New York Law Journal
Technology Today
WWW.NYLJ.COM
An ALM Publication
VOLUME 255—NO. 2
TUESDAY, JANUARY 5, 2016

State E-Discovery

'Pegasus', Adverse Inference Charges and the FRCP

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The New York Court of Appeals' decision in *Pegasus Aviation I v. Varig Logistica S.A.*,[1] appears to endorse the concept that an adverse inference jury charge may be premised on the failure to preserve electronically stored information (ESI). The decision raises interesting questions about the source, purpose and scope of a negligent adverse inference charge, and whether New York law is now at odds with recent amendments to the Federal Rules of Civil Procedure (FRCP).

Motion Court Decision

Upon an alleged default by Varig Logistica S.A. (VarigLog), Pegasus commenced litigation in Florida in February 2008. That suit was discontinued in October 2008 when Pegasus commenced suit in New York against both VarigLog and the "MP defendants." The MP defendants were a group of commonly-controlled private equity firms and the sole shareholders of VarigLog. Pegasus sought to hold the MP defendants responsible for the loss of relevant ESI by VarigLog due to its failure to implement a "litigation hold." The motion court struck VarigLog's answer and ruled that the jury would be instructed that "it may infer that the lost ESI would have supported the veil-piercing claim against the MP defendants." It imposed sanctions against the MP defendants because:

> (1) the MP defendants' control of VarigLog obligated them to see to it that VarigLog preserved evidence relative to this litigation and, in particular, that VarigLog instituted a litigation hold on its ESI; (2) that the MP defendants' failure to ensure that VarigLog implemented a litigation hold constituted gross negligence per se, … ; and (3) VarigLog's culpability rose to the level of gross negligence, where prejudice to plaintiffs could be presumed.

Appellate Division Decision

The Appellate Division found that the MP defendants had a sufficient degree of

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control over VarigLog to trigger a duty to preserve ESI. The majority, however, reversed the motion court's ruling that the MP defendants' failure to discharge that duty was egregious enough to rise to the level of gross negligence. The majority rejected the concept that the "failure to institute a litigation hold, in all cases and under all circumstances, constitutes gross negligence per se." The majority disagreed with the full dissent, and found that only simple negligence "at most" had taken place and therefore "plaintiffs must prove that the lost ESI would have supported their claims." The majority disagreed with the partially dissenting justice, who would have remitted the matter to determine the extent of the prejudice to plaintiffs from the loss of VarigLog's ESI to determine whether sanctions should be imposed.

Court of Appeals Decision

The court saw no reason to disturb the finding that the MP defendants had sufficient control over VarigLog to trigger a duty on its part to preserve. The court also found that there was no basis to disturb the findings by the Appellate Division that the MP defendants were negligent in failing to discharge that duty. The court, nevertheless, found that the Appellate Division majority erred by concluding that Pegasus had not attempted to make a showing of relevance. Essentially agreeing with the partially dissenting justice below, the court concluded that the prudent course of action was to remit the matter "for a determination as to whether the negligently destroyed ESI was relevant to Pegasus' claims against the MP defendants and, if so, what sanction, if any, is warranted."

Duty to Preserve

The appellant's brief in *Pegasus* urged the court to adopt a uniform standard regarding the duty to preserve evidence before litigation commences, and called to the court's attention the distinction in the First Department between the standard adopted pertaining to ESI in *Voom HD Holdings v. EchoStar Satellite*[2] and the standard for other forms of evidence as set forth in *Strong v. City of New York*.[3] In *Voom* and other cases involving ESI,[4] the First Department adopted the standard set out in the Southern District of New York decision *Zubulake v. UBS Warburg*,[5] which provides that "once a party reasonably anticipates litigation, it must suspend its routine document retention/destruction policy and put in place a litigation 'hold' to preserve" ESI. In *Strong*, the First Department rejected application of that standard[6] and relied instead on common law where the standard is whether the spoliator was "on notice" that the evidence "might be needed for future litigation."[7]

'Pegasus' raises interesting questions about the source, purpose and scope of a negligent adverse inference charge, and whether New York law is now at odds with recent amendments to the FRCP.

