

Deceptive Discovery: Second Circuit Affirms Sanctions for Mishandling of Discoverable Data

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Late last month, in [Klipsch Grp., Inc. v. ePRO E-Commerce Ltd.](#), the Second Circuit affirmed a \$2.7 million sanctions award against defendant ePRO after repeated instances of discovery misconduct. Finding that the district court's award properly reflected the additional costs plaintiff Klipsch Group Inc. was forced to bear due to ePRO's actions, the Second Circuit disagreed with ePRO that the sanctions were impermissibly punitive and disproportionate. In an era of increasingly complex digital discovery, this case serves as both a sword and a shield: it protects litigants who pursue corrective discovery efforts to remedy an opponent's willful mishandling of discoverable information, and it punishes litigants who flout their duties to maintain and disclose relevant information.

Background

In August 2012, Klipsch, a manufacturer of sound equipment, brought suit alleging an ePRO subsidiary was selling counterfeit Klipsch headphones. Klipsch sought to learn more about the infringing sales through the discovery of actual sales data and documents ("Structured ESI"), as well as information stored on employee computers and email accounts ("Unstructured ESI").

As discovery progressed, it became clear that ePRO was not fully complying with its discovery obligations. ePRO failed to timely disclose many responsive documents, ePRO restricted a discovery vendor's access to its electronic data, and ePRO neglected to put in place an appropriate litigation hold even after the court directed it to do so, resulting in the loss of a substantial amount of electronic data.

Because of ePRO's repeated discovery missteps, Klipsch moved for discovery sanctions. Although the magistrate judge initially declined to impose sanctions, Klipsch was authorized to forensically examine ePRO's computer systems. The forensic examination revealed that ePRO's sales databases had been edited and that multiple custodians had engaged in various forms of spoliation, including manually deleting thousands of files and emails, utilizing a data wiping software shortly before the examination, and updating computer operating systems to clear program usage data.

Klipsch then filed an ex parte motion seeking additional relief, which the district court granted in substantial part. Ultimately, the court concluded ePRO had willfully spoliated certain electronic information, resulting in some permanently unrecoverable files and data. The sanctions imposed on ePRO included (1) a jury instruction requiring the jury to find that ePRO destroyed relevant Unstructured ESI, (2) a jury instruction permitting the jury to infer that the destroyed evidence would have been favorable to Klipsch, and (3) Klipsch's reasonable costs and fees. The court awarded Klipsch \$2.7 million for the additional corrective discovery efforts, and, fearing ePRO to be a dissipation risk, the court imposed an additional \$2.3 million restraint on ePRO's assets.

The Appeal

The primary driving force behind ePro's interlocutory appeal was the fact that the district court awarded \$2.7 million in sanctions in a case that the court agreed was likely to result in only about \$20,000 in damages. ePRO asserted that sanctions out of proportion to the value of the evidence uncovered or the likely value of the case are impermissibly punitive and a violation of due process.

The Second Circuit rejected ePRO's arguments, holding that discovery sanctions should be commensurate with the costs unnecessarily created by the sanctionable behavior. The Court found that monetary sanctions tied to discovery costs and efforts appearing reasonable ex ante do not become punitive merely because more evidence is not uncovered that could increase damages or provide greater support for claims of fraud or spoliation.

Further, the Court saw no reason why parties in small value cases should be forced to suffer open and notorious discovery misconduct. Discovery sanctions are decided independently of the ultimate outcome of the case and often before a case's conclusion. To the extent proportionality matters, it is only in the sense that sanctions should be plainly proportionate to the costs inflicted on a party that reasonably attempts to remedy its opponent's misconduct.

The Court emphasized that "the integrity of our civil litigation process requires that the parties [], although adversarial to one another, carry out their duties to maintain and disclose the relevant information in their possession in good faith." Non-compliance increases the costs of litigation, and it is for that reason that courts have held discovery sanctions proper even against parties that belatedly comply with their obligations.

Thus, the Second Circuit affirmed the district court in all respects, stressing that the sanctions amount was not excessive regardless of whether it was compared to the small amount of compensatory damages at issue or the value of the information Klipsch recovered.

While this case provides additional guidance on the consequences of mishandling e-discovery, the Second Circuit concluded by cautioning litigants that nothing in its opinion should be interpreted as approval of excessive or disproportionate discovery demands. Discovery sanctions motions should not become a tactic used to inflict gratuitous costs on adversaries.

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