such efforts. The inclusion of such additional conditions may vary between jurisdictions and will likely depend on the anticipated magnitude of the production in the case.

### Comment 10.b. Protection of Confidentiality and Privilege Regarding Rule 34 Inspections

Special issues may arise with any request to inspect a computer system. Protective orders should be in place to guard against any release of proprietary, confidential information and protected personal data if a system is reviewed by the adversary or its expert.

Similar concerns exist regarding the potential disclosure of attorney-client privileged or work product information. There is no guarantee that a non-waiver order in one jurisdiction will be fully honored in another if protected information is disclosed. Accordingly, court-ordered inspections of computer systems should be used sparingly. Further, such orders should be narrowly tailored to the circumstances and accompanied by a sufficient protective order.

### Comment 10.c. Use of Special Masters and Court-Appointed Experts to Preserve Privilege

In certain circumstances, a court may find it beneficial to appoint a “neutral” person (*e.g.*, a special master or court-appointed expert) who can help mediate or manage electronic discovery issues. *See Antioch Co. v. Scrapbook Borders, Inc.*, 210 F.R.D. 645, 652-54 (D. Minn. 2002) (granting motion to appoint “neutral expert in computer forensics”); *Simon Prop. Group L.P. v. mySimon, Inc.*, 194 F.R.D. 639, 641-42 (S.D. Ind. 2000) (using appointed expert operating under constraints of protective order); *Dodge, Warren & Peters Ins. Servs., Inc.*, 105 Cal. App. 4th 1414, 1417, 130 Cal. Rptr. 385 (4 Dist. 2003) (affirming order that allowed inspection by court-appointed expert).

The December 1, 2003 amendment to Rule 53 (Special Masters) should help clarify the availability of special masters to federal courts for addressing electronic discovery issues in appropriate cases where the matters cannot be addressed effectively and timely by an available district judge or magistrate judge of the district. *See* FED. R. CIV. P. 53(a)(1)(C).

One immediate benefit of using such a court-appointed “neutral” third party is the probable elimination of privilege waiver concerns with respect to the review of information by that person. In addition, the “neutral” may be able to speed the resolution of disputes by fashioning fair and reasonable discovery plans based upon specialized knowledge of electronic discovery and/or technical issues with access to specific facts in the case.<sup>20</sup> *See id.*

Special care should be used in crafting the order of appointment (and any protective order) to precisely tailor the scope of appointment and protections against the disclosure or loss of any privileges or protections. It should also be noted such appointments likely will remain the exception and not the rule as most parties, through the disclosure and discovery process should be able to address electronic discovery issues and remaining disputes often can be decided by an available district court or magistrate judge of the district.

### Comment 10.d. Protection of Confidentiality and Privilege Regarding “Clawback” or “Quick Peek” Productions

Given the enormous volume of electronic documents generated and retained in today’s business environment, and in light of the demands of litigation, there is an increasing interest in production subject to so-called “clawback” agreements. *See, e.g., Zubulake v. UBS Warburg LLC*, 216 F.R.D. 280, 290 (S.D.N.Y. 2003) (“*Zubulake III*”) (“Indeed, many

<sup>20</sup> The proposed amendments to the ABA Civil Discovery Standards reflect this same notion. *See* Nov. 17, 2003 proposed *ABA Civil Discovery Standards* at Section 32(a), (c) and (e).

parties to document-intensive litigation enter into so-called ‘claw-back’ agreements that allow the parties to forego privilege review altogether in favor of an agreement to return inadvertently produced privileged documents.”).

In a “clawback” (or “quick peek”) production, documents are produced to the opposing party before or without a review for privilege, confidentiality, or privacy. The key component of such a production is the “clawback” agreement, in which the parties set stringent guidelines and restrictions to prevent the waiver of confidentiality and privilege. The assumption of the parties to such a “clawback” agreement is that if the requesting party finds a document that appears to be privileged, the producing party can “claw back” the document without having waived any privilege.

A “clawback” or “quick peek” procedure or order in civil litigation should not be lightly entered and should have the voluntary consent of the producing party. *See Murphy Oil USA, Inc. v. Fluor Daniel, Inc.*, No. Civ. A. 99-3564, 2002 WL 246439, at \*7 (E.D. La. Feb. 19, 2002) (noting that court cannot compel the disclosure of privileged communications in clawback arrangement). Despite the apparent advantage of reducing the costs of pre-production reviews for privilege and confidentiality (and maybe even responsiveness), there are a host of risks and problems that make “clawback” productions impracticable and, for most cases, ill-advised.

First, the voluntary production of privileged and confidential materials to one’s adversary, even in a restricted setting, is inconsistent with tenets of privilege law that, while varying among jurisdictions, usually require the producing party to meticulously guard against the loss of secrecy for such materials. *See In re Sealed Case*, 877 F.2d 976, 980 (D.C. Cir. 1989) (nearly any disclosure of the communication or document, even inadvertent, waives the privilege); *cf. Fleet Bus. Credit Corp. v. Hill City Oil Co.*, No. 01-02417, 2002 WL 31741282, at \*9-11 (W.D. Tenn. Dec. 5, 2002) (applying a number of factors to determine if inadvertent disclosure waived privilege and concluding that reviewing documents for privilege before disclosure, and then acting swiftly to correct inadvertent disclosure, preserved privilege). Thus, the fact that an adversary sees the voluntarily produced document in any circumstance may be argued to trigger the waiver or loss of protection.

Second, despite the strongest possible language in any “clawback” or “quick peek” order to protect against waiver of privileges and dissemination of information, there is no effective way to limit the arguments of non-parties regarding the legal effect of the production in other jurisdictions and forums. For example, parties in mass tort and product liability cases, who are subject to multiple suits by different counsel in different states, face the reality that their clawback agreement does not protect them from waiver arguments in another state, even if they have a strong protective order in the first state. Given the differences in of privilege laws among jurisdictions, this uncertainly presents a serious and legitimate impediment to any widespread acceptance of a “clawback” model.

Third, counsel has an ethical duty to zealously guard the confidences and secrets of the client. It is possible that questions could arise as to whether voluntarily entering into a “clawback” production could constitute a violation of Model Rules of Professional Conduct 1.1 (requiring a lawyer to use diligence and care in representation) or Model Rules of Professional Conduct 1.6 (protection of client secrets and confidences) if the manner of the production results in later waivers of privileges and protections. While this result may seem remote, it has already arisen in the content of inadvertent productions. *See D.C. Bar Ethics Opinion No. 256* (1995) (examining whether actions of producing counsel violated standard).

Fourth, there is a Pandora's box of issues regarding the possible rights of employees (privacy) and third parties (privacy and commercial trade secrets) that may be implicated in a voluntary "clawback" or "quick peek" production.

Given these concerns, and the due process issues attendant to the potential deprivation of privilege and property rights that could accompany a waiver determination, courts should not compel use of a "clawback" procedure over the objection of a producing party. Even when large volumes of electronic documents are involved, parties are well-advised to search for privileged documents<sup>21</sup> before production, while obtaining a court order that inadvertent production of privileged material does not waive privilege. *See, e.g., Medtronic Sofamor Danek, Inc. v. Michelson*, No. 01-2373, 2003 WL 21468573, at \*12 (W.D. Tenn. May 13, 2003).