Pegasus appears to assume a pre-litigation duty to preserve evidence, but the court did not address when and how specifically the duty could be triggered.[8] The court did not set forth a preservation standard and did not resolve the distinction existing at least within the First Department as to whether there should be a different standard for ESI as opposed to other evidence.

Negligence as Basis for Sanctions

Some commentators have opined that there is a modern trend, commencing at least as of the 1990s, to permit negligence as a basis for a spoliation sanction, including for an adverse inference charge.[9] In New York, as evidenced by Appellate Division decisions, negligence as a predicate for a spoliation sanction initially arose in the products liability context when a key piece of evidence in a manufacturing defect action was inadvertently destroyed.[10] Thus, it appears that the court recognized that adverse inference charges "have been found to be appropriate even in situations where the evidence has been found to have been negligently destroyed." As such, there is little doubt that spoliation sanctions in New York may be based on the negligent failure to preserve ESI evidence.

Source of Authority

The court, however, did not identify the source of a court's power to impose a spoliation sanction based solely on negligence. Rather, the court stated:

> Our state trial courts possess broad discretion to provide proportionate relief to a party deprived of lost or destroyed evidence, including the preclusion of proof favorable to the spoliator to restore balance to the litigation, requiring the spoliator to pay costs to the injured party associated with the development of replacement evidence, or employing an adverse inference instruction at the trial of the action (see *Ortega v. City of New York*,

9 NY3d 69, 76 [2007] [citations omitted]; CPLR 3126 [if a trial court determines that a party has destroyed evidence that "ought to have been disclosed … the court may make such orders with regard to the failure or refusal as are just"]).[11]

The reference to *Ortega* is interesting because *Ortega* began its discussion by observing: "[w]hen parties involved in litigation engage in the destruction of evidence, a number of remedial options are provided by existing New York statutory and common law." While the court referred to the "common law," most of its discussion underlying the "method of dealing with spoliation of evidence in New York"[12] was under CPLR 3126. Accordingly, although the court did not precisely define the source of its power to impose a spoliation sanction, it appears that, in such a context, the authority is CPLR 3126. If the source is CPLR 3126, however, the ability to impose a spoliation sanction must be premised on a party's refusal "to obey an order for disclosure" or in "wilfully" failing "to disclose information which the court finds ought to have been disclosed." How then can "negligence" be the basis for a spoliation sanction, pursuant to CPLR 3126, where there has been no refusal to obey an order or willful conduct?

On the other hand, a court's power to remedy the effects of spoliation may be inherent or otherwise embodied in the common law doctrine of spoliation[13] as noted in *Strong*.[14] However, that doctrine was initially employed in New York where the evidence that had been negligently destroyed left the party seeking the evidence "prejudicially bereft" of the ability to prove a claim or defense or was otherwise critical evidence in the case.[15] Then what are the limits to such common law power[16] and what forms may a spoliation sanction take? When the sanction involves an inference that the jury may or must apply, need the court make findings of fact before being "putting a finger" on the scales of justice favoring the non-spoliating party?[17]

Adverse Inference Charge

The majority in *Pegasus*, as does the partial dissent at the Appellate Division, refers to PJI 1:77 as the model adverse inference instruction. However, what is the source of a court's power to deliver such a charge? The historical analysis of that charge appears to be one rooted in the concept of circumstantial evidence under which the jury is instructed that it may infer consciousness of a party's "weak" case because of the destruction by it of relevant evidence over which it had control.[18] The adverse nature of the charge is that the unavailable evidence would have been unfavorable to the party accused of destroying it. However, under the common law, some level of culpable conduct in destroying the evidence is a prerequisite to charging the jury with the option to infer "unfavorability" of the case. It was only recently, and primarily in the era of ESI, when the negligent failure to preserve evidence became culpable conduct that could form a basis for an adverse inference charge.

