Chesson v. Rives, 2017 NCBC Order 23.

STATE OF NORTH CAROLINA COUNTY OF DAVIDSON	IN THE GENERAL COURT OF JUSTICE SUPERIOR COURT DIVISION 12 CVS 3382
W. CHRISTOPHER CHESSON; JAMES G. LOVELL; and DAVID D. FRASER, Plaintiffs, v. W. LEON RIVES; LEON L. RIVES, II; and RIVES & ASSOCIATES, LLP, Defendants.	**REVISED ORDER ON MOTIONS FOR SANCTIONS**

1. THIS MATTER is before the Court on Plaintiffs' Motion for Sanctions ("Plaintiffs' Motion") and Defendants' Motion for Sanctions ("Defendants' Motion") (collectively "Motions"), which the Court GRANTS IN PART and DENIES IN PART.

I. PLAINTIFFS' MOTION

2. Plaintiffs contend that Defendants should be sanctioned because: (1) they altered certain documents in connection with an audit; (2) they failed to take appropriate steps to have e-mails that are stored on a remote server preserved; and (3) they destroyed a laptop containing potentially relevant information. More specifically, as to the first allegation, Plaintiffs have presented evidence detailing that documents kept in the course of an audit, which Plaintiffs contend did not comply with board standards, were altered after Plaintiffs questioned Defendants' performance of the audit, and Defendants were put on notice of this litigation. As to

the second allegation, Plaintiffs complain that Defendants maintain their electronic business records on a server maintained by Thomson Reuters but failed to request that Thomson Reuters preserve relevant e-mails, as a result of which Thomson Reuters erased the e-mails after one year. As to the third allegation, Plaintiffs claim that Defendants did not maintain the laptop used by Defendant Leon Rives (the "Rives Laptop") in the course of conducting the audit and failed to acknowledge that they did not preserve the laptop until four months after the Court ordered its production.

3. Based on these failures, Plaintiffs ask the Court to strike Defendants' answer, forfeit Defendants' defenses, and enter default judgment against Defendants.

4. The record reflects that Defendants were aware by September 24, 2012, that litigation may have been forthcoming, and that the circumstances surrounding the contested audit would be relevant to the claims presented in this litigation. (Leon Rives Dep. 122:12–25, Oct. 10, 2014 (stating that, at the September 24 meeting and in correspondence following the meeting, Plaintiffs' counsel threatened that "this may result in litigation").) This lawsuit was filed on October 25, 2012, with claims related to the audit. The Complaint was served on Defendants on November 19, 2012.

5. There is record evidence that documents in connection with the audit were altered in the period between September 25 and September 29, 2012, and again in May 2013. However, the Court further understands that the track-changes in those documents show the content of the documents before they were altered,

meaning evidence was not irretrievably lost. (*See* Marshall Aff. Exs. V, X, DD, Nov. 26, 2014).

6. The uncontested evidence is that while Plaintiffs were partners at Rives & Associates, LLP ("RA"), RA's e-mail and electronic document storage was largely kept within an application called Engagement CS, operated by Thomson Reuters, that neither Plaintiffs nor Defendants contacted Thomson Reuters to request that documents be preserved, that Thomson Reuters would have maintained documents upon request, and that without such a request, documents were not maintained after one year.

7. Plaintiffs, on January 23, 2014, first requested to inspect the laptops used by Defendants in connection with the contested audit. (Marshall Aff. Ex. LL, Nov. 26, 2014.) Discovery has indicated that the Rives Laptop suffered damage in either January 2013 or January 2014. (*See* Marshall Aff. Ex. JJ, Nov. 26, 2014 (stating that the laptop was damaged in January 2014 and was "unsalvageable"); Rogers Aff. 1, Aug. 21, 2015 ("In January 2013, I received an emergency phone call to pick up the [Rives Laptop] that had been damaged.").) However, Defendants did not advise Plaintiffs of this damage when responding to Plaintiffs' initial discovery requests or to Plaintiffs' motion to compel, filed in April 2014. The Court entered an order on July 14, 2014 ("July Order"), granting Plaintiffs' motion to compel and requiring Defendants to produce the Rives Laptop. On October 10, 2014, Defendant Leon Rives testified that he purchased a new laptop sometime between the end of

2012 and April 2013, and that he did not know whether RA still possessed the Rives Laptop. (Leon Rives Dep. 240:18–241:15, Oct. 10, 2014.)