In those very limited instances where a "clawback" or "quick peek" order may be practicable, the Court should enter an order that (1) indicates that the court is compelling the manner of production, (2) states such production does not result in an express or implied waiver of any privilege or protection for the produced documents or any other documents, (3) directs that the reviewing party cannot discuss the contents of the documents or take any notes during the review process, (4) permits the reviewing party to select those documents that it believes are relevant to the case, and (5) orders that for each selected document, the producing party either (a) produces the selected document, (b) places the selected document on a privilege log, or (c) places the selected document on a non-responsive log (i.e., regardless of the privileged status, the document is not relevant to the litigation.) *Cf. Murphy Oil*, No. Civ. A. 99-3564, 2002 WL 246439, at \*12 (outlining clawback protocol).<sup>22</sup>

*11. A responding party may satisfy its good faith obligation to preserve and produce potentially responsive electronic data and documents by using electronic tools and processes, such as data sampling, searching, or the use of selection criteria, to identify data most likely to contain responsive information.*

#### Comment 11.a. Search Methodology

In many cases, electronic data are found in broadly categorized folders such as an e-mail "inbox" or "outbox", or are otherwise not archived in a manner that can be used to readily identify responsive information. For example, selective use of key "concept" or word searches is a reasonable approach when dealing with large amounts of electronic data. Indeed, a principal advantage of electronic information is that high-speed methods exist to determine the existence of patterns of words, thereby allowing the narrowing of searches for relevant information. *See Lombardo v. Broadway Stores, Inc.*, 2002 WL 86810, at \*8 (Cal. App. Jan. 22, 2002) ("Broadway urges the hard copy payroll documents were the same as the computerized data. Not so. The hard copy may have contained the same information, but that information was not equally accessible.").

In appropriate circumstances, litigants may find it useful to discuss specific selection criteria, including search terms, to be used in searches of electronic data for production. Parties may be able to begin a dialogue on search methodologies as early as their Rule 26(f) conference.

<sup>21</sup> The search methods discussed in Principle 11, *infra*, in relation to searches for relevant documents may be useful to identify privileged documents as well.

<sup>22</sup> The proposed amendments to the ABA Civil Discovery Standards identify the "clawback" or "quick peek" alternative as a possible provision for a stipulated court order but do not discuss situations where it would be advisable, privilege waiver questions pertaining to other jurisdictions, whether a court could direct the procedure over an objection, or the other protections listed above in the event the parties stipulated to such an order. *See* Nov. 17, 2003 proposed *ABA Civil Discovery Standards* at Section 32(d)(ii) and (f).

Courts should encourage and promote the use of such techniques in appropriate circumstances. See *Tulip Computers Int'l B.V. v. Dell Computer Corp.*, No. Civ. A. 00-981, 2002 WL 818061, at \*4 (D. Del. Apr. 30, 2002) (“Tulip’s consultant will search the CD ROM on certain mutually agreed upon search terms that relate to the infringing products or to this case. Such terms may involve ‘Tulip’ or code words for the allegedly infringing models such as ‘STINGER,’ ‘MASH,’ or ‘HONEYCUT.’ If the search terms generate hits, Dell will review the documents and produce them to Tulip subject to the privilege and confidentiality designations provided under the protective order.”).

Courts can allow sampling techniques to refine the accuracy of searches and to reduce the cost of discovery. See *McPeek v. Ashcroft*, 202 F.R.D. 31, 34-35 (D.D.C. 2001). For example, sampling might determine that a very low percentage of files (such as e-mails and attachments) on a data tape contain terms that are responsive to “key” terms. This may weigh heavily against any need to further search that source, or it may be a factor in a cost shifting analysis. Sampling may also reveal substantial redundancy between sources (*i.e.*, duplicate data is found in both locations) such that it is reasonable for the organization to preserve and produce data from only one of the sources. See *Cmt. 11.c, infra*.

The scope of terms employed must be reasonably calculated to return relevant data. If not, courts may order additional searches, which will increase the cost and burden of discovery. For example, in *In re Amsted Industries, Inc. “Erisa” Litig.*, 2002 WL 31844956, at \*2 (N.D. Ill. Dec. 18, 2002), the court found that the defendants’ document production efforts, which involved word searches on 25 backup tapes of e-mail and the questioning of individuals regarding e-mails on their computers, were insufficient, and that additional searches not limited by defendants’ relevancy objections were required.

*Illustration i.* The active e-mail accounts of the individuals likely to have information relevant to litigation contain 10,000 individual e-mails from the relevant time period. Rather than read each one, the producing party uses a series of search terms that capture the key concepts in the allegations of the complaint. The producing party has satisfied its search obligations.

#### Comment 11.b. Sampling

Litigants should consider the use of sampling techniques when appropriate to narrow the burden of searching voluminous electronic data for relevant information. By reviewing an appropriate sample of a large body of electronic information, litigants can often determine the likelihood that a more comprehensive review of the materials will yield useful information.

For example, in *McPeek v. Ashcroft*, 202 F.R.D. 31 (D.D.C. 2001), Magistrate Judge Facciola ordered the “backup restoration of the e-mails attributable to” a particular individual’s computer during a one-year period. *Id.* at 34. Judge Facciola viewed this restoration as “a test run,” *id.*, which would allow the court and the parties to better determine whether a further search of the backup tapes was justified. Upon reviewing the results of the sample restoration, Judge Facciola held that further restoration of backup tapes was largely unjustified, and ordered very limited discovery of e-mails contained on backup tapes. See *McPeek v. Ashcroft*, 212 F.R.D. 33, 37 (D.D.C. 2003); see also *Zubulake v. UBS Warburg LLC*, 217 F.R.D. 309, 324 (S.D.N.Y. 2003) (“Requiring the responding party to restore and produce responsive documents from a small sample of backup tapes will inform the cost-shifting analysis.”).

### Comment 11.c. Consistency of Manual and Automated Collection Procedures

Both manual and automated procedures for collection may be appropriate in particular situations. Whether manual or automated, the procedures must be directed by legal counsel to assure compliance with discovery obligations.

Manual collection involves selecting items that are potentially relevant to a given litigation. This selection can be performed by the document authors or custodians themselves, by litigation support or information services personnel, or by others. In a manual collection, the items may be copied or transmitted by the end-user. This should be accomplished under a defined protocol.

Automated collection involves using computerized processes to collect data meeting certain criteria, such as search terms, file and message dates, or folder locations. Automated collection can be integrated with an overall electronic data archiving or retention system, or it can be implemented using agents specifically designed to retrieve information on a case-by-case basis. Regardless of the method chosen, consistency across the production can help ensure that responsive documents have been produced as appropriate.

*12. Unless the producing party knows that particular metadata is material to the resolution of a dispute, there is no obligation to preserve and produce metadata absent agreement of the parties or order of the court.*

### Comment 12.a. Metadata

An electronic document usually includes not only the visible text but also hidden text, formatting codes, formulae, and purposefully generated metadata associated with the document. Much of it can be described as data that tells the computer how to display the document (for example, the proper fonts, spacing, size and color). Depending on the circumstances of the case, particular metadata may be critical or completely irrelevant.

Other embedded data reflects information intentionally created by the user or by the organization's information management system. Such information may, for example, track the title of the document, the user identification of the computer that created it, the assigned data owner, and other document "profile" information. Often this information is not significant to the resolution of a dispute, but there are situations where it may be important.

When a document is printed (or saved in an image format), much of the "display" of the document is preserved, but not the hidden metadata. Some of the metadata existing in a computer file can be routinely accessed by users; other metadata is not routinely accessible. Sometimes the metadata is inaccurate, as when a form document reflects a standard "author" who created the template but did not draft the document.

