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Two Roads Diverge in Managing E-Discovery Costs

The big difference that federal and New York responses can make.

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THE COSTS of civil discovery in the computer age appear to be prompting divergent responses by the federal and New York state courts. These differences, which are still evolving, could have significant implications for litigants and lawmakers.

Litigants with a choice of forum should consider these differences in selecting which court system best suits their objectives. And lawmakers should monitor these differences to assess what rules best reconcile the often competing goals of ready access to the civil justice system, full development of the facts relevant to the case, and the efficient, cost-effective resolution of the parties' dispute.

The costs of electronic discovery are well-known and have received ample coverage throughout this decade, in this publication and others.[1] The source of these costs is society's increasing reliance on the electronic creation, transmission and retention of information, especially in the corporate context. Because information is so easily created, kept and copied, the volume that is available and potentially relevant to a dispute had ballooned geometrically.

While these costs can be somewhat controlled by the creative use of technology and counsel's use of sound management principles in managing a document review, there are limits. The application of classic liberal discovery principles can still require the production of hundreds of thousands or even millions of "documents," where in the past the same case would have involved discovery into a small fraction of that number.

Retaining and collecting this information is by itself extraordinarily expensive, even when the most efficient methods are employed. And on top of those costs, attorneys still must review the collected material for responsiveness and privilege, which can be prohibitively expensive for even a middle-sized case that is well managed. These costs can be so large that they have recently been blamed for tamping down the usual increase in litigation that accompanies an economic recession.[2]

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These increased costs have fundamentally changed the cost-benefit calculus that had informed many of the rules of procedure applicable in civil cases. Lawmakers accordingly have responded by seeking to recalibrate the rules to reflect the new reality.

In the federal system, there have been changes in the rules of discovery and evidence that apply once a case is past the threshold pleading stage, as well as recent changes by the U.S. Supreme Court in the standards that apply even to the commencement of a potentially burdensome action. And in the New York state system, there has been increasing attention to the application of existing discovery rules in the electronic context.

These changes are creating, or at least highlighting, important differences in how the two court systems address the problems of electronic discovery.

The Federal Courts' Response

Focusing on the federal system first, in 2006 the discovery provisions of the Federal Rules of Civil Procedure were modified to address the challenges specifically posed by e-discovery.

The rules makers adopted the philosophy that encouraging adversaries to cooperate at the outset of the case could help control discovery costs.[3] The rules makers further made clear that the Federal Rules' long-standing requirement that discovery be reasonable and proportional should be vigorously applied to electronic discovery.[4]

In addition, rules makers encouraged the use of "quick-peek" and "clawback" agreements to reduce the risks of the inadvertent production of privileged documents, a risk that increases materially as the size and/or speed of a production increases.[5] Recently, Congress adopted Federal Rule of Evidence 502 to further encourage the use of these agreements.[6]

Significantly, however, the rules makers did not modify the traditional "American Rule" that parties must bear their own costs of litigation, including the costs of attorney's fees incurred in discovery. While the Federal Rules sometimes provide for cost or fee-shifting in discovery, those circumstances are the exception rather than the rule.[7]

That approach is sometimes effective. In cases where the parties are similarly situated with respect to e-discovery, such as in business litigation between equally sized companies, these rules can help control costs by creating the specter of "mutually assured destruction": Overly burdensome requests by one side would simply prompt the same from the other side, so both parties have an incentive to be reasonable and focused in conducting discovery.

However, in cases where the parties are asymmetrically situated with respect to e-discovery, such as in a typical class action, these rules do little to deter over-reaching by the smaller party. Since that party can impose costs far greater than can be imposed on it, the incentive to be reasonable and targeted is greatly reduced. That fact in turn dramatically increases the risk that the smaller party will misuse the threat of discovery run amok as a lever to induce a non-meritorious settlement.

