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Document Destruction May Lead To Civil And Criminal Sanctions

In two recent cases, federal courts have imposed substantial sanctions on corporations and their non-party officials for destroying documents related to pending litigation. In its decision *In re Prudential Ins. Co. of America Sales Practices Litig.,* 169 F.R.D. 598 (D.N.J. 1997), the U.S. District Court for the District of New Jersey imposed a $1 million civil sanction on Prudential Insurance Company and required it to pay costs and attorney's fees. In *U.S. v. Lundwall,* 1 F.Supp.2d 249 (S.D.N.Y. 1998), the U.S. District Court for the Southern District of New York refused to dismiss an indictment for obstruction of justice against officials of Texaco, Inc.

Early on in the Prudential litigation, the district court issued an order requiring all parties to "preserve all documents and other records containing information potentially relevant to the subject matter of this litigation." Despite this court order, four Prudential field offices destroyed potentially relevant documents.

The court determined that the document destruction occurred because of a series of lapses by Prudential. Specifically, although Prudential management distributed warnings through its e-mail system to employees to preserve documents, the e-mails were an ineffective, haphazard means of relaying information about document preservation because they did not go to every employee, and failed to include copies of the Court Order or even mention either the Order or the pending lawsuit.

In addition, the court noted that Prudential failed to create a hotline or other procedure to enable non-management employees to report evidence of document destruction, and

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neglected to designate a primary contact person for issues related to document preservation. Moreover, Prudential had actually instructed employees -- through its previously-published "Marketing Material Audit Blueprint" -- to destroy outdated marketing materials.

The United States for the Southern District of New York refused to dismiss the indictment of two officials of Texaco for destroying documents in a civil case involving claims of racial discrimination against Texaco. After receiving instructions from its legal counsel to retain and collect documents relevant to the discrimination case, Texaco assigned two officials to collect relevant documents requested by the plaintiff. Instead, these officials first withheld and then destroyed documents sought by the plaintiff. The court held that the federal statute prohibiting obstruction of justice (18 U.S.C. §1503) -- "whoever corruptly…endeavors to influence, obstruct or impede, the due administration of justice, shall [be guilty of a federal crime] " -- was clear and broad enough to encompass the acts of document destruction. The court found that, even though civil penalties were available through discovery sanctions, prosecutors could pursue criminal sanctions against the individuals because their behavior had been intentional.

Both of these cases demonstrate the seriousness with which courts view document destruction during pending litigation. Parties who become engaged in litigation should quickly discuss with counsel appropriate methods of document retention and preservation of evidence, including the most effective ways to communicate such directives to employees at all levels and to enforce the directives.

United States Supreme Court Allows Health Insurance Fraud Claims To Be Brought Under Federal RICO Statutes

Earlier this year the United States Supreme Court unanimously allowed health insurance beneficiaries to invoke federal law to recover triple damages and attorney's fees for health care fraud. In *Humana, Inc. v. Forsyth*, 119 S.Ct. 710 (1999), the Court expressly recognized the applicability of the federal Racketeer Influenced and Corrupt Organizations Act ("RICO") -- 18 U.S.C. § 1961 et seq. -- to such claims, finding that RICO complemented and did not interfere with state insurance laws, and, thus, was not barred by the McCarran-Ferguson Act, 15 U.S.C. § 1011, et seq.

The plaintiffs in the case alleged that the defendant insurance company had conspired with its co-defendant and wholly-owned hospital to secure large discounts on the insurer's portion of

hospital charges. The plaintiff-employee-beneficiaries brought their case under the RICO statute. The defendants argued that the use of RICO impaired Nevada's state insurance laws because the federal statute allowed broader remedies than those provided under state law, and, therefore, was unavailable to potential plaintiffs under the restrictions of the McCarran-Ferguson Act. 1

In rejecting the defendants' arguments, the Supreme Court found that in passing the McCarran-Ferguson Act, Congress did not intend "to preclude federal regulation merely because the regulation imposes liability additional to, or greater than, state law." *Id.,* at 717. Therefore, because Nevada's state insurance law allowed beneficiaries to bring statutory and common-law fraud claims, beneficiaries could also, when applicable, invoke RICO's private right of action even though the federal claim might entitle successful plaintiffs to treble damages and attorney's fees awards which the state law claims did not provide.