Although there are exceptions to every rule, especially in an evolving area of the law, there should be a modest legal presumption in most cases that the producing party need not take special efforts to preserve or produce metadata.<sup>23</sup> It is likely to remain the exceptional situation in

<sup>23</sup> The vitality of this presumption is reflected in the D.C. Circuit Court of Appeals' opinion in *Pub. Citizen v. Carlin*, 184 F.3d 900, 908-11 (D.C. Cir. 1999), *cert. denied*, 529 U.S. 1003 (2000). The plaintiffs there challenged the Archivist of the United States' promulgation of a General Records Schedule which allowed the disposal of word processing and electronic mail files located in personal computers once they were copied to a paper or electronic recordkeeping system. *Inter alia*, the plaintiffs argued that the "print and retain" option obliterated valuable metadata which improperly diminished the value of the records in question. The Court of Appeals rejected these arguments and, in reversing the district court, held that the value of electronic retention must be balanced against the feasibility of doing so, the funds and resources available for records management, and the operating needs of the custodial agencies. *Id.* at 910 ("... we think [the Archivist's] decision to permit agencies to maintain their recordkeeping systems in the form most appropriate to the business of the agency is reasonable. [There is no] claim that agencies have a legal duty to establish electronic recordkeeping systems."). The court also noted that the Archivist interpreted the regulation to require the retention of information preserving the "context, structure and context" of the record (*i.e.*, material information) and there was no reason to conclude the Archivist's view was plainly erroneous. *Id.* at 910-11.

which metadata must be produced. See, e.g., *Munshani v. Signal Lake Venture Fund II, LP*, 13 Mass. L. Rptr. 732, No. 005529BLS, 2001 WL 1526954, at \*3-4 (Mass. Super. Ct. Oct. 9, 2001) (court found that plaintiff had fabricated documents based upon testimony of court-appointed forensic consultant who revealed fraud in creation of proffered e-mail evidence).<sup>24</sup>

Notwithstanding this legal presumption, the routine preservation and production of metadata may be beneficial in a number of ways. First, the preservation and production of metadata may provide better protection against inadvertent or deliberate modification of evidence by others. Second, preserving documents in their native electronic format usually preserves the associated metadata without incurring additional steps or costs. Third, the systematic removal or deletion of certain metadata may involve significant additional costs that are not justified by any tangible benefit. Fourth, the failure to preserve and produce metadata may deprive the producing party of the opportunity to later contest the authenticity of the document if the metadata would be material to that determination.

Balanced against these factors is the reality that most of the metadata has no evidentiary value, and any time (and money) spent reviewing it is a waste of resources. However, since certain metadata could contain or reveal privileged, secret, or other sensitive information, an organization may determine that it must review such metadata before producing it.

Thus, a reasonable balance is that, unless the producing party is aware (or should reasonably be aware) that particular metadata is relevant, the producing party should have the option of producing all, some or none of the metadata.<sup>25</sup> In most cases, responding parties will reasonably choose to produce some or all of the metadata because of potential relevance or cost considerations. Of course, if the producing party knows or should reasonably know that particular metadata is relevant to the dispute, it should be produced.

In short, litigants and courts need to scrutinize the claims and defenses before determining how to handle metadata. Organizations should not automatically discount the potential benefits of retaining metadata to ensure the documents are authentic and to preclude the fraudulent creation of evidence. Finally, parties should consider discussing at the outset of litigation the need to preserve and produce metadata.

#### Comment 12.b. Formats Used for Collecting Data

The appropriate format for collection should be determined after considering the nature of the litigation. Parties should carefully consider whether converting electronic documents to other formats would impose unnecessary costs on the producing party. Also, because electronic data (e.g., metadata) can sometimes be altered by converting formats or by copying the data, parties should document their process of collecting and producing electronic documents to ensure that the documents can later be authenticated if needed at trial.

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<sup>24</sup> Much of the information that can be retrieved from metadata is less relevant and necessary than the information that can be retrieved from paper documents. For example, certain metadata, such as metadata reflecting prior revisions to a document, can be analogized to paper drafts. There is authority supporting the proposition that paper drafts are rarely needed to prove the point in contention. Indeed, one court (speaking in the paper context) noted:

Drafts, by their very nature, rarely satisfy the test of relevance . . . Absent extrinsic evidence tending to show the relevance of a particular draft, production of these documents is likely to lead only to wasteful fishing expeditions concerning the identification and deciphering of handwriting and the reasons for immaterial revisions.

*Grossman v. Schwarz*, 125 F.R.D. 376, 385 (S.D.N.Y. 1989).

<sup>25</sup> *Cf. John C. Montaña, Legal Obstacles to E-Mail Destruction* at 32 (ARMA International Education Foundation, Oct. 19, 2003) ("In view of the fact that courts in [various] jurisdictions are prepared to accept printouts into evidence, and that the governments themselves view printout-based e-mail retention as a legitimate means of carrying out their mandated records management duties, it appears that, unless a specific legal requirement with a clear contrary indication applies, paper-based retention of e-mail is an acceptable course of action.")

### Comment 12.c. Production of Electronic Data and Documents Should Only be Required in One Format

Electronic data should be produced in a form that preserves the substantive information of the data relevant to the claims and defenses in the action. Ordinarily parties should only be required to produce documents in one format.

Absent specific objection, agreement of the parties, or order of the court, producing electronic data in a commonly accepted image format (paper, PDF, or TIF) should be sufficient in most cases.<sup>26</sup> Similarly, absent specific objection, agreement of the parties or order of the court, data that is not ordinarily viewable when normally printed need not be produced. In certain cases, it may be preferable and more cost-effective to produce in an electronic format.

Often the parties will be able to agree upon a format of production during their Rule 26 conference. Sometimes the requesting party will specify the format it seeks in its Rule 34 request for production of documents. In such cases, the responding party may produce the documents in the requested format or may lodge an objection under the Federal Rules of Civil Procedure. It is best for the requesting party to identify at the outset a preferred manner of production so that agreement can be reached or so that disputes can be adjudicated before production. The format chosen should allow the parties to verify the genuineness and authenticity of the documents for evidentiary purposes.

A party should not be required to produce documents in both hard copy and electronic format. *See, e.g., McNally Tunneling Corp. v. City of Evanston*, No. 00 C 6979, 2001 WL 1568879, at \*4 (N.D. Ill. Dec. 10, 2001) (denying motion to compel production of computer files that had already been produced in hard copy form where requesting party only offered vague assertions supporting its need for electronic version); *Williams v. Owens-Illinois, Inc.*, 665 F.2d 918, 932-33 (9th Cir. 1982) (same). *But see Anti-Monopoly, Inc. v. Hasbro, Inc.*, No. 94 Civ. 2120, 1995 WL 649934, at \*2 (S.D.N.Y. Nov. 3, 1995) (“[P]roduction of information in ‘hard copy’ documentary form does not preclude a party from receiving that same information in computerized/electronic form.”). If a court requires production of documents a second time in a different format, the court should consider shifting the costs of production to the requesting party. *See In re Air Crash Disaster at Detroit Metro. Airport on August 16, 1987*, 130 F.R.D. 634, 636 (E.D. Mich. 1989) (requiring requesting party to bear costs of creating copies of data in electronic form).

