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Based on defendant parent company's "control," NY's highest court orders new trial on sanctions for spoliation for destroyed ESI

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Opening the door for requiring greater litigation oversight by parent companies, the New York State Court of Appeals (New York's highest court) issued an opinion upholding the trial court's determination that a parent company exercised sufficient control over the subsidiary to be negligent in not requiring the institution of a litigation hold at the subsidiary, and, therefore, could properly be sanctioned for spoliation of evidence. The trial court found that the failure to institute a litigation hold notice, coupled with at least two computer crashes, rose to the level of gross negligence. The appellate court, however, reversed the sanctions against the parent company, finding that the failure amounted only to simple negligence and that the plaintiffs had not proven that the missing ESI was relevant. The court of appeals sided with the appellate court on the issue of negligence, finding that the failure to issue a litigation hold notice was not "per se gross negligence." The court of appeals, however, held that the appellate court "all but ignored [the plaintiff's] arguments concerning the relevance of the documents" and remanded the case to the trial court for a determination as to whether the destroyed ESI was relevant to plaintiffs' claims against the parent defendants and what sanction, if any, is warranted. While there was much dispute about the level of culpability of the parent company, all three courts agreed that the parent exercised sufficient control to be liable for the spoliation. This case leaves no doubt that the best course of action is to require implementation of a litigation hold.

Background

The plaintiffs, a number of corporations under the Pegasus umbrella ("Pegasus"), originally brought suit in Florida against Varig Logistica ("VarigLog"), a Brazilian air cargo company, for breach of contract related to aircraft leases. In October 2008, Pegasus dismissed its Florida suit and filed suit against both VarigLog and its owner, MP Global Advisers ("MP"), in New York, alleging breach of contract and conversion, alleging that MP Global Advisers acted as the "alter ego" of VarigLog.

During discovery, it was discovered that prior to 2008, VarigLog had no e-mail or other electronic data preservation system. Beginning in March 2008, shortly after being sued in Florida by Pegasus, VarigLog began an ESI backup program. Yet multiple computer crashes in February and March of

2009 wiped out much of that data. VarigLog had never instituted a litigation hold. As a result, Pegasus sought sanctions against both VarigLog and its parent, MP.

The trial court finds "gross negligence"

Under New York law, a party seeking sanctions for spoliation of evidence must establish (1) that the party with control over the destroyed evidence had the obligation to preserve it, (2) that the evidence was destroyed with a "culpable" state of mind, and (3) that the destroyed evidence was relevant to that party's claims. The Supreme Court not only found that MP's control over VarigLog's operations were such that they had a duty to preserve the evidence, but that the failure to institute a "litigation hold" amounted to gross negligence as a matter of law and was, therefore, per se relevant to the claims of Pegasus. Important in the control analysis, MP had been granted authority of the "administration and management" of VarigLog through a Brazilian court, and other facts indicated that MP held significant control over VarigLog's operations. Thus, the trial court granted the Pegasus motion for sanctions against MP as well as VarigLog, striking MP's answer and imposing a trial adverse inference sanction regarding the missing ESI.

A split appellate court reverses sanctions decision

The five-justice appellate court reversed the sanctions against MP with two dissenting justices. While the appellate court agreed that MP had a duty to preserve VarigLog's ESI, the appellate court instead found that failure to institute a litigation hold to be only simple negligence. The appellate court then reasoned that the plaintiffs had not shown the relevance of the destroyed ESI to their claims and, as such, no sanctions were warranted.

Of the two dissenting justices, one agreed with the trial court that MP acted with gross negligence while the other, though not finding gross negligence, believed that some type of sanction was warranted.

New York's highest court sides with appellate court in simple negligence finding

On the appeal and certified question from the appellate court, the court of appeals was limited in factual finding to agreeing either with the trial court or with the appellate court on the issue of culpability or negligence. The court of appeals agreed with the appellate court that MP's actions were simple negligence, not gross negligence, and therefore, not per se relevant. Judge Pigott, writing for the majority, noted that "a party's failure to institute a litigation hold is but one factor that a trial court can consider in making a determination as to the alleged spoliator's culpable state of mind." (Slip op. at 11.) Judge Pigott also noted the appellate court's review that highlighted MP's retention of separate legal counsel throughout the proceedings and MP's adequate response to all of the discovery requests made directly to them, thereby "negating any inference that the MP defendants were reckless concerning Pegasus's demands made on them." (Id.)

The ability to pursue "alter ego" liability for spoliation sanctions should make parent companies wary of assuming that a subsidiary is taking proper protections in litigation regarding its ESI and even its paper documents. Again, the best practice is to institute a litigation hold with the help of outside counsel.

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