> By its reliance upon 'Voom', the court in 'Pegasus', at a minimum, created an apparent difference between federal law and New York law on negligence as a predicate for a spoliation/adverse inference charge.

The question then is whether there is authority permitting the jury to draw such an inference based solely on a negligent failure to preserve evidence? Recently, the court decided *People v. Durant*,[19] declining to "invariably require a court to issue an adverse inference instruction … based solely on the police's failure to electronically record the custodial interrogation of the defendant." The court reasoned in part that an inference of "unfavorability" would be unwarranted because the results of the custodial interrogation would be uncertain and that the choice by the police not to record it "is just as likely to stem from an innocent oversight or a legitimate adherence to a neutral departmental policy." Given *Durant*, should an inference of "unfavorability" be available when the failure to preserve evidence was only negligent?

Amended FRCP 37(e)

Federal courts have disagreed about whether an adverse inference charge as a sanction for spoliation may be imposed based on negligence. The debate has been resolved by the recent amendments to the FRCP, effective Dec. 1, 2015. FRCP 37(e)(2) has been amended to preclude the use of an adverse inference charge based on negligence. The Committee Notes make clear that the amendment sought to negate a court's "inherent authority" to deliver such a charge as a spoliation sanction and to otherwise abrogate decisions, such as the Second Circuit decision in *Residential Funding v. DeGeorge Financial*,[20] which authorized an adverse inference sanction based on negligence.[21]

The significance of the amendment is that the First Department decisions in *Ahroner* and *Voom*, as noted by the motion court, are premised solely on *Zubalake IV* for the authority that negligence may provide the basis for an adverse inference charge as a spoliation sanction. But *Zubalake IV* itself relies solely on *Residential Funding* as its authority for that proposition. Thus, the basis for the adverse inference charge predicated on negligence as a spoliation sanction has been abrogated by the FRCP recent amendments.

Thus, by its reliance upon *Voom*, the court in *Pegasus*, at a minimum, created an apparent difference between federal law and New York law on negligence as a predicate for a spoliation/adverse inference charge. Practitioners are left to wonder whether the court sought to intentionally adopt a different standard than the federal courts where the briefs in *Pegasus* addressed the impending amendments to FRCP 37(e).

Conclusion

Pegasus seems to answer the question that an adverse inference charge may be based solely on negligence. However, given the change in the FRCP and the general lack of detailed discussion in New York authority as to the source and scope of such a charge, *Pegasus* poses more questions than it answers.

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1. 2015 N.Y. Slip Op. 09187 (Dec. 15, 2015).

2. 93 A.D.3d 33 (1st Dept. 2012).

3. 112 A.D.3d 15 (1st Dept. 2013). But see *Duluc v. AC & L Food*, 119 A.D.3d 450 (1st Dept. 2014) (applying *Voom* to a non-ESI case).

4. See *U.S. Bank N.A. v. GreenPoint Mtg. Funding*, 94 A.D.3d 58 (1st Dept. 2012); *Tener v. Cremer*, 89 A.D.3d 75 (1st Dept. 2011); *Ahroner v. Israel Discount Bank of New York*, 79 A.D.3d 481 (1st Dept. 2010).

5. 220 F.R.D. 212, 218 (S.D.N.Y. 2003) (*Zubulake IV*).

6. *Strong*, 112 A.D.3d at 23 ("We nevertheless conclude that reliance on the federal standard is unnecessary in this context. *Zubulake* interpreted federal rules and earlier federal case law to adapt those rules to the context of ESI discovery.").

7. See *Westbroad Co. v. Pace El.*, 37 A.D.3d 300 (1st Dept. 2007); *Enstrom v. Garden Place Hotel*, 27 A.D.3d 1084 (4th Dept. 2006); *Lawrence Ins. Group v. KPMG Peat Marwick*, 5 A.D.3d 918 (3d Dept. 2004); *DiDomenico v. C & S Aeromatik Supplies*, 252 A.D.2d 41 (2d Dept. 1998).