*13. Absent a specific objection, agreement of the parties or order of the court, the reasonable costs of retrieving and reviewing electronic information should be borne by the responding party, unless the information sought is not reasonably available to the responding party in the ordinary course of business. If the data or formatting of the information sought is not reasonably available to the responding party in the ordinary course of business, then, absent special circumstances, the costs of retrieving and reviewing such electronic information should be shifted to the requesting party.*

### Comment 13.a. Factors for Cost-Shifting

The ordinary and predictable costs of discovery are fairly borne by the producing party. However, Rule 26(b) empowers courts to shift costs where the demand is unduly

<sup>26</sup> It is important to remember that the vast majority of civil cases involve only a small amount of discovery and there is no good reason to require that all cases involve meticulous electronic discovery absent a particular need in specific circumstances. *Cf.* Thomas E. Willging, John Shapard, Donna Stienstra, & Dean Miletich, *Discovery and Disclosure Practice, Problems, and Proposals for Change: A Case-based National Survey of Counsel in Closed Federal Civil Cases* (Federal Judicial Center, 1997) (providing statistical analysis of use of discovery devices and frequency of disputes).



burdensome because of the nature of the effort involved to comply. If a court requires retrieval of information that is not reasonably available, it should also adjudicate the need for cost shifting. *See Rowe Entm't, Inc. v. The William Morris Agency, Inc.*, 205 F.R.D. 421, 431 (S.D.N.Y. 2002) (“[A] party that happens to retain vestigial data for no current business purposes, but only in case of an emergency or simply because it has neglected to discard it, should not be put to the expense of producing it.”).

Absent special circumstances, costs of electronic discovery involving extraordinary effort or resources to restore data to an accessible format should be allocated to the requesting party. For example, restoring deleted data, disaster recovery tapes, residual data, or legacy systems may involve such extraordinary efforts or resources.

The *Rowe* court laid out eight factors to use in determining whether to shift the costs of discovery to the requesting party: the specificity of the requests, the likelihood of a successful search, the availability of the materials from other sources, the purpose of the retention, the benefit to the parties, the total costs, the ability to control costs, and the parties’ resources. *See Rowe*, 205 F.R.D. at 429-31.

These factors provide a useful tool to enable courts and litigants to analyze the circumstances under which the expenses of discovery exceed those that a responding party should reasonably be expected to bear. *See also ABA Civil Discovery Standards*, Standard 29(b)(iii)(1999) (“The discovering party generally should bear any special expenses incurred by the responding party in producing requested electronic information.”);<sup>27</sup> Texas R. Civ. P. 196.4 (“If the court orders the responding party to comply with the request [for materials not available to the responding party in the ordinary course of business], the court must also order that the requesting party pay the reasonable expenses of any extraordinary steps required to retrieve and produce the information.”); *Medtronic Sofamor Danek, Inc. v. Michelson*, No. 01-2373, 2003 WL 21468573, at \*2-9 (W.D. Tenn. May 13, 2003) (applying *Rowe* factors); *Murphy Oil USA, Inc. v. Fluor Daniel, Inc.*, No. Civ. A. 99-3564, 2002 WL 246439, at \*5-8 (E.D. La. Feb. 19, 2002) (same).

The factors announced in *Rowe* were revised and refined by Judge Shira Scheindlin in *Zubulake v. UBS Warburg LLC*, 217 F.R.D. 309 (S.D.N.Y. 2003) (“*Zubulake I*”). Judge Scheindlin began by holding that “whether production of documents is unduly burdensome or expensive turns primarily on whether it is kept in an *accessible* or *inaccessible* format.” *Id.* at 318. Data is in an accessible format if it can be easily retrieved and processed. Such data includes active data, near-line data, and archival data. Data in an inaccessible format is “not readily usable.” *Id.* at 318-19. Inaccessible data includes backup tapes and deleted, fragmented, or damaged data. For accessible data, cost-shifting is not appropriate. *Id.* at 319.

For inaccessible data, however, Judge Scheindlin concluded that a set of factors similar to those in *Rowe* should determine whether the court should shift costs to the requesting party. Those factors, in the order of importance, are:

1. The extent to which the request is specifically tailored to discover relevant information;
2. The availability of such information from other sources;
3. The total cost of production, compared to the amount in controversy;
4. The total cost of production, compared to the resources available to each party;
5. The relative ability of each party to control costs and its incentive to do so;

<sup>27</sup> The proposed amendments to the ABA Civil Discovery Standards omit this guidance and instead set forth a list of factors to be considered. *See* Nov. 17, 2003 proposed *ABA Civil Discovery Standards* Section 29(b)(iii).

6. The importance of the issues at stake in the litigation; and
7. The relative benefits to the parties of obtaining the information.

*Id.* at 322. *Zubulake I* stands to become a major precedent in the law of the cost-shifting for electronic discovery.

There remains a significant open question as to whether the “total cost of production” factor should include the estimated costs of reviewing retrieved documents for privilege, confidentiality and privacy purposes. The *Zubulake III* decision (*Zubulake v. UBS Warburg LLC*, 216 F.R.D. 280 (S.D.N.Y. 2003)) excludes the cost of production (e.g., review for privilege) from consideration,<sup>28</sup> but Rule 26 does not so narrowly define the burdens that can be considered by a court in the proportionality analysis. The inclusion/exclusion of such figures can greatly affect the outcome of the balancing test and, in light of the broad considerations mandated in Rules 26(b)(2) and 26(c)<sup>29</sup> and the potentially enormous costs of privilege review of voluminous electronic materials, it may be appropriate to shift some of the privilege review costs to the requesting party in certain circumstances. See *Chimie v. PPG Indus. Inc.*, 218 F.R.D. 416, 421-22 & n.7 (D. Del. 2003) (court found that in circumstances of case “and despite the magnitude of the labor” it was necessary “for PPG to log all arguably relevant documents for which it claims privilege” covering a 20 year period but added that “[t]he costs associated with searching for documents over such an extended period are open to further discussion. It may be that some cost sharing is warranted.”).

#### Comment 13.b. Cost-Shifting Cannot Replace Reasonable Limits on the Scope of Discovery

Shifting the costs of extraordinary efforts to preserve or produce electronic information should not be used as an alternative to sustaining a responding party’s objection to undertaking such efforts in the first place. Instead, such efforts should only be required where the requesting party demonstrates substantial need or justification.

In shifting discovery costs, the courts should discourage burdensome requests that have no reasonable prospect, given the size of the case, of producing material assistance to the fact finder. See *Stallings-Daniel v. Northern Trust Co.*, No. 01 C 2290, 2002 WL 385566, at \*1 (N.D. Ill. Mar. 12, 2002) (denying request for discovery where “[n]othing in the documents produced justifies an intrusive and wholly speculative electronic investigation into defendant’s e-mail files.”).

*Illustration i.* A requesting party demands that the producing party preserve, restore, and search a backup tape for information about a topic in dispute. The requesting party produces some evidence that relevant information, not available elsewhere, may exist on the tape. The information, not being readily available, is costly to acquire and the

<sup>28</sup> *Zubulake III*, 216 F.R.D. at 290 (“the responding party should always bear the cost of reviewing and producing electronic data once it has been converted to an accessible form”); see also *Computer Assocs. Int’l, Inc. v. Quest Software, Inc.*, No. 02 C 4721, 2003 WL 21277129, at \*2 (N.D. Ill. June 3, 2003) (refusing to shift costs of privilege review of computer hard drives prior to production of hard drive images to requesting party because costs of privilege review for paper documents would not be shifted).

