Nixon Peabody LLP
Corporate Responsibility Alert
Developments in the law of Corporate Governance

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Supreme Court's Reversal in Arthur Andersen Case Casts Spotlight on Document Retention Policies

By Mark D. Robins

The Supreme Court has reversed one of the most publicized convictions flowing out of the Enron debacle—the conviction of public accounting giant Arthur Andersen for witness tampering. Because this conviction was based on the manner in which Andersen implemented its document retention policy, much of corporate America may hope that this case signals a reversal of the judiciary's recent trend of imposing harsh penalties for failure to preserve evidence. However, the unique criminal statute at issue may prevent the Supreme Court's decision from having a direct or immediate effect on this trend. Accordingly, document retention is likely to remain a legal minefield for the foreseeable future.

Andersen's Document Retention Policy and the Collapse of Enron

Andersen's conviction arose out of its destruction of evidence pertaining to its audit work for Enron just as the Enron scandal was emerging. In August of 2001, shortly after Enron's CEO, Jeffrey Skilling, resigned, Enron's senior accountant, Sherron Watkins, warned newly reappointed CEO, Kenneth Lay, and two Andersen partners of looming accounting problems. By August 28, 2001, potential improprieties at Enron were reported in the Wall Street Journal and an informal investigation was opened by the SEC. By early September, Andersen had formed a "crisis-response" team including in-house counsel, Nancy Temple, and by October 8, Andersen had retained outside counsel in connection with potential Enron-related litigation. The next day, Ms. Temple's notes reflect that an SEC investigation was "highly probable."

Nevertheless, on October 10, one of the two Andersen partners who was warned by Ms. Watkins spoke at a general training meeting that included personnel on the Enron engagement team and urged compliance with Andersen's document retention policy. This

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partner expressed the view that destruction of evidence under the policy would be "great" if litigation were to be filed the next day. Two days later, Ms. Temple sent an e-mail to the same partner indicating that he should "remind the engagement team of our documentation and retention policy."

One day after Enron's October 16 announcement that it would take a $1.01 billion charge to earnings, the SEC notified Enron of the investigation and requested documents. The SEC's request was forwarded to Andersen on October 19. The same day, Ms. Temple sent an internal e-mail attaching a copy of Andersen's document retention policy. During a call with the crisis-response team the next day, Ms. Temple instructed everyone to "make sure to follow the . . . policy." Three days later, Mr. Lay declined to answer questions during an analyst call because of "potential lawsuits, as well as the SEC inquiry." After this call, the head of Andersen's audit engagement team for Enron instructed other partners on the team to ensure that team members were complying with the policy. Substantial destruction of paper and electronic records ensued. Even after the SEC opened a formal investigation on October 30, the destruction continued until one day following service of a subpoena by the SEC.

The Witness Tampering Statute and Andersen's Conviction

Based on this conduct, Andersen was convicted of violating the federal witness tampering statute. Among other things, this statute prohibits anyone who "knowingly uses intimidation or physical force, threatens, or corruptly persuades another person, or attempts to do so, . . . with intent to cause or induce any person to . . . withhold a record, document, or other object from an official proceeding [or] alter, destroy, mutilate, or conceal an object with intent to impair the object's integrity or availability for use in an official proceeding. . . ." At issue were the words "knowingly . . . corruptly persuades" and "official proceeding." The jury was instructed that Andersen could be convicted even if it honestly and sincerely believed that its conduct was lawful. The Supreme Court held that it was improper to convict Andersen without instructing the jury that a conviction requires knowledge of the wrongdoing. The Supreme Court also held that the jury instructions improperly failed to inform the jury that it must find a link between the "persuasion" to destroy the documents and a particular "official proceeding." The Supreme Court agreed with the government that no proceeding need be pending or about to be instituted at the time of the offense, but held that, in order to act knowingly as a corrupt persuader, some particular official proceeding must be contemplated by the person who is persuading others to destroy documents.

What Does the Reversal Portend for Document Retention Policies?

The *Andersen* case marks a break from the recent raft of judicial rulings imposing harsh penalties on companies for failing to preserve evidence. However, the different outcome has much to do with the criminal context of the case and the particular statutory language at issue pertaining to persuading others to destroy evidence. In the civil context, many courts have been willing to impose harsh penalties for failure to preserve items such as back-up tapes containing e-mails—some courts doing so even where the conduct at issue was merely negligent. Even in jurisdictions that require a higher degree of culpability to impose such

penalties, this higher degree of culpability has often been found where individuals within a company fail to take steps to preserve all relevant evidence in the face of circumstances that should have made it clear that the company needed to locate and preserve evidence of the type that was lost. For example, in one case, the Eighth Circuit Court of Appeals found sufficient bad faith to impose sanctions where a defendant destroyed evidence pursuant to a document retention policy after the defendant knew that litigation was likely and that the items destroyed were items of a type usually important to the type of claim at issue.

Even in the criminal context, the types of obligations at issue in the *Andersen* case have since been enhanced. For example, the Sarbanes-Oxley Act amended the witness tampering statute to impose criminal penalties on anyone who "corruptly alters, destroys, mutilates, or conceals a record, document, or other object, or attempts do to so, with the intent to impair the object's integrity or availability for use in an official proceeding." Furthermore, the Sarbanes-Oxley Act imposes criminal penalties on anyone who knowingly alters or destroys evidence with the intent to impede, obstruct, or influence a federal investigation or bankruptcy proceeding and on auditors who fail to maintain all audit or review workpapers for a period of five years from the end of the fiscal year in which an audit or review was concluded. The SEC's regulations pursuant to the Sarbanes-Oxley Act require accountants who conclude certain audits or reviews to retain workpapers and other documents forming the basis of the audit or review, as well as other categories of evidence related to the audit or review, for a period of seven years following conclusion of the audit or review.

For companies besieged by the burgeoning number of decisions imposing harsh sanctions for failure to comply with the rapidly evolving duty to preserve evidence, the *Andersen* decision does offer a ray of hope in the Supreme Court's recognition that destruction of documents pursuant to document retention policies is not inherently wrongful. As stated by the Court: "It is, of course, not wrongful for a manager to instruct his employees to comply with a valid document retention policy under ordinary circumstances." However, the recent trend in civil litigation indicates that numerous types of circumstances are likely to be deemed not "ordinary" and, therefore, to be triggers to the duty to preserve evidence.

Accordingly, companies face the challenges of not only crafting appropriate document retention policies that meet their business needs and regulatory requirements but also putting in place procedures that will ensure the appropriate suspension of any destruction when the duty to preserve evidence is triggered, and ensuring that appropriate personnel have a sufficient understanding of when the duty to preserve is triggered and what must be preserved. Crafting such procedures will require not only legal guidance but input from many aspects of an organization on its data storage architecture, individual employee storage practices, and the types of records that tend to be implicated by various potential claims.

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