8. For example, in *MetLife Auto & Home v. Joe Basil Chevrolet*, 1 N.Y.3d 478, 483 (2004), the court observed that there was a failure to procure a preservation order, while in *Ortega v. City of New York*, 9 NY3d 69, 79 (2007), the court noted the existence of such an order.

9. Wm. Grayson Lambert, "Keeping the Inference in the Adverse Inference Induction: Ensuring the Instruction Is an Effective Sanction in Electronic Discovery Cases," 64 S.C. L. Rev. 681 (2013).

10. See *Abar v. Freightliner*, 208 A.D.2d 999 (3d Dept. 1994); *Kirkland v. New York City Hous. Auth.*, 236 A.D.2d 170 (1st Dept. 1997). See also *Squitieri v. City of New York*, 248 A.D.2d 201 (1st Dept. 1998); *Mudge, Rose Guthrie, Alexander & Ferdon v. Penguin Air Conditioning*, 221 A.D.2d 243 (1st Dept. 1995).

11. 2015 N.Y. Slip Op. 09187 at **5.

12. *MetLife*, 1 N.Y.3d at 482-83.

13. See *Ortega*, 9 N.Y.3d at79 (in rejecting the creation of an independent tort of spoliation, the court stated that "in many of the instances where other jurisdictions have recognized an independent tort, a New York court could have provided a remedy to the spoliation victim through our traditional litigation sanctions.").

14. *Strong*, 112 A.D.3d at 21 ("it is New York's common-law doctrine of spoliation, rather than CPLR 3126, that we must consider"). See *DiDomenico v. C & S Aeromatik Supplies*, 252 A.D.2d 41 (2d Dept. 1998) (Second Department struck the answer, noting: "[s]eparate and apart from CPLR 3126 sanctions is the evolving rule that a spoliator of key physical evidence is properly punished by the striking of its pleading. This sanction has been applied even if the destruction occurred through†negligence rather than wilfulness, and even if the evidence was destroyed before the spoliator became a party, provided it was on notice that the evidence might be needed for future litigation").

15. See, e.g., *Kirkland*, 236 A.D.2d 170.

16. Before the court can invoke such power, must the conduct rise to the level of a "fraud on the court" and be established by clear and convincing evidence as in *CDR Creances S.A.S. v. Cohen*, 23 N.Y.3d 307 (2014)? If so, that would rule out negligence as a basis for a spoliation sanction at least insofar as predicated upon a court's inherent power authority.

17. See, e.g., *Mali v. Fed. Ins. Co.*, 720 F.3d 387, 391-94 (2d Cir. 2013) (discussing difference between a circumstantial evidence adverse inference charge and such a charge imposed for misconduct as a spoliation sanction, the latter requiring the court to issue findings).

18. See, e.g., *Nation-Wide Check v. Forest Hills Distr.*, 692 F.2d 214, 219 (1st Cir. 1982) ("conscious abandonment of potentially useful evidence is, at a minimum, an indication that Gordon believed the records would not help his side of the case"); *Vick v. Texas Employment Com*, 514 F.2d 734, 737 (5th Cir. 1975) (quoting McCormick, Evidence §273 at 660-61 (1972) ("[m]ere negligence is not enough, for it does not sustain an inference of consciousness of a weak case.")); 2 Wigmore, Evidence §291 (Chadbourn rev. 1979).

19. 2015 N.Y. Slip Op. 08609 (Nov. 23, 2015).

20. 306 F.3d 99 (2d Cir. 2002).

21. Id. at 24-25 (quoting *Kronisch v. United States*, 150 F.3d 112, 126 (2d Cir. 1998) (stating that an adverse inference instruction serves the remedial purpose, "insofar as possible, of restoring the prejudiced party to the same position he would have been in absent the wrongful destruction of evidence by the opposing party")).