<sup>29</sup> Rule 26(b)(2) grants broad discretion to the trial court to guide discovery, and the court is empowered to limit the frequency and/or extent of discovery sua sponte or on motion by a party under Rule 26(c). FED. R. CIV. P. 26(b)(2). Rule 26(c) specifies a non-exclusive list of provisions that could be adopted in a protective order, including:

- (1) that the disclosure or discovery not be had;
- (2) that the disclosure or discovery may be had only on specified terms and conditions, including a designation of the time or place;
- (3) that the disclosure or discovery may be had only by a method of discovery other than that selected by the party seeking discovery;
- (4) that certain matters not be inquired into, or that the scope of the disclosure or discovery be limited to certain matters;
- (5) that discovery be conducted with no one present except persons designated by the court;

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(7) that a trade secret or other confidential research, development, or commercial information not be revealed or revealed only in a designated way[.]

\*\*\*  
FED. R. CIV. P. 26(c).

producing party seeks a protective order conditioning its production upon payment of costs, including the costs of review. *See* TEX. R. CIV. P. 196.4. Absent proof that the producing party has intentionally deleted information that is relevant to the issues in the case, the protective order should be granted and the requesting party should pay for the costs associated with the request.

14. *Sanctions, including spoliation findings, should only be considered by the court if, upon a showing of a clear duty to preserve, the court finds that there was an intentional or reckless failure to preserve and produce relevant electronic data and that there is a reasonable probability that the loss of the evidence has materially prejudiced the adverse party.*

#### Comment 14.a. Knowing, Willful, and Reckless Violations of Preservation Obligations

Due to the complexity of modern computer systems, the large volumes of electronic data, and the continuing changes in information technology, there exists a potential for good faith errors or omissions in the process of preserving and producing electronic information. Neither spoliation findings nor sanctions should issue without proof of a knowing violation of an established duty to preserve or produce electronic data or a reckless disregard for a preservation obligation.<sup>30</sup>

A spoliation finding should require that there be a willful or reckless disregard of an existing discovery order, subpoena, preservation order, or similar preservation obligation. *See New York State Nat'l Org. for Women v. Cuomo*, No. 93 Civ. 7146, 1998 WL 395320, at \*2-3 (S.D.N.Y. July 14, 1998) (rejecting sanctions for destroyed computer databases where there was no evidence of bad faith or that plaintiffs were prejudiced by the loss); *see also Stevenson v. Union Pac. R.R. Co.*, \_\_\_ F.3d \_\_\_, 2003 WL 23104550 at \*4-7 (8th Cir. Jan. 5, 2004) (adverse inference instruction (sanction) should not be given on the basis of negligence alone; there must be a finding of bad faith or some other culpable conduct, such as the ongoing destruction of documents during litigation and discovery even after they have been specifically requested). *Cf. Lewy v. Remington Arms Co.*, 836 F.2d 1104, 1112 (8th Cir. 1988) (“[A] court should consider the following factors before deciding whether to give the [spoliation] instruction to the jury. First, the court should determine whether Remington’s record retention policy is reasonable considering the facts and circumstances surrounding the relevant documents. Second, in making this determination the court may also consider whether lawsuits concerning the complaint or related complaints have been filed, the frequency of such complaints, and the magnitude of the complaints. Finally, the court should determine whether the document retention policy was instituted in bad faith.”).

Ordinarily, the court should not impose sanctions unless the responding party has violated specific restrictions set forth in a court order. *See Kucala Enterprises, Ltd. v. Auto Wax Co.*, No. 02 C 1403, 2003 WL 22433095 (N.D. Ill. Oct. 27, 2003) (adopting Magistrate’s recommended dismissal of plaintiff’s claim (as well as award of fees and expenses) when plaintiff used “Evidence Eliminator” software to delete information on his computer’s hard drive in violation of protective order and after court had granted defendant’s motion to compel inspection of the hard drive; district court modified Magistrate’s recommended dismissal of non-infringement and allowed defense of counterclaim of infringement in light of the fact that proof for such claims exists outside of evidence deleted but nevertheless conditioned exception

<sup>30</sup> This area of law is somewhat unsettled and harmonization of all decisions is difficult. That said, the assessment of sanctions is made along a “continuum of fault—ranging from innocence through the degrees of negligence to intentionality” and counsel should note that certain courts have held that “an adverse inference may be appropriate in some cases involving the negligent destruction of evidence.” *See Residential Funding Corp.*, 306 F.3d at 108; *see also* Cmt. 14.b (“Negligent” vs. “Culpable” Spoliation).

on the requirement that plaintiff make all discovery forthwith going forward); *Metro. Opera Ass'n. v. Local 100, Hotel Employees & Rest. Employees Int'l Union*, 212 F.R.D. 178 (S.D.N.Y. 2003) (holding that defendant and its counsel acted willfully and in bad faith in failing to comply with discovery by systematically failing to preserve and produce documents, including disposing of several computers after receiving notice that plaintiff intended to forensically examine those computers, and entering a finding of liability against defendant and awarding attorneys' fees based on discovery abuses). *But see Linnen v. A.H. Robins Co.*, 10 Mass. L. Rptr. 189, No. 97-2307, 1999 WL 462015, at \*10 (Mass. Sup. Ct. June 16, 1999) (obligation to cease recycling of backup tapes arose by inference after *ex parte* order governing same was lifted because plaintiff had served broad discovery request on defendant).

Untimely challenges to non-production of information should not, however, provide a basis for a motion for sanctions. *Allen Pen Co. v. Springfield Photo Mount Co.*, 653 F.2d 17, 23 (1st Cir. 1981).

Illustration i. A party seeks "documents" in discovery and makes no objection to the production of electronic materials without metadata. Shortly before trial, it files a motion for sanctions and an adverse instruction based on the failure to produce metadata. Having not raised the issue earlier, the party has waived the right to seek metadata or sanctions.

#### Comment 14.b. "Negligent" vs. "Culpable" Spoliation

A number of courts have invoked the tort concept of negligence in addressing spoliation of evidence claims. It is critical, however, to understand that establishing a standard of care (*e.g.*, negligence) does *not* answer the question of whether any sanction is warranted. In particular, the focus should be on culpability: *i.e.*, in the circumstances of the present case, should a party bear culpability (and consequences) for the loss of electronic data? "Culpability" may include what could be considered "negligent conduct," but it does *not* equate all such conduct with an entitlement to sanctions even if the data is lost. For example, failing to take reasonable steps to ensure a good faith effort to preserve relevant electronic data may lead to spoliation instructions or other sanctions. *See Stevenson v. Union Pac. R.R. Co.*, \_\_\_ F.3d \_\_\_, 2003 WL 23104550, at \*4-7 (8th Cir. Jan. 5, 2004) (adverse inference instruction for pre-litigation destruction of evidence through a document retention program cannot be based on negligence alone but requires a finding of bad faith; facts of case supported finding of bad faith pre-litigation destruction of voice tape and the failure to suspend routine destruction of track maintenance records after commencement of suit and receipt of document requests was sanctionable warranting adverse inference instructions, but the absence of evidence of bad faith regarding pre-litigation destruction of track maintenance records rendered inference instruction on loss of those records inappropriate and an abuse of discretion);<sup>31</sup> *Residential Funding Corp. v. DeGeorge Fin. Corp.*, 306 F.3d 99, 108 (2nd Cir.

