



# Bankruptcy Litigation Committee

## ABI Committee News

**In This Issue**

**Volume 6, Number 1 / January 2009**

- [The Emergence of E-Discovery in Bankruptcy](#)
- [The Availability and Application of Civil Sanctions in Bankruptcy Court](#)
- [So Who's An Expert Anyway?](#)

### The Emergence of E-Discovery in Bankruptcy

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Bankruptcy courts are not immune to electronic discovery disputes. Professionals serving clients involved in bankruptcy litigation would be well-advised to understand the legal and practical implications that the preservation, collection, analysis and production of electronically stored information (ESI) has on the discovery process.

Many recent cases illustrate the mishaps that may occur in connection with ESI. In *In re Quintus Corp.*, 353 B.R. 77 (Bankr. D. Del. 2006), for example, Avaya acquired substantially all of the assets of Quintus, a debtor in bankruptcy. Subsequently, the trustee commenced an adversary proceeding alleging a breach of contract against Avaya. Among other things, the trustee sought the production of electronic documents. Based in part on Avaya's failure to produce electronic documents in discovery, the trustee sought summary judgment against Avaya. During the trial, the trustee learned that the requested electronic documents had been destroyed. Accordingly, the court found in favor of Quintus and held that, "Avaya deliberately deleted the debtors' electronic records in order to give itself more computer space...[F]urther, Avaya did not merely alter the evidence, it destroyed it. Thus, the court concluded that the most severe sanction of judgment against Avaya [for discovery abuse] was warranted." K&L Gates LLP, *\$1.888 Million Judgment Entered in Favor of Bankruptcy Trustee Based on Adverse Party's Spoliation of Financial Records*(Nov. 3, 2006), [www.ediscoverylaw.com/2006/11/articles/case-summaries/1888-million-judgment-entered-in-favor-of-bankruptcy-trustee-based-on-adverse-partys-spoliation-of-financial-records/](http://www.ediscoverylaw.com/2006/11/articles/case-summaries/1888-million-judgment-entered-in-favor-of-bankruptcy-trustee-based-on-adverse-partys-spoliation-of-financial-records/). Thus, the court awarded the trustee \$1.9 million

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as a sanction for a deliberate violation of the discovery rules.

Moreover, in *In re New Century TRS Holdings Inc., a Delaware corporation, et al.*, (No. 07-10416, Bankr. D. Del.), the debtor's law firm had to apologize to the bankruptcy court for a "discovery mishap" in which more than 700,000 e-mails were not turned over to the bankruptcy examiner as requested. The law firm "[b]lamed an outside vendor for the problem... [A]s for the document production mishap...[the bankruptcy examiner] consistently complained about delays and difficulties in conducting the investigation." O'Melveny & Myers LLP, *O'Melveny Says It's Sorry for Missing E-Mails*, Law.Com (Jan. 23, 2008), [www.law.com/jsp/article.jsp?id=1200996345419](http://www.law.com/jsp/article.jsp?id=1200996345419).

In this article, we discuss several topics of interest related to electronic discovery as it applies to bankruptcy. First, we address the importance and value of ESI. Second, we explore recent changes to federal rules related to ESI. Third, we explain the importance of ESI in bankruptcy cases and proceedings. Finally, we discuss the preservation, collection and analysis of ESI in bankruptcy cases and proceedings.

### **Importance and Value of ESI**

Substantive investigations that occur during the bankruptcy process, such as substantive consolidation, insolvency, insider transactions, actual or constructive fraudulent behavior and the administration of the creditor claim process, could all lead to the recovery of property to or for the benefit of the debtor's estate. ESI can be invaluable in providing support for these investigations.

Surveys indicate that a large majority of all documents produced since 2000 were created in digital form. Over 183 billion e-mail messages are sent per day. Further, just 1 GB of Excel files can yield more than 165,000 pages. ESI is not going away; it's expanding exponentially.

### **Changes to Federal Rules of Civil Procedure**

Civil procedure has not been blind to this ESI evolution. The changes to the Federal Rules of Civil Procedure (FRCP), effective Dec. 1, 2006, reflect this. For example, Fed. R. Civ. P. 26, incorporated in bankruptcy proceedings and matters under Bankruptcy Rules 7026 and 9014, was amended to direct that a party must, among other things, address the management, retention and disclosure of ESI early in a case. Fed. R. Civ. P. 26 (2008). For example, at the outset of an adversary proceeding, subject to certain exemptions or stipulations or order of the court, a party must voluntarily, and without awaiting a discovery request, provide the other parties with a description by category and location of all ESI that the party has in its possession, custody or control and may use this information to

support its claims or defenses. Fed. R. Civ. P. 26(a)(1)(A)(ii) (2008).<sup>[2]</sup> Moreover, Rule 26 now requires that counsel gain a familiarity with the parties' systems and develop a discovery plan that addresses ESI. See Fed. R. Civ. P. 26(f)(3)(C) (2008). The Federal Rules of Civil Procedure encourage discussion at an early stage when it is anticipated that ESI will be produced. Thus, FRCP rule 26 imposes on counsel the obligation of understanding their clients' ESI, and ESI in general, to effectively communicate with others.