8. On November 17, 2014, Defendants for the first time advised Plaintiffs that the Rives Laptop had been damaged, was "unsalvageable," and was no longer in Defendants' possession. (Marshall Aff. Ex. JJ, Nov. 26, 2014.) While the exact date that the Rives Laptop was damaged is unclear due to Defendants' inconsistent evidence, it is undisputed that it was damaged after this litigation was pending. (*See* Marshall Aff. Ex. JJ, Nov. 26, 2014; Rogers Aff. 1, Aug. 21, 2015.) It is also undisputed that the Rives Laptop was not preserved and was never produced to Plaintiffs for examination.

9. Spoliation occurs where a party "(1) intentionally destroyed or failed to preserve (2) potentially relevant materials (3) while aware of the possibility of future litigation." *SCR-Tech LLC v. Evonik Energy Servs. LLC*, No. 08-CVS-16632, 2014 NCBC LEXIS 72, at *14 (N.C. Super. Ct. Dec. 31, 2014). Recent federal amendments to the Federal Rules of Civil Procedure provide that sanctions for spoliation are only appropriate where the evidence is lost and not recoverable. *See* Fed. R. Civ. P. 37(e) (explaining that the Court can sanction a party who "failed to take reasonable steps to preserve" potentially relevant electronically stored information that "*cannot be restored or replaced through additional discovery*") (emphasis added).

10. The Court concludes that, although the evidence demonstrates that Defendants altered documents prepared in connection with the contested audit, the track-changes within those documents show when and how the documents were

altered, as well as the content of the documents before they were altered. The Court then concludes that sanctions based on these alterations are not appropriate at this time. The Court reserves the right to issue a permissive adverse-inference jury instruction, subject to further developed evidence. But there is not adequate evidence to do so at this time.

11. Plaintiffs have further asserted that evidence that these audit documents were altered is adequate proof that Defendants materially altered other audit documents. The Court disagrees. A jury may conclude that Defendants' conduct violated the Public Company Accounting Oversight Boards' audit standards, but the Court concludes that the alterations proven to date do not rise to sanctionable spoliation.[1]

12. As to the failure to request that Thomson Reuters preserve documents, based on the particular facts of this case, the Court concludes that neither party should be sanctioned on that basis.

13. As to the Rives Laptop, the Court concludes that Defendants were not justified in failing to maintain the Rives Laptop. Although the record is unclear as to whether the Rives Laptop was intentionally destroyed, such a finding is not necessary to conclude that spoliation occurred. *See McLain v. Taco Bell Corp.*, 137 N.C. App. 179, 184, 527 S.E.2d 712, 716 (2000) (explaining that spoliation of

[1] In their brief, Plaintiffs reference their contention that Aaron Patel, an RA employee, made false statements under oath about events related to the altered documents. The Court understands that these false statements are not the basis for Plaintiffs' Motion, which seeks sanctions based on alleged spoliation of the audit documents and the Rives Laptop, and therefore, the Court does not address this allegation.

potentially relevant evidence "occurs along a continuum of fault—ranging from innocence through the degrees of negligence to intentionality" (quoting *Welsh v. United States*, 844 F.2d 1239, 1246 (6th Cir. 1988)). Even if the Rives Laptop or information stored on it was destroyed through no fault of Defendants, the Court concludes that Defendants should have preserved the Rives Laptop to allow Plaintiffs to conduct a forensic examination. Defendants' failure to preserve the Rives Laptop entitles Plaintiffs to a jury instruction for a permissive adverse inference that the Rives Laptop contained information unfavorable to Defendants. *See Holloway v. Tyson Foods, Inc.*, 193 N.C. App. 542, 547, 668 S.E.2d 72, 75 (2008).

14. Further, Defendants' failure to comply with the July Order, and their evasive responses to Plaintiffs' discovery requests justifies the Court, in its discretion, awarding Plaintiffs the portion of their attorneys' fees incurred in connection with their motion to compel the production of the Rives Laptop. *See* N.C. Gen. Stat. § 1A-1, Rule 37(b)(2) (2015). Subject to further developed evidence, the Court reserves the right to issue a mandatory adverse-inference jury instruction.

15. In its discretion, the Court concludes that it is not necessary, and would be inappropriate without further compelling evidence and considering the respective actions of all parties in this case, to further sanction Defendants by striking their answers or defenses in this action. *See Clark v. Alan Vester Auto Grp., Inc.*, No. 06-CVS-1411, 2009 NCBC LEXIS 13, at *30 (N.C. Super. Ct. July 17, 2009) (explaining that while the court has discretion to strike defendants' answer or enter default

judgment against defendants "such a remedy would impose the harshest of sanctions").