<sup>31</sup> The *Stevenson* Court explained the distinction between negligent and culpable conduct that would warrant an adverse inference instruction in the circumstances of the case:

In *Lewy*, we were called upon to address the prelitigation destruction of documents pursuant to a routine document retention policy, but the record was insufficient for us to decide whether the trial court erred by giving the adverse inference instruction. [836 F.2d at 1112] Consequently, we set forth ... guidelines for the court to consider on remand, and they include a bad faith consideration. *See id.* By way of example, and as dicta, we also stated that if a corporation "knew or should have known that the documents would become material at some point in the future then such documents should have been preserved." *Id.* In support of this proposition, however, we quoted *Gumbs v. Int'l Harvester, Inc.*, 718 F.2d 88, 96 (3d Cir. 1983), which states that the adverse inference from the destruction of evidence arises only where the destruction was intentional "and indicates a fraud and a desire to suppress the truth, and it does not arise where the destruction was a matter of routine with no fraudulent intent." Thus, while in dicta we articulated a "knew or should have known" negligence standard, such a standard, standing alone, would be inconsistent with the bad faith consideration and the intentional destruction required to impose an adverse inference for the prelitigation destruction of documents. We have never approved of giving an adverse inference instruction on the basis of prelitigation destruction of evidence through a routine document retention policy on the basis of negligence alone. Where a routine document retention policy has been followed in this context, we now clarify that there must be some indication of an intent to destroy the evidence for the purpose of obstructing or suppressing the truth in order to impose the sanction of an adverse inference instruction. *See Lewy*, 836 F.2d at 1112.

*Stevenson v. Union Pac. R.R. Co.*, 2003 WL 23104550, at \*5 (footnote omitted).

2002) (holding that sanctions may be appropriate for negligent failure to take adequate steps to preserve and produce documents in a timely manner); *Wiginton v. CB Richard Ellis, Inc.*, No. 02 C 6832, 2003 WL 22439865, at \*7 (N.D. Ill. Oct. 27, 2003) (“[O]nce a party is put on notice that specific relevant documents are scheduled to be destroyed according to a routine document retention policy, and the party does not act to prevent that destruction, at some point it has crossed the line between negligence and bad faith. At that point we must find that the reason for the destruction becomes because the party knew that relevant evidence was contained in the documents and wanted to hide the adverse information, rather than because the documents were scheduled to be destroyed.”).<sup>32</sup> If a party has specifically requested documents in electronic format, allowing those documents to be destroyed, even if hard copies of those documents still exist, can lead to sanctions. *See Lombardo v. Broadway Stores, Inc.*, 2002 WL 86810, at \*8 (Cal. App. Jan. 22, 2002) (affirming sanctions award for allowing and concealing loss of electronic files and rejecting the argument that there was no spoliation when paper copies of the documents still existed).

#### Comment 14.c. Prejudice

A party seeking sanctions should be required to prove that there is a reasonable likelihood the party has been materially prejudiced by the act complained of. *See, e.g., Zubulake v. UBS Warburg LLC*, No. 02 Civ. 1243, 2003 WL 22410619, at \*6 (S.D.N.Y. Oct. 22, 2003) (“In order to receive an adverse inference instruction, Zubulake must demonstrate not only that UBS destroyed relevant evidence as that term is ordinarily understood, but also that the destroyed evidence would have been favorable to her.”); *Concord Boat Corp. v. Brunswick Corp.*, No. LR-C-95-781, 1997 WL 33352759, at \*7 (E.D. Ark. Aug. 29, 1997) (holding that destruction of “tangentially relevant” e-mail would not justify imposition of sanctions); *Allen Pen Co. v. Springfield Photo Mount Co.*, 653 F.2d 17, 24 (1st Cir. 1981) (destruction of evidence that could be obtained from other sources does not support adverse inference sanction); *cf. Residential Funding Corp. v. DeGeorge Fin. Corp.*, 306 F.3d 99, 112-13 (2nd Cir. 2002) (court held that, absent a showing of prejudice, the jury’s verdict in favor of the producing party should not be disturbed on remand but that court could nevertheless consider discovery sanctions if it found that the producing party acted “with a culpable state of mind”).

An award of sanctions without a showing of prejudice is particularly inappropriate in the context of electronic discovery, which often involves searching through many thousands or even many millions of files and messages. Given the volumes of data involved, such processes are bound to be imperfect, and data can be inadvertently missed in the discovery process.

If a party believes it may be sanctioned for failing to produce data, even when the failure did not prejudice the opponent, producing parties will have incentives to produce a vastly over-inclusive set of data to guarantee that every conceivably relevant item is included. Such a result would impose unnecessary costs on both the requesting party and the producing party. Neither the letter nor the spirit of the discovery rules requires this approach.

#### Comment 14.d. The Good Faith Destruction of Documents in Compliance with a Reasonable Records Management Policy Should Not be Considered Sanctionable Conduct Absent Reasonable Notice to the Organization of a Duty to Preserve the Documents.

<sup>32</sup> In *Wiginton*, the court noted that the defendant could have taken steps to search for electronic documents but did not and concluded that the “complete failure to perform any search rises above the level of mere negligence, and this willful blindness in the context of the facts surrounding the destruction of the documents, leads us to find that the documents were destroyed in bad faith.” *Wiginton v. CB Richard Ellis, Inc.*, No. 02 C 6832, 2003 WL 22439865, at \*7 (N.D. Ill. Oct. 27, 2003) (court also noted that “bad faith” was not a precondition to the imposition of sanctions).

Where a party destroys documents in good faith under a reasonable records management policy, no sanctions should attach. Of course, this does not mean a party with a records management policy may destroy documents with impunity as long as that destruction has a basis in the policy. To the contrary, “[t]he duty to preserve material evidence arises not only during litigation but also extends to that period before the litigation when a party reasonably should know that the evidence may be relevant to anticipated litigation.” *Silvestri v. General Motors Corp.*, 271 F.3d 583, 591 (4th Cir. 2001). Once an organization reasonably anticipates that documents in its possession may be relevant to reasonably foreseeable litigation, the organization should preserve those documents, even if a records management program calls for the routine destruction of those documents. As one court recently noted, this requires answering two separate questions: “*when* does the duty to preserve attach, and *what* evidence must be preserved.” *Zubulake v. UBS Warburg LLC*, No. 02 Civ. 1243, 2003 WL 22410619, at \*2 (S.D.N.Y. Oct. 22, 2003).

Failure to properly preserve documents may result in sanctions, including monetary fines, instructions to the jury commanding them to infer that the destroyed documents would be adverse to the interests of the responding party, and, in extreme cases, default judgments. *See, e.g., Carlucci v. Piper Aircraft Corp.*, 102 F.R.D. 472 (S.D. Fla. 1984) (“Having determined that Piper intentionally destroyed documents to prevent their production, the entry of a default is the appropriate sanction.”). Therefore, an organization’s records management policy should recognize that the organization will sometimes have to suspend its ordinary retention and disposition of records, and should include procedures designed to implement such suspensions.

However, if a party does not reasonably anticipate litigation, the destruction of documents in compliance with a reasonable records management policy should not be considered sanctionable conduct. Instead, the fact that the destruction occurred in compliance with a preexisting policy should be considered *prima facie* evidence of the good faith of the organization. Thus, for example, in *Vick v. Texas Employment Commission*, the plaintiff alleged that there should be an adverse inference against the defendant for the improper destruction of records. 514 F.2d 734 (5th Cir. 1975). The court denied the claim, holding that:

[The] records on Vick were destroyed before trial, apparently pursuant to Commission regulations governing disposal of inactive records. Vick’s argument is unpersuasive. The adverse inference to be drawn from destruction of records is predicated on bad conduct of the defendant ... There was indication here that the records were destroyed under routine procedures without bad faith and well in advance of Vick’s service of interrogatories. Certainly, there were sufficient grounds for the trial court to so conclude.