Fed. R. Civ. P. 34, incorporated in bankruptcy proceedings through Bankruptcy Rules 7034 and 9014, governs the production of ESI, among other things, allowing the requesting party to specify the form of production. See Fed. R. Civ. P. 34(a) and (b)(1)(C) (2008) *see also*, Fed. R. Civ. P. 34(b)(2)(D) and (E) (2008) (regarding responding to a request for production of electronically stored information and producing electronically stored information, respectively). Specification of the desired form or forms may facilitate the orderly, efficient and cost effective discovery of electronically stored information. The Rule recognizes that different forms of production may be appropriate for different types of electronically stored information. See Fed. R. Civ. P. 26(b)(2)(B) (2008).

Rules 26 and 34 impose an onus on counsel to not only understand the legal and practical implications of ESI, but also to understand what the new rules require, how best to execute ESI production and in what form in order to effectively counsel clients. The Federal Rules of Bankruptcy Procedure (FRBP) incorporate these rules and refer directly to the FRCP with respect to the discovery and production of ESI.

### **Importance of ESI in Bankruptcy**

As noted above, ESI can be an invaluable investigative tool in bankruptcy cases and proceedings. As an example, electronic financial records can be analyzed to identify preferential transfers or insider transactions, and further analyzed to assess potential offsetting defenses, such as ordinary course and new value. Additionally, e-mail, as well as electronic financial records, can be used to support or refute an actual fraud allegation or claim for substantive consolidation.

Further, Fed. R. Bankr. P. rule 2004(c), has incorporated procedures to compel a party to produce ESI. Due to the importance and overwhelming volume of ESI, in practice, parties often negotiate an exchange of documents and ESI to avoid the broad powers of FRBP rule 2004(c). Given the volume of ESI, its legal necessity, and its importance to bankruptcy, it is beneficial to address here how ESI is preserved, collected and analyzed.

### **ESI Preservation, Collection and Analysis**

ESI can be stored on laptops, desktops, network servers, e-mail servers,

removable media, PDAs and many other devices. When forensic examiners collect ESI from these sources, they can then perform a variety of different analyses that can assist attorneys, financial advisors and examiners in better understanding the facts and circumstances surrounding potential causes of action. Such analyses can include culling/document review, metadata analyses and deletion analysis.

*Culling/Document Review:* Most cases, bankruptcy or otherwise, begin with collecting, culling and reviewing the ESI. After certified forensic examiners preserve the ESI with the appropriate tools and prepare the necessary documentation, the ESI is transferred to a secure lab and ESI that is most likely not relevant to the case is removed. Examples of irrelevant ESI include multiple copies of the same files (this process is called "de-duplication"); known system files that are often prepackaged and installed on computers, such as Microsoft executables for Word and Excel; and files outside of the date range of interest. Password-protected and other "exception" files are also addressed at this time. Once these processes are completed and exception files are addressed, a keyword list is often applied to the resulting data to further refine the search for relevant information. See *generally* Fed. R. Bankr. P. 2004(c) (2008) (regarding compelling attendance for oral examination and production of documents through issuance of a subpoena by counsel); see Fed. R. Bankr. P. 9016 (2008) (regarding the production of electronically stored information by subpoena).<sup>[3]</sup>

Now the "processed" ESI is ready for review. Review platforms are available in many shapes and sizes and should be selected based on their suitability to a particular case. When selecting a review platform, consideration should be given to issues such as the volume of ESI, number of reviewers and their locations, foreign language requirements, redaction requirements, cost and many other criteria. Various platforms address these issues differently and have different advantages.

*Metadata Analysis:* Attorneys, financial advisors and examiners often ask "Who saw this document and when?," "Who authored this document?" and others. These questions can be important to a bankruptcy case, especially those in which fraud is alleged. These questions can be addressed by using different metadata analysis tools. If a document, or set of documents, is of specific concern, more information can be gleaned and exposed about the document(s) beyond a simple view of the document properties in Windows Explorer. The "track changes" feature in Microsoft Word can also be exposed, as well as the time and date of the last several authors of the document, the printing dates and times and the number of modifications made to the document.

*Deletion Analysis:* Not only can deleted files that may be pertinent to a case be recovered, but the ability to know whether an individual has purposely altered the

contents of a hard drive prior to preservation can be equally valuable. The identification of wiping utilities can be paramount to a spoliation or adverse inference claim. See Fed. R. Bankr. P. 7037(e) (2008).<sup>[4]</sup>

## Conclusion

Although the ESI preservation effort, analysis and even the concept of ESI generally may seem daunting, it is a necessary step, as well as an effective means by which relevant information can be leveraged to recover assets to or for a debtor's estate. Bankruptcy practitioners, attorneys, financial advisors and examiners can better serve the needs of their clients by understanding the breadth and depth of electronic discovery in bankruptcy litigation.

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  2. It should be noted that Rule 26 provides for specific limitations on producing electronically stored information where the sources of such information are not reasonably accessible because of undue burden or cost. Similar to traditional documentary discovery, a protective order can be sought and discovery can be compelled upon the showing of good cause.
  3. Keywords are not always applied. The determination of whether keywords should be applied is based on the circumstances of each case. In addition, there are limitations to keyword searching. For more information, see Jennifer Aira-Ventrella, "Harnessing the Hidden Value," *New Jersey Law Journal*, June 16, 2008.
  4. It should be noted that absent exceptional circumstances, a court may not impose sanctions on a party for failing to provide electronically stored information lost as a result of the routine, good-faith operation of an electronic information system.