For these reasons and others, there are serious limitations on the federal courts' ability to control abusive discovery within the discovery process itself. These concerns have recently led the Supreme Court to raise the pleading standards applicable in non-fraud actions under FRCP 8, in the now-famous *Twombly* and *Iqbal* decisions.[8] The Supreme Court now requires far more than mere "notice" of a claim before it will permit a defendant to be subjected to the potentially extreme costs of civil discovery in the federal system. *Twombly* and *Iqbal* instead require that the plaintiff plead facts that make the claim "plausible."[9]

While the Court did not specifically identify the costs of e-discovery as a motivating factor in its decision to raise the pleading bar, it did extensively discuss the costs of discovery generally, especially in *Twombly*.

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Those costs today are overwhelmingly dominated by the costs of e-discovery.

In that connection, it is no coincidence that *Twombly* was a putative nationwide antitrust class action. That is exactly the sort of asymmetric litigation that gives rise to the most acute risk of abusive discovery, in which a single small plaintiff imposes disproportionate costs on defendants in order to induce a favorable settlement. Plaintiffs in *Twombly* argued that this risk could be controlled by the district court's involvement in actively managing discovery. But the High Court disagreed, citing an article by then-professor, now-judge Easterbrook about the serious practical limitations a court faces when trying to control the discovery process.[10]

Accordingly, although *Twombly* and *Iqbal* may be reversed by Congress in legislation currently being debated,[11] at the moment they mark a key part of the federal courts' overall response to the costs and burdens of e-discovery. In sum, that response entails:

(1) increased pleading requirements to screen out cases that do not merit imposing the burden of e-discovery costs on defendants, and

(2) discovery rules designed to foster cooperation in controlling discovery costs, but which still require the parties to bear the costs and fees of responding to the other side's discovery demands.

In the New York Courts

In important respects, New York state courts appear to be heading down a different path.

The New York law on e-discovery "remains uncodified and largely undeveloped."[12] While the Commercial Division in New York has issued rules directed to it, those rules do little more than direct that the parties discuss the issues posed by electronic data.[13] There are also proposed rule amendments from city and state bar committees.[14] Beyond that, New York's approach to the problems posed by e-discovery is ad hoc.

But as reflected in a recent article in the Law Journal, the New York cases on this issue are beginning to diverge from federal cases in a critical respect: They are employing a presumption in favor of requiring that the costs of e-discovery, potentially including attorney's fees, be borne by the requester.[15] This trend reflects New York's longstanding presumption as codified in CPLR §3101, New York's analog to the general discovery provisions of FRCP 26.

If this trend continues, it could mark a major difference between New York's approach to e-discovery and that of the federal courts. Cost and fee shifting, if rigorously enforced, could reduce or eliminate the problems posed by asymmetric e-discovery burdens under the federal system, albeit at the expense of sacrificing some amount of the "truth seeking" function by forcing parties to narrow their discovery demands.

Against the backdrop of this cost and fee shifting presumption, it is not surprising that, so far at least, New York courts have not embraced the higher pleading requirements of *Twombly* and *Iqbal*.[16] The discovery cost pressures that exist under the federal system, upon which the Supreme Court relied so heavily in *Twombly*, may not exist in New York state courts, at least not to the same extent.

Put differently, the New York courts appear to be crafting a unique solution to the costs of e-discovery that, if it proceeds along the path it is currently taking, will make New York stand apart from the federal courts and other state courts that follow the federal approach to this issue.[17] That approach would involve lower pleading requirements than those of the Federal Rules, but a presumption in favor of cost and fee shifting in discovery that could deter abusive tactics, if rigorously enforced.

Implications of Different Approaches

These emerging differences between the federal and New York state responses to increased e-discovery costs have important implications for clients and lawmakers.

For clients, the diverging approaches should inform forum selection in those cases where there is a choice, either by the plaintiff in initiating the action or by the defendant in seeking to remove it from state court or to dismiss it from federal court in favor of a state court proceeding. As the law currently stands, pleading standards are indisputably higher in federal court, which would counsel plaintiffs against that forum and defendants in favor of it.

