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Impact of New Federal Rules on E-Discovery and Experts

New amendments to the Federal Rules of Civil Procedure (FRCP) are now in effect. The amendments expand the duties of parties, both actual and potential, to federal proceedings to preserve and protect all forms of relevant electronic data. Parties must now take steps to preserve all relevant, discoverable data, including preventing the destruction of electronic evidence. These new duties permit attorneys to assess the role that experts such as business appraisers and valuation specialists can take as requestors, recipients, and suppliers of electronic information in litigation matters.

The major changes

The amendments standardize procedures regarding "electronically stored information" (ESI) within the federal court system; they recognize and give ESI equal status as paper documents during discovery. The primary focus is on the early disclosure and preservation of any electronic data that may become evidence in a case.

Parties now have an affirmative duty, during the initial stages of litigation, to develop a plan to preserve and produce electronic evidence and to provide that information in a "readable" format. Amended Form 35 now provides a "report" to the court regarding these initial discussions. Should any dispute arise, the parties must meet and confer before filing a motion to compel. The rules do limit discovery for data that is not "reasonably accessible" because of "undue burden or cost" (determinable by the court on a subjective basis). The scheduling order may also contain post-production, agreed-upon limits for privilege or work-product exceptions; this minimizes the risk of inadvertent waiver while facilitating the discovery process.

The rules do permit exceptions for electronic data that is lost or destroyed as a result of "routine, good-faith operation of an electronic information system." But they also require the parties to consider the systems in place and possible destruction of ESI when developing their discovery plan. Accordingly, parties to litigation may want to (i) adopt a document retention policy that meets the safe harbor provisions; (ii) have procedures in place to halt destruction of documents when notified of a dispute; and (iii) recruit or retain a knowledgeable information technology (IT) person to help respond to discovery requests.

Including experts early

Depending on the size and complexity of the case, attorneys may want to consider including experts early in the discovery of electronic information. For example, valuation analysts could assist in defining the most "usable" format to produce ESI—which can be critical, as once a request for a certain format is made, alternative formats may not be permitted.

The experts' retention of electronic data is also an important consideration; attorneys should ensure sure that routine document management (and destruction) by experts does not reach the level of spoliation. The risks of spoliation claims decrease if parties take early steps to identify and preserve ESI. Cost is a final consideration. Typically, the management of e-discovery requires a higher level of expertise than paper discovery, and document review, consultants' time, and disruption can add to the overall expense of a case. As the courts, counsel, and clients become more familiar with the new rules, the parameters for preserving and producing e-evidence will become clearer.

Note: *A copy of the amended FRCP is available at http://www.uscourts.gov/rules/EDiscovery_w_Notes.pdf. The Advisory Committee notes are also included.*

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Court Questions Posttrial Daubert Challenge to Lost Profits Expert and Award

CADCO, Inc. v. Fleetwood Enter., 2007 Mo. App. LEXIS 458 (2007)

In this case, the defendant challenged the plaintiff's lost profits expert, a credentialed valuation analyst, for the first time on appeal. In denying the motion, the appeals court sounded baffled and possibly affronted, noting that the defendant had failed to object to the plaintiff's expert witness when he was called—or when he was qualified; or when he rendered his lost profits opinion; or even when his testimony concluded.

Notably, [the defendant] also failed to object when [the expert] described his method of analysis for determining lost profits, including a summary of the facts and data on which he based that analysis and his resulting opinion.

Because the defense failed to preserve its objection at trial, the appeals court reviewed the admission of the expert's testimony for "plain error." The plaintiff was a Missouri retailer of mobile homes, the defendant a California manufacturer who'd granted the plaintiff an exclusive sales agreement in its territory, including rights of first refusal to sell certain high-end models. After the defendant diverted mobile homes to a competitor, the plaintiff sued, claiming violation of the sales agreement; it presented the expert's lost profits analysis, which assumed that the plaintiff would have sold all units that its competitor ended up selling.

Defendant claimed there was no foundation for this assumption. But the expert also examined the average profit margin on the units sold, the related business expenses, and the market effect of the competitor's "unauthorized" sales. He considered the plaintiff's proven sales record in the region, its tax returns and financial statements, industry forecasts and territorial analyses, sales invoices and rebate calculations, and product bulletins and newsletters. He also interviewed the plaintiff's president, a "good businessman," and studied the depositions of and reports by defendant's experts.

After hearing all this evidence, the jury assessed more than $1.26 million in actual damages against the defendant and $650,000 in punitives. But since it allocated 24% of the fault to the plaintiff, the trial court reduced the award accordingly and also offset it by the plaintiff's $35,000 settlement with its competitor. The appeals court corrected this offset, as the settlement didn't double-count the damages against the defendant. The court of appeals found no plain error, however, in the expert analysis, which was reliable and well –supported [not hyphenated if following the noun], and affirmed the remaining award of over $1.7 million, including interest.

Federal Court Clarifies Rule on Discovery of Draft Valuation Reports

University of Pittsburgh v. Townsend, 2007 U.S. Dist. LEXIS 24620 (2007)

The problem of draft valuation reports has become more prominent, given the spate of spoliation cases spawned by technology advances and the recent update to the Federal Rules of Civil Procedure (FRCP) regarding "electronically stored information." (Effective December 2006, the new rules are posted at http://www.uscourts.gov/rules/EDiscovery_w_Notes.pdf.)

In particular, what direction should attorneys give analysts regarding their overwriting the electronic versions of valuation reports? Are the drafts discoverable? What about emails between attorneys and analysts—are these discoverable? At what point must analysts preserve all copies and correspondence related to draft valuation reports?