Federal Prosecutors Now Subject To All State Ethical Regulations

On April 19, 1999, the McDade Amendment, 28 U.S.C. § 530B, became effective, subjecting all federal government attorneys, including federal prosecutors, to the ethical laws and rules of the states in which they practice. 2 The Department of Justice had vigorously opposed this requirement and is expected to challenge its application on an issue by issue, state-by-state basis. In the white collar context, the Department of Justice believes that defense attorneys will use the Amendment to impede or delay, if not prevent, particular investigative practices of federal prosecutors, including *ex parte* prelitigation or preindictment communications with lower and mid-level employees, and will discourage independent government witnesses from cooperating with defense counsel.

The ultimate reach of the Amendment is unknown at this time. [3] However, if unchanged, it could have a material effect on the freedom prosecutors have enjoyed in their investigative work.

Economic Espionage Act Creates Dilemma For Victims Of Intellectual Property Theft

The Economic Espionage Act (EEA), 18 U.S.C. §§ 1831, et. seq., is a powerful new weapon against the theft of intellectual property, especially trade secrets. *United States v. Hsu,* 115 F.3d 189 (3rd Cir. 1998) is the first (and to date only) federal appellate court decision involving

an EEA prosecution. It illustrates the conflict between congressional intent to protect proprietary information from disclosure to the public (thereby destroying the value of the trade secret) and the right of a criminal defendant to the disclosure of documents in the government's possession that are material to preparation of the defense.

The defendants were charged under 18 U.S.C. § 1832(a)(4) and (a)(5) with attempt and conspiracy to receive and possess the formulae and processes for Taxol, an anti-cancer drug manufactured by Bristol-Myers. The government sought a protective order under § 1835 of the EEA to protect the confidentiality of the victim's trade secrets during trial, and to preclude its disclosure to the very same defendants who had sought to steal the formulae and processes. The trial court balanced the competing interests of trade secret confidentiality and the defendant's constitutional right to discovery in favor of the defendant's access to the claimed proprietary information.

The Third Circuit reversed, reasoning that: (1) defendants were only charged with attempt and conspiracy to steal trade secrets, not the completed offense of theft of trade secrets; (2) proof that the defendants sought to steal actual trade secrets is not an element of the crimes of attempt or conspiracy under the EEA; (3) therefore, any trade secrets in the Bristol-Myers documents are not material to the preparation of defendants' defense to those charges of attempt and conspiracy; and (4) therefore, defendants have no right to discovery of those immaterial documents.

Hsu raises but does not resolve two critical issues that will be faced in future EEA prosecutions. First, victim corporations may face a dilemma in deciding whether to refer to the Department of Justice cases of attempted theft of trade secrets where commencement of federal prosecution under the EEA might compel disclosure of trade secrets to the defendant and defense counsel as part of discovery - the very same secrets that the victim corporation seeks to protect by making its voluntary referral to the government. Second, defense counsel increasingly may seek to establish the materiality of the purported trade secrets allegedly for the preparation of potential defenses of entrapment, outrageous government conduct, or jurisdiction - but perhaps for the additional purpose of compelling discovery of trade secrets, the prospect of which might force settlement or dismissal.

In short, the EEA provides the owners of trade secrets with an effective tool in combating the

dangers of trade secret theft. However, given the potential discovery pitfalls, companies confronted with potential theft should think through their entire strategy together with counsel before deciding how best to address any given trade secret issue.