*Id.* at 737. As one commentator has noted, “in the absence of a duty to preserve records, courts have consistently refused to sanction parties who have destroyed records pursuant to a records retention program.” Donald S. Skupsky and John C. Montaña, *Law, Records and Information Management* at 134 (1994).<sup>33</sup>

<sup>33</sup> It should be noted that even in a circumstance where an adverse inference instruction (sanction) may be appropriate, the party should be allowed an opportunity “to put on some evidence of its document retention policy and how it affected the destruction of the requested records as an innocent explanation for its conduct.” *Stevenson v. Union Pac. R.R. Co.*, \_\_\_ F.3d \_\_\_, 2003 WL 23104550 at \*7 (district court abused its discretion by not allowing reasonable rebuttal to inference; “[a]bsent this opportunity, the jury is deprived of sufficient information on which to base a rational decision of whether to apply the adverse inference, or an otherwise permissive inference easily becomes an irrebuttable presumption.”).

## APPENDIX A: GLOSSARY

**Active Data:** Active Data is information residing on the direct access storage media of computer systems, which is readily visible to the operating system and/or application software with which it was created and immediately accessible to users without undeletion, modification or reconstruction.

**Archival Data:** Archival Data is information that is not directly accessible to the user of a computer system but that the organization maintains for long-term storage and record keeping purposes. Archival data may be written to removable media such as a CD, magneto-optical media, tape or other electronic storage device, or may be maintained on system hard drives in compressed formats.

**Backup Data:** Backup Data is information that is not presently in use by an organization and is routinely stored separately upon portable media, to free up space and permit data recovery in the event of disaster.

**Backup Tape:** *See* Disaster Recovery Tape.

**Backup Tape Recycling:** Backup Tape Recycling describes the process whereby an organization's backup tapes are overwritten with new backup data, usually on a fixed schedule (*e.g.*, the use of nightly backup tapes for each day of the week with the daily backup tape for a particular day being overwritten on the same day the following week; weekly and monthly backups being stored offsite for a specified period of time before being placed back in the rotation).

**Computer Forensics:** Computer Forensics is the use of specialized techniques for recovery, authentication, and analysis of electronic data when a case involves issues relating to reconstruction of computer usage, examination of residual data, authentication of data by technical analysis or explanation of technical features of data and computer usage. Computer forensics requires specialized expertise that goes beyond normal data collection and preservation techniques available to end-users or system support personnel.

**Data Mining:** "Data Mining" generally refers to techniques for extracting summaries and reports from an organization's databases and data sets. In the context of electronic discovery, this term often refers to the processes used to cull through a collection of electronic data to extract evidence for production or presentation in an investigation or in litigation. Data mining can also play an important role in complying with data retention obligations under an organization's formal document management policies.

**De-Duplication:** De-Duplication ("De-Duping") is the process of comparing electronic records based on their characteristics and removing duplicate records from the data set.

**Deleted Data:** Deleted Data is data that, in the past, existed on the computer as live data and which has been deleted by the computer system or end-user activity. Deleted data remains on storage media in whole or in part until it is overwritten by ongoing usage or "wiped" with a software program specifically designed to remove deleted data. Even after the data itself has been wiped, directory entries, pointers, or other metadata relating to the deleted data may remain on the computer.

**Deletion:** Deletion is the process whereby data is removed from active files and other data storage structures on computers and rendered inaccessible except using special data recovery

tools designed to recover deleted data. Deletion occurs in several levels on modern computer systems: (a) File level deletion: Deletion on the file level renders the file inaccessible to the operating system and normal application programs and marks the space occupied by the file's directory entry and contents as free space, available to reuse for data storage. (b) Record level deletion: Deletion on the record level occurs when a data structure, like a database table, contains multiple records; deletion at this level renders the record inaccessible to the database management system (DBMS) and usually marks the space occupied by the record as available for reuse by the DBMS, although in some cases the space is never reused until the database is compacted. Record level deletion is also characteristic of many e-mail systems. (c) Byte level deletion: Deletion at the byte level occurs when text or other information is deleted from the file content (such as the deletion of text from a word processing file); such deletion may render the deleted data inaccessible to the application intended to be used in processing the file, but may not actually remove the data from the file's content until a process such as compaction or rewriting of the file causes the deleted data to be overwritten.

**Disaster Recovery Tape:** Disaster Recovery Tapes are portable media used to store data that is not presently in use by an organization to free up space but still allow for disaster recovery. May also be called "Backup Tapes."

**Distributed Data:** Distributed Data is that information belonging to an organization which resides on portable media and non-local devices such as home computers, laptop computers, floppy disks, CD-ROMs, personal digital assistants ("PDAs"), wireless communication devices (*e.g.*, Blackberry), zip drives, Internet repositories such as e-mail hosted by Internet service providers or portals, web pages, and the like. Distributed data also includes data held by third parties such as application service providers and business partners.

**Document:** *See* Rule 34 of the Federal Rules.

**Electronic Mail:** Electronic Mail, commonly referred to as e-mail, is an electronic means for communicating information under specified conditions, generally in the form of text messages, through systems that will send, store, process, and receive information and in which messages are held in storage until the addressee accesses them.

**Forensic Copy:** A Forensic Copy is an exact bit-by-bit copy of the entire physical hard drive of a computer system, including slack and unallocated space.

**Fragmented Data:** Fragmented data is live data that has been broken up and stored in various locations on a single hard drive or disk.

**Instant Messaging ("IM"):** Instant Messaging is a form of electronic communication which involves immediate correspondence between two or more users who are all online simultaneously.

**Legacy Data:** Legacy Data is information in the development of which an organization may have invested significant resources and which has retained its importance, but which has been created or stored by the use of software and/or hardware that has been rendered outmoded or obsolete.

**Metadata:** Metadata is information about a particular data set which may describe, for example, how, when, and by whom it was received, created, accessed, and/or modified and how it is formatted. Some metadata, such as file dates and sizes, can easily be seen by users;



other metadata can be hidden or embedded and unavailable to computer users who are not technically adept. Metadata is generally not reproduced in full form when a document is printed. (Typically referred to by the less informative shorthand phrase “data about data,” it describes the content, quality, condition, history, and other characteristics of the data.)

**Migrated Data:** Migrated Data is information that has been moved from one database or format to another, usually as a result of a change from one hardware or software technology to another.

**Pointer:** A pointer is an index entry in the directory of a disk (or other storage medium) that identifies the space on the disc in which an electronic document or piece of electronic data resides, thereby preventing that space from being overwritten by other data. In most cases, when an electronic document is “deleted,” the pointer is deleted, which allows the document to be overwritten, but the document is not actually erased.

**Residual Data:** Residual Data (sometimes referred to as “Ambient Data”) refers to data that is not active on a computer system. Residual data includes (1) data found on media free space; (2) data found in file slack space; and (3) data within files that has functionally been deleted in that it is not visible using the application with which the file was created, without use of undelete or special data recovery techniques.

**Sampling:** Sampling usually (but not always) refers to the process of statistically testing a data set for the likelihood of relevant information. It can be a useful technique in addressing a number of issues relating to litigation, including decisions as to which repositories of data should be preserved and reviewed in a particular litigation, and determinations of the validity and effectiveness of searches or other data extraction procedures. Sampling can be useful in providing information to the court about the relative cost burden versus benefit of requiring a party to review certain electronic records.

## APPENDIX B: AUTHORITIES CITED

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## APPENDIX C:

SUGGESTED CITATION FORMAT  
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*The Sedona Principles* (2004), 5 *Sedona Conf. J.* at p. 151 *et seq.* (2004).