But especially in asymmetrical discovery situations, federal court is more perilous for a defendant, which is likely to have to bear its own costs of production. That factor weighs in favor of federal court for plaintiffs and against it for defendants, an ironic result in light of Congress' efforts in recent years to channel class action litigation into federal court though statutes like the Securities Litigation Uniform Standards Act (SLUSA), Pub. L. No. 105-353, 112 Stat. 3227 (1998), and the Class Action Fairness Act (CAFA), Pub. L. No. 109-2, 119 Stat. 4 (2005).

Congress passed those statutes on the theory that state courts were more prone to abuse by plaintiffs than federal courts. But if the law in New York continues to develop as it has been, then the federal courts' insistence on defendants bearing their own costs of production would in fact make New York state court a more attractive forum for defendants, assuming the complaint would survive the motion to dismiss stage of the case in federal court.

The implications for lawmakers of divergent responses to e-discovery costs in the federal and New York state systems are even more significant. If New York's pleading and cost shifting rules continue to diverge from those of the federal courts, then New York may provide an important experiment that lawmakers should study in assessing what works best in this area, in the tradition of Justice Brandeis's "laboratories of democracy." Well designed studies that account for differences in case types and other factors could shed light on whether New York or the federal system strikes a better balance between access to the courts, the search for truth and the costs of discovery. That information would be an invaluable contribution to the national discussion on these critical issues.

1. See, e.g., Jennifer H. Rearden & Farrah Pepper, "Sedona Continues Call for Cooperation," New York Law Journal, Oct. 29, 2009; Joel Stashenko, "E-Discovery 'Fiasco' Stalls Case, Hikes Costs," New York Law Journal, Sept. 20, 2007; Ian C. Ballon, "How Companies Can Reduce the Costs and Risks Associated With Electronic Discovery," The Computer Lawyer, July 1998.

2. Karen Sloan, "For Litigators, a Different Kind of Recession," National Law Journal, Aug. 18, 2009 ("Several attorneys interviewed for this article said that they believe the cost of e-discovery was the primary reason the volume of litigation has not increased in the way it did after the last recession.").

3. Fed. R. Civ. P. 26(f) advisory committee's note (2006) ("When the parties do anticipate disclosure or discovery of electronically stored information, discussion at the outset may avoid later difficulties or ease their resolution."); see also *Board of Regents of Univ. of Nebraska v. BASF Corp.*, No. 4:04-CV-3356, 2007 WL 3342423, at *5 (D. Neb. Nov. 5, 2007) ("The overriding theme of recent amendments to the discovery rules has been open and forthright sharing of information by all parties to a case with the aim of expediting case progress, minimizing burden and expense, and removing contentiousness as much as practicable.").

4. Fed. R. Civ. P. 26(b)(2) advisory committee's note (2006) (noting that if the requested electronic source information is not "reasonably accessible" then the requesting party must show "good cause" to obtain discovery); id. ("Appropriate considerations may include (1) the specificity of the discovery request; (2) the quantity of information available from other and more easily accessed sources; (3) the failure to produce relevant information that seems likely to have existed but is no longer available on more easily accessed sources; (4) the likelihood of finding relevant, responsive information that cannot be obtained from other, more easily accessed sources; (5) predictions as to the importance and usefulness of the further information; (6) the importance of the issues at stake in the litigation; and (7) the parties' resources.").

5. Fed. R. Civ. P. 26(f) advisory committee's note (2006) ("Parties may attempt to minimize these costs and delays by agreeing to protocols that minimize the risk of waiver. They may agree that the responding party will provide certain requested materials for initial examination without waiving any privilege or protection—sometimes known as a 'quick peek.' …On other occasions, parties enter agreements—sometimes called 'clawback agreements'…").

6. Fed. R. Evid. 502 advisory committee's note (2007) ("[The Rule] responds to the widespread complaint that litigation costs necessary to protect against waiver of the attorney-client privilege or work product have become prohibitive due to the concern that any disclosure…will operate as a subject matter waiver of all protected communications or information. This concern is especially troubling in cases involving electronic discovery.").