Second Circuit Recognizes That Business Documents Prepared In Anticipation Of Litigation Are Entitled To Work Product Protection

In *U.S. v. Adlman*, 134 F.3d 1194 (2d Cir. 1998), the United States Court of Appeals for the Second Circuit adopted a broad test for determining whether a document was prepared in "anticipation of litigation" and, therefore, is entitled to protection under the work product doctrine of Fed. R. Civ. P. 26(b)(3).

In *Adlman*, the Internal Revenue Service ("IRS") sought a memo which had been prepared by a company's outside accounting firm at the request of the company's attorney. The memo pertained to the tax implications of a proposed corporate restructuring. The company's attorney sought the advice of the accounting firm because he expected that, if the restructuring occurred, there would be a large loss and tax refund which, in turn, would trigger an audit and litigation by the IRS. When the IRS requested the memo in discovery, the company's attorney declined to produce it, citing the work product privilege.

The district court rejected the work product argument because, when the memo was prepared, litigation had not yet occurred. Consequently, the court held that the memo was not prepared "in anticipation of litigation." Moreover, the district court held that the memo was prepared primarily for business purposes rather than to prepare for litigation.

On appeal, the United States Court of Appeals for the Second Circuit vacated the district court's order, holding that it had likely applied the wrong standard for determining whether the memo was prepared in "anticipation of litigation." The Court held that the appropriate test for determining whether a document is prepared "in anticipation of litigation" is a "because of" test rather than a "primarily to assist in" test. Under the "because of" test, a document is entitled to protection regardless of whether its primary purpose is to assist in, prepare for, or conduct litigation, as long as it can be shown that the document would not have been created but for the anticipation of litigation. The fact that a document has a dual purpose or that its primary purpose is to serve a business purpose is irrelevant. In *Adlman*, then, the memo was entitled to work product protection because, although it was prepared to inform a proposed corporate

restructuring (that is, to inform a business decision), it would not have been created but for the fact that the corporation anticipated litigation from the IRS.

In reaching this decision, the Second Circuit 4 joined the Third, Fourth, Seventh, Eighth, and D.C. Circuits in adopting the broader "because of" test. The First Circuit has yet to address this issue. *See U.S. v. Massachusetts Institute of Technology*, 129 F.3d 681, 687 (1st Cir. 1997) (noting that "there is little law in this area -- partly, one suspects, because work product usually remains embodied in documents unquestionably prepared for litigation..."). However, several district courts in the First Circuit have applied the broader "because of" test. *See, e.g.*, *Colonial Gas Co. v. Aetna Cas. & Sur. Co.*, 144 F.R.D. 600, 605 (D. Mass. 1992) (citing *Resnick v. American Dental Ass'n*, 95 F.R.D. 372, 375 (N.D.Ill. 1982)); *Winter Panel Corp. v. Reichhold Chemicals, Inc.*, 124 F.R.D. 511, 515 (D. Mass. 1989) (applying "because of" test but rejecting claim of work product privilege).

Court Upholds Denial Of Lewinsky's Attorney-Client Privilege Because Of Crime-Fraud Exception

In *In Re: Sealed Case*, 162 F.3d 670 (D.C. Cir. 1998), the United States Court of Appeals for the District of Columbia upheld a district court ruling that Monica Lewinsky could not rely on the attorney-client privilege to protect her personal attorney from testifying before the grand jury because the crime-fraud exception applied to her conduct.

In January 1997, Monica Lewinsky received a deposition subpoena to produce items and testify in the *Paula Jones v. William Jefferson Clinton* civil case. In connection with this subpoena, Lewinsky retained an attorney who drafted an affidavit in which Lewinsky stated that she never had a sexual relationship with the President.

A year later, pursuant to the Office of Independent Counsel's investigation, a grand jury issued a subpoena to Lewinsky's attorney for documents and testimony.