It may be appropriate to cite specific pages, principles, or comments. For example:

*The Sedona Principles: Best Practices, Recommendations & Principles for Addressing Electronic Document Discovery* 3-4 (Sedona Conference Working Group Series 2004).

*The Sedona Principles*, Principle 11.

*The Sedona Principles*, Cmt. 5.e.

*The Sedona Principles*, 5 *Sedona Conf. J.* 151, p\_\_ (2004).

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1 = Attended October 2002 Annual WG Meeting  
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APPENDIX E:  
BACKGROUND ON THE SEDONA CONFERENCE<sup>SM</sup>  
& ITS WORKING GROUP SERIES

The Sedona Conference<sup>SM</sup> is a nonprofit, 501(c)(3) research and education institute dedicated to the advancement of law and policy in the areas of antitrust, complex litigation and intellectual property rights. The Sedona Conference<sup>SM</sup> meets that goal in part through the stimulation of ongoing dialogues among leaders of the bench and bar in each area under study. To that end, The Sedona Conference<sup>SM</sup> hosts three major conferences each year in unique, retreat-like settings. Fifteen of the nation's finest jurists, attorneys, academicians and others prepare written materials for, and lead the discussions during, each two-day conference.

What sets our conferences apart from all other legal study programs is the quality and intensity of the dialogues, generating cutting-edge analyses. To ensure the proper environment for this level of interaction, each conference is strictly limited to 45 experienced participants in addition to the faculty (who remain and participate throughout the entire conference). The best of the written materials are then published annually in *The Sedona Conference Journal*, which is distributed on a complimentary basis to courthouses and public law libraries around the country and by subscription to others. The Journal is also available on Westlaw and is listed in H.W. Wilson's Index to Legal Periodicals. The Sedona Conference<sup>SM</sup> has received broad and strong accolades from participants since its inception. (See "Raves" section of our website).

The Sedona Conference<sup>SM</sup> Working Group Series is designed as a bridge between our advanced legal conferences and an open think-tank model that can produce authoritative works designed to stimulate the development of the law. Working Groups in the Series begin with the same high caliber of participants as our regular season conference faculty and participants. The total "active" Group, however, is limited to less than 40 (though anyone can join The Working Group Membership Program to gain access to an individual Working Group's work area). The Group circulates ideas, questions, developments and references ahead of a face-to-face meeting. At the meeting, decisions are made regarding the form, direction and content of the output, teams are assembled, and the drafting gets underway. Following a few months of work, a public comment version is then published and subjected to peer review before the "final" work product is published. Consistent with our mission, all "public comment" drafts and completed Working Group publications are available for free download for individual use from our website. For details on reprint permission, see the "publications" area of our website or contact us at [tsc@sedona.net](mailto:tsc@sedona.net).

Funding for The Sedona Conference<sup>SM</sup> comes from individuals, law firms and corporations, in the form of conference sponsorships and registration fees. Funding for the 2003-04 Working Group Addressing Electronic Document Retention and Production came from individual Working Group membership fees, as well as sponsorships provided by Electronic Evidence Discovery, Inc., Jones Day, Mayer Brown Rowe & Maw LLP (Founding Sponsors), and Carrington Coleman Sloman & Blumenthal, Ernst & Young, and PricewaterhouseCoopers (Supporting Sponsors).

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# OVERVIEW OF CHANGES TO *THE SEDONA PRINCIPLES IN 2004*

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## *The Sedona Conference<sup>SM</sup> Working Group or Electronic Document Retention and Production Sedona, AZ*

Nearly a year ago, the Sedona Conference Working Group on Electronic Document Production published *The Sedona Principles: Best Practices, Recommendations & Principles for Addressing Electronic Document Production*. At that time, the Working Group issued an open call to all interested people and organizations requesting comments on *The Sedona Principles*. We received many comments, both orally and in writing, which helped us understand how to refine *The Sedona Principles* to reflect better the “best practices” for the discovery of electronic information and to highlight issues of importance to courts, litigants and counsel. Also, in the intervening months since the initial publication of *The Sedona Principles*, new cases have been decided and new secondary authorities published which inform the way in which litigants address electronic discovery. Accordingly, the Working Group is pleased to announce the publication of the revised *Sedona Principles*.

Readers who are familiar with the initial version of *The Sedona Principles* may notice several changes between that version and the current version. Most notably, the introduction to *The Sedona Principles* has been completely revised to better introduce readers to concepts involved in electronic discovery. This reformulated introduction, we think, better serves to provide readers without a background in electronic discovery with the information necessary to understand the complex issues implicated by the discovery of electronic information.

We have also revised *The Sedona Principles* to account for the many developments in the law of electronic discovery that have occurred since our initial publication. Cases such *Zubulake v. UBS Warburg LLC*, No. 02 Civ. 1243, 216 F.R.D. 280, 217 F.R.D. 309, and 2003 WL 22410619 (S.D.N.Y. 2003), *Keir v. UnumProvident Corp.*, 2003 WL 21997747 (S.D.N.Y. Aug. 22, 2003), and *Medtronic Sofamor Danek, Inc. v. Michelson*, 2003 WL 21468573 (W.D. Tenn. May 13, 2003) have helped form the emerging body of law addressing electronic discovery. We also included references to the proposed revisions to the ABA Civil Discovery Standards addressing electronic discovery issues that were disseminated in November of 2003.

The Principles themselves have changed in two ways. First, we reviewed and revised the language from a stylistic vantage point to better communicate the principle. Second, we changed the text of Principles 7 and 11. Principle 7 was revised to better focus on the standard for evaluating and challenging production adequacy under Rule 37. Principle 11 was modified to reflect a better understanding of metadata and the complex issues that can arise regarding preservation and production of metadata.

The commentary has also been revised in a number of ways. First, we reviewed and revised the language from a stylistic viewpoint to clarify and simplify the statements. Second, we eliminated statement, citations and illustrations where we did not think they provided meaningful guidance to the comment. Third, we added citations to significant new authorities as noted above. Fourth, in some areas we rewrote commentary to make clear that the Working Group does not intend to endorse the methodology or selection criteria employed by one particular vendor over that employed by another. Fifth, we added entirely new commentary in the following areas:

- The Benefits of Written Document Management Policies
- Written Records Management Policies Should Account for Records in Both Paper and Electronic Form
- Privilege Logos for Voluminous Electronic Documents
- Preservation of Expert Witness Drafts and Materials
- Use of Special Masters and Court-Appointed Experts to Preserve Privilege
- Protection of Confidentiality and Privilege Regarding “Clawback” or “Quick Peek” Productions
- Sampling
- Cost-Shifting Cannot Replace Reasonable Limits on the Scope of Discovery
- “Negligent” vs. “Culpable” Spoliation
- The Good Faith Destruction in Compliance with a Reasonable Records Management Policy Should Not Be Considered Sanctionable Conduct Absent Reasonable Notice to the Organization of a Duty to Preserve the Documents

When the public comment version of *The Sedona Principles* was published in 2003, it was our hope that they could serve as a guide to litigants and courts alike. The role that *The Sedona Principles* have played during the intervening time has exceeded our greatest expectation. We offer the revised *Sedona Principles* in our continuing effort to help practitioners, litigants and courts alike in addressing the challenging issues involved in the world of electronic discovery.

Finally, we are very thankful for the contributions of all persons who have taken the time to comment upon the March 2003 version of *The Sedona Principles*, and especially thankful for all of the contributions and efforts of the participants, members and observers to the Working Group for helping us make this a better document.

January 21, 2004

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