II. DEFENDANTS' MOTION

16. Defendants contend that Plaintiffs violated the Court's Protective Order, entered on February 24, 2014, by producing confidential documents, at a minimum to the DOJ in response to a grand jury subpoena, and perhaps to others as may be established by discovery. Defendants request that they be permitted to conduct limited discovery to determine the scope of Plaintiffs' unauthorized disclosures.

17. On November 17, 2014, Plaintiffs received a grand jury subpoena from the DOJ seeking the production of depositions and exhibits from this matter, including documents designated confidential pursuant to the Protective Order. (Pls.' Resp. to Defs.' Mot. Sanctions Ex. C.) Plaintiffs responded to the grand jury subpoena on November 24, 2014, and January 5, 2015, providing the requested documents without seeking a court order permitting disclosure or Defendants' written permission as required by the Protective Order. Plaintiffs contend that the U.S. attorney "repeatedly requested" that Plaintiffs not inform Defendants' counsel about the subpoena. Defendants counter that Plaintiffs did not have a legal obligation to keep the existence of the subpoena a secret because the subpoena specifically states that "[a]s a subpoena recipient, you are under no obligation of secrecy." (Pls.' Resp. to Defs.' Mot. Sanctions Ex. C.)

18. Case precedent in the federal and state courts is unsettled as to whether a grand jury subpoena excuses a party's obligation under a civil protective order. *See, e.g.*, *In re Grand Jury*, 286 F.3d 153, 156 (3d Cir. 2002) ("[A] grand jury subpoena supersedes a civil protective order unless the party seeking to avoid the subpoena demonstrates the existence of exceptional circumstances that clearly favor enforcement of the protective order."); *In re Grand Jury Subpoena (Under Seal)*, 836 F.2d 1468, 1477 (4th Cir. 1988) (holding that a party is always allowed to comply with a grand jury subpoena, no matter what the civil protective order requires); *Martindell v. Int'l Tel. & Tel. Corp.*, 594 F.2d 291, 296 (2d Cir. 1979) ("[A] witness should be entitled to rely upon the enforceability of a protective order against any third parties, including the Government," absent extraordinary circumstances). However, the application of any legal standard may depend on the specific factual circumstances.

19. Accordingly, the Court, in its discretion, concludes that Defendants should be allowed to conduct limited discovery to determine the circumstances surrounding Plaintiffs' production of confidential materials to non-authorized parties, after which the parties should brief the question of whether Plaintiffs should be sanctioned in connection with that production.

THEREFORE, based on the above, and in the Court's discretion:

1. The Court finds that no spoliation sanctions should be imposed in connection with the alteration of audit documents because evidence of the content of the documents prior to alteration is available and, if relevant, Plaintiffs can present evidence of the alteration.

2. The Court finds that spoliation sanctions should be imposed in connection with Defendants' failure to preserve the Rives Laptop, and therefore, Plaintiffs are entitled, at a minimum, to a permissive inference jury instruction that the Rives Laptop contained information adverse to Defendants.
3. Plaintiffs are entitled to recover their attorneys' fees expended in connection with their efforts to inspect the Rives Laptop.
4. Plaintiffs shall, on or before January 20, 2017, submit their specific request for such attorneys' fees, with supporting documentation. If Defendants wish to respond, they shall submit such response within fourteen days.
5. The Court determines that no sanctions should be imposed in connection with any parties' failure to request that Thomson Reuters preserve documents.
6. Based on the evidence that Plaintiffs provided confidential information in response to a grand jury subpoena, Defendants shall be entitled to conduct limited discovery to determine the scope and extent of Plaintiffs' unauthorized disclosures, including to whom such disclosures were made and what documents were disclosed. Such discovery shall be limited as follows:
    a. The discovery shall be limited to the matters addressed in Defendants' Motion for Sanctions;
    b. Such discovery must be completed on or before March 3, 2017;

c. Defendants shall propound no more than ten interrogatories and no more than twenty requests for production of documents;

d. Absent further leave of court, Defendants shall be limited to three depositions, to be completed in one day, and at which no party shall examine a witness for more than a total of four hours.

7. Defendants shall, on or before March 24, 2017, file a supplemental brief expressing their contentions as to what sanctions, if any, should be imposed against Plaintiffs. The time for response and any reply briefs shall be in accordance with the Business Court Rules.

IT IS SO ORDERED, this the 18th day of January, 2017.

/s/ James L. Gale

James L. Gale
Chief Business Court Judge