Experts admit destroying emails at attorneys' direction

After developing complex medical scanning technology, the University of Pittsburgh accused the defendants, two medical imaging companies and their principals, of subverting the technology and misappropriating the related intellectual property. To prove these claims, it retained two scientific experts and a damages expert.

Quite early in the proceedings—and well before the deadlines for expert disclosures--the defendants requested "all documents" the experts had relied on or revised in connection with their reports. The plaintiff objected to the request as premature and advised that it would comply with all disclosure requirements of Rule 26 FRCP when and as they arose.

Nearly a year and a half later, defendants deposed the scientific experts, subpoenaing "any and all" documents related to the preparing of their reports—

including all drafts and correspondence with the attorneys. But during their depositions, both experts testified that they'd worked from only one electronic draft, without retaining copies. Further, they'd both emailed drafts to plaintiff's counsel, who'd emailed back "editorial" and "stylistic" revisions, including the correction of typos and addition of legal authority. Per counsel's instructions, neither expert kept copies of the emails or the revised drafts.

Plaintiff's attorney later admitted that he routinely advised experts not to keep draft reports. Although it's not clear whether he also regularly instructed them to destroy related emails, he did apologize to the Court for doing so, indicating that this most likely would not be his practice going forward.

Do experts have a duty to preserve drafts?

The defendants argued that Rule 26 (a)(2) FRCP imposes an affirmative duty on experts to preserve all documents related to the preparation of their reports, including emails and drafts. Moreover, defendants had requested these documents early in discovery, but because plaintiff's experts had willfully destroyed this evidence, they claimed the appropriate sanction was to bar the experts from testifying at trial.

By contrast, the plaintiff said it had no clear obligation to produce the draft reports until the deposition subpoenas (at which time no further documents were destroyed). And any email correspondence between the experts and the attorneys raised issues of privileged communications and work product.

The Court disagreed with elements of both parties' arguments. First, it clarified that FRCP 26(a)(2) does not impose an "affirmative duty" upon experts to preserve "all documents," particularly draft reports. Nor must the experts provide copies of draft reports as part of their required 26(a)(2)(B) disclosures, which mandates "a complete statement of all opinions…and the basis…therefore."

However, while the Rule doesn't "technically" require the production of draft reports, they are "certainly discoverable," the Court said. The question was one of timing. The defendants' discovery request was too "awkwardly worded" to clearly require the production of draft reports, but even a more specific request would have been "unreasonable." Served more than a year before the Rule 26(a)(2)(B) deadlines, the request would have imposed a "continuing obligation on a party to disclose any document from an expert—whether it be a letter or a draft—as it is received through the consultation process." Moreover, "such a requirement would virtually nullify the expert disclosure deadline established by the Court."

The defendants clearly requested the draft reports in their deposition subpoenas. "Only at that point were the experts under a duty to retain any drafts and produce them." Because the parties had destroyed the drafts prior to the subpoenas, they would not be subject to sanctions.

Email correspondence must be disclosed

Rule 26(a)(2)(B) does require the disclosure of "the data or information considered by the [expert] in forming the opinions." To the extent that correspondence between counsel and experts contain any factual assumptions or background used in the reports, "such correspondence must be disclosed." The Advisory Comments to the Rule clearly exclude these communications from privilege or work-product immunity.

Thus, the plaintiff was obliged to disclose emails between counsel and experts if they contained "information or data" to be used in the reports. Even those without such specific content were still discoverable, the Court said, and it was improper "for plaintiff's counsel to have instructed and/or otherwise suggested to the experts that such communications should be destroyed."

But it also noted the attorney's apology and the absence of fraudulent intent. As the depositions and a subsequent Daubert hearing afforded the defendants ample opportunity to cross-examine the experts, both on the content of the emails and counsel's revisions to their reports, the Court declined to impose any discovery sanctions—certainly none so harsh as precluding the experts from testifying at trial.

Royalty rates challenged under Daubert

There's no indication that the plaintiff's damages expert destroyed evidence related to his report (although these aspects of the Court's opinion should apply as much to valuation analysts as any other experts). Instead, defendants argued that his use of a "reasonable royalty rate" did not fit the facts of the case, as there was no license agreement between the parties and no underlying patent infringement claim—the cause of action that traditionally supports a reasonable royalty theory.

But federal law prohibits the sale or licensing of intellectual property developed with government funds, the University contended. Plus, its claims focused on the value of this property and the expectation of receiving a reasonable return, and thus its valuation approach was appropriate. The Court agreed, finding specifically that the lack of a patent

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infringement claim did not preclude the application of a reasonable royalty rate.

Defendants also argued that, contrary to acceptable accounting practice, the expert had "bundled" the intellectual property rights. Because he couldn't "unbundle" them, his calculations become "meaningless" if the University didn't actually own an element of the bundle, for example, or another did not exist.

The Court found the methodology reliable. Historically, the University had bundled intellectual property in a license. Moreover, the defendants also typically combined research with know-how in a patent assignment. If some elements of the bundle existed in the public domain or were otherwise overvalued—these factors would go to the weight of the damages evidence and not its admissibility.

Likewise, the expert's lack of familiarity with the specific medical technology (he couldn't describe the precise "scanner process") and its terminology (he used "know how" interchangeably with "trade secret") was not fatal to his analysis. Neither was his application of comparable data from licenses executed after the valuation date.

Rather, his report was premised on the factual assumption, provided by the University's counsel and other experts, that the claimed intellectual property were at least in part owned by the University, which was entitled to compensation for its use by others. The expert's reliance on this assumption was reasonable, according to the Court, and his valuation was not invalidated by his lack of scientific and/or medical expertise in identifying the particular intellectual property at issue.