

The Duty to Preserve Evidence:

The High Cost of Electronic Discovery and Even Higher Cost of Non-Compliance



Banks are subject to the constant threat of litigation on a variety of fronts — from disgruntled former employees, borrowers facing foreclosure, and regulators. While the merits of each lawsuit may vary, the obligation to preserve evidence does not.

What may be surprising to many companies is that the obligation to preserve evidence arises long before a lawsuit is filed, and the costs for failing to do so can be staggering. In egregious cases, courts have entered judgment against litigants who failed to preserve, thereby preventing them from defending litigation on the merits. Litigants have also been ordered to pay the opposing party's attorneys' fees, which can be substantial in complex commercial litigation.

When must a bank preserve records?

A common misconception is that formal legal process (*i.e.*, service of a summons and

complaint) triggers the duty to preserve evidence. In fact, the duty arises upon reasonable anticipation of litigation.

- **Scenario 1:** Andrew has worked at the bank for five years. Recently, he has been missing work and tells his supervisor that his son is sick. Andrew abruptly resigns and, during his exit interview, tells the human resource specialist that his supervisor engages in favoritism, so he found a more flexible workplace. Two weeks later Andrew files a U.S. Equal Employment Opportunity Commission (“EEOC”) charge and, fourteen months later, he files a lawsuit claiming violation of the Family and Medical Leave Act.

- **Scenario 2:** Borrower Maria obtains a loan to finance construction of a new home. Six months into construction, she encounters difficulty with her contractor and suppliers, resulting in significant delays. The bank continues to make disbursements in accordance with periodic inspection and draw request procedures, but Maria frequently contacts bank personnel to complain about the timing and amount of the disbursements. Twelve months later, when Maria is unable to complete construction, she files a lawsuit claiming breach of contract and violation of the Washington Consumer Protection Act.

When did the bank have an obligation to preserve evidence in these scenarios? Andrew may argue that the obligation arose during his exit interview when he alleged favoritism, but certainly no later than when the EEOC charge was received. Maria may argue that the obligation arose when she complained to bank personnel, at least one year before she filed suit. Under both scenarios, the bank risks liability above and beyond the underlying claims if it failed to take necessary steps to preserve relevant evidence.

What is required? Once a duty to preserve exists, the bank is required to ensure that relevant evidence is neither altered nor destroyed. Because identifying relevant evidence can be difficult, particularly at early stages of a dispute, err on the side of over-inclusion and take steps to broadly preserve all information, documents and electronic data related to the underlying subject matter.

The bank should first issue a written “litigation hold.” This is the process by which key players are notified of the potential dispute and their obligation to preserve records. Second, the bank should identify internal policies and procedures that might result in the alteration or destruction of potentially relevant evidence and immediately suspend them.

Absent careful planning, relevant evidence may be destroyed, also known as “spoliation.” For example, Andrew’s laptop may be wiped clean and re-assigned after his departure. Similarly, computers used to manage Maria’s loan may be eliminated when the branch upgrades its hardware.

Many internal bank systems delete emails periodically (i.e., after sixty or ninety days), so Andrew and Maria’s internal and external emails may be destroyed even after the bank receives notice of a dispute. Even if a back-up system exists, retrieval of relevant information will be more costly and time-consuming. Nor is a court likely to sympathize with the burden of higher costs as, with few exceptions, courts view the high costs of electronic discovery as the cost of doing business.

The consequences of spoliation. Often, outside counsel is not retained until after a lawsuit is filed. Competent counsel will issue a written litigation hold immediately, directing the bank to preserve all evidence (electronic or otherwise), so that it may be collected and prepared for discovery. In our hypothetical scenarios, counsel will be dismayed to learn that virtually all electronic evidence has already been deleted or destroyed, including Andrew’s communications with his supervisor and Maria’s complaints about disbursements.

Increasingly harsh punishments have been imposed on litigants who are unable or unwilling to produce emails and other electronically stored information when requested in discovery. While the sanction often depends on the litigant’s recklessness or intent, courts have considerable latitude when it comes to redressing spoliation.

At one end of the spectrum, courts often require the offending litigant to bear the costs of additional discovery, or more costly discovery as needed to retrieve altered or deleted data. This is true even if the underlying claim would not have justified such costs in the absence of spoliation. Thus, while Maria’s claim may be frivolous and Andrew’s damages minimal, the sanction for failing to preserve evidence may be substantial. Attorneys’ fees and costs may be imposed, ranging from a few thousand to a few million dollars. In 2004 the district court in the District of Columbia sanctioned a party \$2.75 million for, among other things, implementing a 60-day email deletion policy after a preservation order was issued. Other common sanctions include adverse inferences

or jury instructions, for example, telling the jury to presume evidence would have been detrimental to the non-preserving party had it not been destroyed.

At the other end of the spectrum are judgment and dismissal sanctions. In the case of more egregious misconduct, litigants who failed to preserve evidence have lost the ability to defend themselves on the merits or had their lawsuit dismissed, and have been required to pay the opposing party’s attorneys’ fees.

Managing the costs of electronic discovery. Taking the proper steps to ensure preservation can be costly and disrupt operations. Considering the high volume of litigation that ends with early dismissal or a negotiated settlement, making discovery unnecessary, such cost and disruption may seem unduly burdensome. But as the practice of electronic discovery has evolved, so has the ability of litigants to identify spoliation and seek sanctions. Proper precautions are now more important than ever.

While preservation can be costly, the above examples illustrate how the bank’s failure to preserve relevant evidence can cost far more. Banks can reduce long-term costs by implementing internal document management systems and personnel policies designed to automatically identify and address potential disputes. With more law firms developing specialized electronic discovery groups, banks have new and more cost-effective options for document identification, management and preservation. Consulting with legal professionals early — and before spoliation can occur — also helps protect against the risk of sanctions. 



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TAG Program — *continued from page 9*

ICBA and community bankers from all over the country have been active in calling and writing their legislators to encourage their support. Please join in the effort for your state.

As of this writing, I am pleased to announce that the ABA (just yesterday) finally came out in support of an extension. Community banks now have an additional voice in this fight, rather than ICBA being the only trade association openly supporting passage. CBW signed a letter some months ago to the

regulators and elected officials, clearly indicating our support of TAG and detailing the basis for the need for the extension.

So, I strongly encourage your participation in this endeavor – to avoid something of importance being taken away from community banks at a critical time and avoid causing further problems of liquidity and deposit concentration.

DON’T LET THE RUG BE PULLED OUT FROM UNDER COMMUNITY BANKS AGAIN! 