Lewinsky sought to quash the subpoenas contending that the documents and testimony were protected by the attorney-client privilege. The district court rejected this claim, holding that the crime-fraud exception to the attorney-client privilege applied -- that is, because Lewinsky consulted her attorney for the purpose of committing perjury and obstructing justice and because she, in fact, used material that her attorney prepared to commit perjury and obstruct

justice, she could not invoke the attorney-client privilege. The Court of Appeals affirmed.

Attorneys May Be Convicted Of Obstruction Of Justice For Extreme Litigation-Related Activities

In *U.S. v. Cueto*, 151 F.3d 620 (7th Cir. 1998), the United States Court of Appeals for the Seventh Circuit upheld attorney Amiel Cueto's criminal conviction of obstruction of justice for his litigation-related actions on behalf of his client.

The case arose out of the conviction of Thomas Venezia for racketeering, illegal gambling, and conspiracy. Cueto, an attorney and advisor to Venezia, was subsequently convicted of obstruction of justice for his efforts in connection with the government's investigation and prosecution of Venezia, including:

- Accusing a state liquor agent who was investigating Venezia's business operations of bribery and requesting that the State Attorney indict the agent.
- Filing a complaint for bribery against the agent in state court.
- Drawing the agent into court on a separate matter, and then serving the agent papers which required him to appear for a preliminary injunction hearing within fifteen minutes.
- A fter the court entered a preliminary injunction against the agent prohibiting the agent from investigating Venezia, and the agent ignored the injunction and continued investigating Venezia's illegal gambling operations, Cueto requested that the agent be held in contempt.
- When the agent prevailed in federal court to dissolve the injunction, Cueto filed an appeal in the Court of Appeals and, upon denial, filed a petition for certiorari to the Supreme Court.
- Once the grand jury was empaneled to investigate Venezia, Cueto filed various motions to hinder the investigation and to discharge the grand jury.

After a jury trial, Cueto was convicted of obstruction of justice. Cueto appealed the decision, claiming that traditional litigation-related conduct is not within the scope of the obstruction of justice statute since much of what lawyers do are attempts to influence the justice system. The Court of Appeals rejected this argument, holding that litigation-related criminality hinges more on motivation or intent than on acts performed. The court held that, while Cueto's means did not violate the law, his motivation and intent ran afoul of the obstruction of justice statute.

Cueto and Venezia had entered into a variety of businesses together, many of which relied on financing from Venezia's illegal gambling activities. The court noted that the more Cueto could shield Venezia from governmental investigation the more Cueto would benefit financially. The court stated, "It is undisputed that an attorney may use any lawful means to defend his client, and there is no risk of criminal liability if those means employed by the attorney in his endeavors to represent his client remains within the scope of lawful conduct. However, it is the corrupt endeavor to protect the illegal gambling operation and to safeguard his own financial interest, which motivated Cueto's otherwise legal conduct, that separate his conduct from that which is legal." *Id.*, at 631.

[1] The McCarran-Ferguson Act provides in relevant part: No Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance. 15 U.S.C. § 1012(b).

[2] Specifically, the amendment provides: An attorney for the Government shall be subject to State laws and rules, and local Federal court rules, governing attorneys in each State where such attorney engages in that attorney's duties, to the same extent and in the same manner as other attorneys in the State. 28 U.S.C. § 503B(a).

[3] Apparently to address some of these concerns, on the day the Amendment became effective, Senator Orin Hatch filed a bill severely restricting the reach of the Amendment. Under the proposed changes, the statute would cover only federal prosecutors employed by the Department of Justice rather than all government attorneys, would subject those prosecutors only to the laws and rules of states in which the prosecutor is specifically licensed as an attorney, and would not apply at all if a given state law or rule either was "inconsistent with Federal law or interferes with the effectuation of Federal law or policy, including the investigation of violations of Federal law."

[4] The Second Circuit noted that any work product protection was still subject to the "substantial need" showing of Rule 26(b)(3) and other well-established restrictions on the work product doctrine itself.

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