7. Fed. R. Civ. P. 26(b)(2)(B); see also *Zubulake v. UBS Warburg LLC*, 217 F.R.D. 309 (S.D.N.Y. 2003); *Rowe Entm't Inc. v. William Morris Agency Inc.*, 205 F.R.D. 421 (S.D.N.Y. 2002).

8. *Ashcroft v. Iqbal*, 129 S.Ct. 1937 (2009); *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007).

9. *Iqbal*, 129 S.Ct. at 1953; *Twombly*, 550 U.S. at 557.

10. *Twombly*, 550 U.S. at 559.

11. Notice Pleading Restoration Act, S. 1504, 111th Congress (2009); Access to Justice Denied—*Ashcroft v. Iqbal*: Hearing Before the Subcomm. on the Constitution, Civil Rights, and Civil Liberties of the H. Comm. on the Judiciary, 111th Cong. (Oct. 27, 2009).

12. Joint Comm. on Elec. Discovery, New York City Bar, "Explosion of Electronic Discovery in All Areas of Litigation Necessitates Changes in CPLR" (August 2009).

13. 22 N.Y.C.R.R. §202.70 (Rule 8 of the New York Commercial Division of the Supreme Court).

14. See, e.g., Comm. on State Courts of Superior Jurisdiction, New York City Bar, "Proposed Amendment to Uniform Rule 202.12" (Dec. 28, 2007); Commercial & Fed. Litig. Sec., New York State Bar Ass'n, "Report Recommending Certain Amendments to the CPLR Concerning Electronic Discovery" (December 2007).

15. See Christopher M. Caparelli and Tracy Zanco, "Allocating E-Discovery Costs in New York," New York Law Journal, Aug. 18, 2009; Patrick M. Connors, "Which Party Pays the Costs of Document Disclosure," 29 Pace L. Rev. 441, 450 (2009) (noting that the rule requiring the requesting party to incur discovery costs "has now been subscribed to by several" New York courts); see also *T.A. Ahern Contractors Corp. v. Dormitory Auth.*, 875 N.Y.S.2d 862, 869 (Sup. Ct., N.Y. Cty. 2009); *Delta Fin. Corp. v. Morrison*, 13 Misc.3d 604, 608-09 (Sup. Ct., Nassau Cty. 2006); *Etzion v. Etzion*, 7 Misc.3d 940, 944-45 (Sup. Ct., Nassau Cty. 2005); *Lipco Elec. Corp. v. ASG Consulting Corp.*, No. 8775/01, 2004 WL 1949062, at *7-*8 (Sup. Ct., Nassau Cty. Aug. 18, 2004).

16. See, e.g., *Phillips v. City of New York*, 884 N.Y.S.2d 369, 383 n.26 (1st Dept. 2009) (upholding the sufficiency of the plaintiff's allegation that she was "a person with a disability as defined in Executive Law §292(21)"); see also N.Y. C.P.L.R. 3013 (2009) (providing that the touchstone is "notice of the transactions, occurrences, or series of transactions or occurrences, intended to be proved and the material elements of each cause of action or defense"); *Rapoport v. Schneider*, 29 N.Y.2d 396, 403-04 (N.Y. 1972) (noting that "the primary purpose of pleadings" is "that of notice").

17. For instance, Delaware's civil procedure rules tend to track the Federal Rules of Civil Procedure verbatim. See *Grogan v. O'Neil*, 292 F. Supp. 2d 1282, 1292 n.16 (D. Kan. 2003) ("Rules 12(b)(6) and 56 of the Delaware Chancery Court Rules are substantially identical to the analogous rules in the Federal Rules of Civil Procedure."); see also *Omnicare Inc. v. Mariner Health Care Mgmt. Co.*, No. 3087-VCN, 2009 WL 1515609, at *7 (Del. Ch. May 29, 2009). And California recently adopted electronic discovery rules that are modeled on the Federal Rules of Civil Procedure. See Cal. Civ. Proc. Code §§2031.030, 2031.060, 2031.210, 2031.285, 2031.310.