Preservation Of Electronic Records Of Third-Party Contractors

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"Know when to Hold 'Em."

OUTSOURCING TO third-party contractors—both domestic and international—is becoming commonplace in today's global marketplace. Indeed, many firms are outsourcing business functions traditionally done by in-house employees. Information technology call centers, advertising and marketing services, and other critical business operations are increasingly being transferred to outside contractors. *See, e.g.,* Scott W. Pink, *Recent Trends in Outsourcing: Understanding and Managing the Legal Issues and Risk*, 781 PLI/Pat 363 (March 2004) ("In the United States alone, outsourcing…is expected to grow to between $160 and $200 billion in annual revenue by 2005"); Vivian Hanson and John F. Delaney, *Offshore Outsourcing: Trends and Issues*, 807 PLI/Pat 447 (Fall 2004) ("Nearly 500,000 white-collar jobs have moved offshore to India, China, the Philippines, Russia and Eastern Europe"). As the ranks of firm employees have dwindled, the boundaries between company employees, and the third-party contractors who are doing more of the firms' work, have become increasingly hazy. One of the boundaries that have become blurred is whether companies must ensure that third-party contractors, like employees, preserve information that is relevant to pending or reasonably foreseeable litigation.

THE DUTY TO PRESERVE GENERALLY • By now, it is well established that a company has a duty to preserve

its own records that are relevant to pending or reasonably foreseeable litigation. *Zubulake v. UBS Warburg LLC*, 229 F.R.D. 422, 432-33 (S.D.N.Y. 2004) ("*Zubulake V*"); *United States of America v. Philip Morris USA Inc.*, 327 F. Supp. 2d 21 (D.D.C. 2004). Failure to exercise due diligence in preserving and producing relevant print and electronic records can lead to significant sanctions against the company or its executives, including default judgment, adverse inference jury instructions, monetary fines, and even criminal sanctions. *See* CNN, May 4, 2004 (reporting that Frank Quattrone was convicted of obstruction of justice for "encouraging" employees to "clean up those files" while under criminal investigation).

The *Zubulake* court took pains to announce that companies act at their own peril if they fail to fulfill their records retention and production obligations. And even before that, dozens of other courts had been spreading the same message—electronic records must be preserved properly, or significant sanctions will ensue. All of these cases, in addition to the now well-known "Sedona Principles" (*The Sedona Principles: Best Practices Recommendations & Principles for Addressing Electronic Document Production*, January 2004, available at: http://www.thesedonaconference.org) and other scholarly work, are vivid reminders that companies are, in Judge Scheindlin's words, clearly "on notice" of their duty to preserve and produce relevant electronic records. *Zubulake V*, supra, 229 F.R.D. at 440 ("now that the key issues have been addressed and national standards are developing, parties and their counsel are fully on notice of their responsibility to preserve and produce electronically stored information").

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The Litigation Hold

According to Judge Scheindlin, upon notice of pending or reasonably anticipated litigation, counsel needs to first create and distribute a "litigation hold" for relevant print and electronic records. That is, the party or entity must suspend its normal records retention and deletion policies, practices, procedures, and schedules, and instead work to ensure that documents and records relevant to the litigation are preserved. The litigation hold, therefore, trumps the normal records retention policy.

The litigation hold also requires counsel to send actual notice to employees and other parties who may be in possession of potentially relevant information. *Zubulake V*, supra, 229 F.R.D. at 432-33. This notice should make clear that these employees and other parties should preserve any documents or records relevant to the litigation.

What has not been addressed by *Zubulake V* or other case law is whether, and to what extent, a company must ensure that these duties are fulfilled by third-party contractors to whom the company has outsourced critical business functions.

A HYPOTHETICAL • The following is an increasingly common scenario that highlights potential third-party contractor records retention issues.

"Company," a national fast-food chain, is served with a class action complaint alleging that its popular product, "Freedom Fries," is responsible for a nationwide epidemic of obesity among minors. More specifically, the complaint alleges that the marketing campaign developed by Company's marketing agency ("Agency") misrepresented the safety of Freedom Fries and failed to warn of the adverse health effects of their consumption by minors. The complaint details that Company used patriotic themes and "Support our Troops" ribbon images on its print, television, and packaging

advertising to induce minors to believe that eating Freedom Fries was their patriotic duty.

Company's contract with Agency expressly provides that all work product developed by Agency under the account is "work for hire" and owned completely by Company. Several Agency employees work full-time at Company corporate headquarters under the direct supervision of Company staff and use Company e-mail and network computers to create and store work. Other Agency employees use their own Agency corporate resources to develop and store print and electronic work product for the account.

Shortly after service of the complaint, Company issued a records hold notice ("litigation hold") to all its employees to preserve all records, print or electronic, concerning the manufacture, sale, advertising, and marketing of Freedom Fries. Next, in the face of the lawsuit and adverse publicity, Company terminated its contract with its advertising Agency.

General Counsel for Company is considering whether Company has an obligation to notify Agency to preserve and transfer all records in its possession relating to the Freedom Fries advertising and marketing campaign. What should he or she do?

How Far Does The Hold Go?

Company's management and counsel must now decide whether Company's duty to preserve records relevant to the pending or reasonably foreseeable litigation extends to records in the possession of Agency. That is, does Company's records hold notice apply to such records in the custody of Agency, and does Company have a duty to ensure that these records are indeed preserved in accordance with Company's preservation obligations?

The ABA Approach

Although there is no clearly established authority on this issue, the American Bar Association Section of Litigation has intimated that such a duty may exist. In 1999, the ABA published its civil discovery standards. See Kenneth J. Withers, *Advanced Discovery Issues: Discovery & Protection of Electronic Data*, Appendix F, (SH093 ALI-ABA Course of Study 737, 778, June 23, 2003). The ABA standards provide a model order entitled "Order Regarding Data Preservation." The model order provides:

"Until the parties reach agreement on a preservation plan, all parties and their counsel are reminded of their duty to preserve evidence that may be relevant to this action. The duty extends to documents, data, and tangible things in the possession, custody, and control of the parties to this action, and any employees, agents, contractors,…or other non-parties who possess materials reasonably anticipated to be subject to discovery in this action."

Based on the ABA's model order, a company arguably has a duty to preserve the records of its independent contractor. This is because the model order appears to contemplate the preservation of data that is relevant to the litigation even if it is in the possession of a contractor or other non-party. See also ABA, *Amendments to Civil Discovery Standards*, August 2004, found at www.abanet.org/litigation/discoverystandards/2004civildiscoverystandards.pdf (discussing the duty to preserve potentially relevant documents in the client's "custody or control"); *The Sedona Principles*, supra, Comment 5.d., January 2004, available at: www.thesedonaconference.org ("Parties also should consider whether notice must be sent to third parties, such as contractors and vendors who provide information technology services"). Company is, therefore, left to ask, "When and under what circumstances could such a duty attach?"

A third-party contractor exists in a no man's land of sorts—somewhere between a functional "extension" of the company's operations on the one hand, and a truly independent third party on