What's In Store For E-Discovery In Bankruptcy?

Law360, New York -- Given the limitations of discovery in the context of a bankruptcy proceeding, historically, there has been a lurking question regarding the applicability of the various "rules" on e-discovery to a bankruptcy case. Although it seemed pretty clear via Rule 7001 of the Federal Rules of Bankruptcy Procedure that the case law regarding e-discovery and ESI-related issues derived under the applicable Federal Rules of Civil Procedure would apply in an adversary proceeding, it was less clear whether and to what extent the same jurisprudence would or even should be given the same weight in a contested matter under Bankruptcy Rule 9016 or even some of the routine matters that typically arise in a case under the United States Bankruptcy Code.

ABA Electronic Discovery (ESI) in Bankruptcy Working Group

On March 15, 2012, a small working group out of the ABA weighed in on these hefty questions. Drawing heavily from the principles published by the Second Conference, the working group, composed of judges, former judges, bankruptcy practitioners, litigation attorneys and representatives from the office of the United States Trustee, issued an Interim Report on various ESI issues in order to "invite and stimulate comments from a wider audience with respect to" to its proposed guidelines in large Chapter 11 cases, smaller Chapter 11 cases, and Chapter 7 and 13 cases.

According to the ABA working group, "[a] person or entity preparing to file a bankruptcy case should consider appropriate steps to preserve ESI and other evidence." (Interim Report at 1.) The ABA working group continued to recommend that "potential debtors and non-debtor parties have an obligation to preserve ESI and other evidence related to the filing of a contested matter, adversary proceeding or other disputed issue in a bankruptcy case." (Id.). Finally, the ABA working group counseled that this "duty to preserve may arise prior to the formal filing of the bankruptcy case or other litigated matter, generally when the case filing or other potential litigation matter becomes reasonably anticipated." (Id.)

The Interim Report also recommends the early implementation and of a court-approved "ESI Protocol." Much like the "Notice and Procedures" orders that are typical in a large complex Chapter 11 case, and ESI Protocol Order would govern the relative obligations of the major Chapter 11 parties — the debtor-in-possession, the creditors committee, the DIP lender, etc. According to the working group, the

> ESI protocol should address preservation efforts implemented by the debtor, document databases or repositories established by the debtor, issues related to the intended form or forms of production of ESI by the debtor, any sources of ESI that the debtor deems not reasonably accessible because of undue burden or cost, any categories of ESI that the debtor specifically identifies as not warranting the expense of preservation, document retention programs nor policies that remain in effect and any other significant ESI-related issues.
>
> (Id. at 4.)

Strategic Importance of ESI Protocol — Early On

Surprisingly, notwithstanding the level of specificity and the obvious work that went into the Interim Report, the working group's recommendations have received a lukewarm reception by bankruptcy practitioners. For example, a search of pleadings, motions, briefs and published opinions in the last year has revealed zero entries of an "ESI Protocol" or similar order despite the working group's recommendation. Although one would think that such an order would be among the multiple "first day orders" typically sought by Chapter 11 debtors, it appears that DIP attorneys have yet to include this type of request in their arsenal of first day motions.

In contrast, the ESI Protocol Order is a common device used by nonbankruptcy litigators. Indeed, several United States district courts now offer "model ESI protocols" for practitioners on their websites. (See e.g., United States District Court for the Western District of Washington; United States District Court for the District of Maryland.)

There are unique concerns in bankruptcy that might explain the "extra" reluctance of parties to dive into the ESI quagmire. Perhaps of greatest concern is the limited financial resources that a debtor would have at its disposal to undertake the preservation, collection and search of ESI. Unlike the hypothetical litigant in a multiparty class action or products liability dispute, a Chapter 11 debtor is almost certainly already at

the brink of financial distress; thus, the idea of incurring the often times astronomical costs of e-discovery[1] can be formidable, if not patently cost prohibitive.

For instance, in In re Residential Capital LLC, the debtor successfully defended against a motion to compel the restoration, review and production of emails, on the grounds that it would entail the debtor's incurrence of "millions of dollars in expenses," and that the "employees necessary for the restructuring and preservation of estate assets [would] be distracted during this critical period." Case No. 12-12020 (MG), 2012 U.S. Bankr. Ct. Motions 42078, at *2-3 (Bankr. S.D. N.Y. Aug. 7, 2012).

Still, debtors-in-possession should be mindful of the risks that adhere to disregarding the working group's recommendation. In addition to the administrative efficiency associated with an early entry of an interim ESI Protocol Order, such an order can also forestall accusations of "bad faith" under 11 U.S.C. § 1112(b). This can be of particular importance in the context of single asset real estate cases, where the scepter of "bad faith" motions is always at the fore. For instance, while a finding of spoliation may not be dispositive as to a debtor's bad faith in filing a Chapter 11 case, it can certainly be chief among the reasons that a case should be dismissed or the automatic stay lifted. Moreover, just like in a nonbankruptcy case, spoliation accusations can be expensive to ward off or defend against, and an ESI Protocols order can serve as a prophylactic measure against such sideshows.

Moreover, as a court in equity and under its authority pursuant to 11 U.S.C. § 105(a), a bankruptcy court arguably has greater latitude with respect to tailoring an ESI Protocol order than a federal district court. As the working group notes, "[a]pproval of the ESI protocol should not preclude the debtor or other parties from seeking additional or different treatment of ESI in appropriate circumstances." (Interim Order at 5.) It stands to reason, then, that a debtor-in-possession could include within its ESI Protocol provisions that safeguard against the incurrence of unreasonable costs and the draining of resources that would otherwise be committed to re-emergence.

In sum, as savvy bankruptcy litigators begin to consider the strategic possibilities of spoliation allegations in connection with ESI preservation obligations, a prudent DIP attorney should also consider potential defenses against such tactics. The ABA working group has proposed one such possible solution in the ESI Protocol.

—By Joanne Lee, Foley & Lardner LLP

Joanne Lee is a senior counsel in Foley & Lardner's Chicago office.

The opinions expressed are those of the authors and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] Experts have estimated the average cost of e-Discovery is $18,000 per gigabyte of data reviewed. These days, even the smallest organizations may have matters as big as a terabyte, or 1,000 gigabytes, rendering e-discovery costs for even the smaller companies in the millions of dollars.