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E-mails become trial for courts

Costly electronic discovery `part of potentially every case in the 21st Century'

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A high-stakes fraud trial pitting New York financier Ronald Perelman against investment banking firm Morgan Stanley began Wednesday in Florida, but some of the most important battles in the case have already been fought.

For more than a year the two sides sparred over Morgan Stanley's repeated failure to hand over e-mail messages connected to a $1.5 billion merger in 1998 between Coleman Inc., a camping gear maker majority-owned by Perelman, and Sunbeam Corp., the Wall Street firm's client. Perelman wanted to review e-mails to find evidence that Morgan Stanley knew or should have known of accounting fraud at Sunbeam before he struck a deal with the company.

The judge finally got fed up. Last month she ruled that Morgan Stanley had been "grossly negligent" in handling its e-mails. She also blamed its chief legal counsel, the Chicago law firm Kirkland & Ellis, for the delays and rebuked the firm for its "stonewall tactic."

Morgan Stanley fired Kirkland two weeks before the start of trial and threatened the firm with a malpractice lawsuit.

Florida Circuit Court Judge Elizabeth Maass also took the unusual step of telling the jurors that they could infer that Sunbeam had defrauded investors like Perelman. The ruling undercut Morgan Stanley's defense and may make Perelman's case much easier to prove.

Morgan Stanley's situation is just the latest example of what has become a widespread problem in court: The failure to retain and share digital information. The issue has not received as much attention as more political legal controversies, such as curbing class-action lawsuits and capping medical-malpractice awards. But it can make or break many lawsuits.

"More money is probably spent litigating electronic discovery problems than in litigating class actions," said Ken Withers, senior education attorney at the Washington-based Federal Judicial Center, the research arm of the U.S. courts. "This is part of potentially every case in the 21st Century."

In today's digital world, electronic evidence--from spreadsheets to PowerPoint presentations to the most ubiquitous of all, e-mail messages--has become the modern-day paper trail.

A sole e-mail from an in-house attorney at Andersen advising a partner to edit an internal memo about Enron Corp.'s financial disclosures helped convict the accounting firm of obstruction of justice. Litigants that intentionally destroy electronic evidence or drag their feet in sharing documents can face the wrath of judges, as the Morgan Stanley case and other recent court decisions illustrate.

In one case contested in federal court in Chicago, a company was punished after its owner bought a copy of a software program called "Evidence Eliminator" to erase files from his computer. The judge in the case threatened that the owner's suit against a rival over patent infringement be thrown out because of the owner's "egregious conduct." The judge forced the offender to pay a portion of his opponent's fees and costs.

With the costs of retrieving electronic information skyrocketing, skirmishes during discovery, as the pretrial information-gathering stage is called, have become commonplace. Restoring e-mail can cost roughly $2 per message, including the cost of attorneys needed to review the documents, according to Chicago law firm Vedder Price Kaufman & Kammholz.

If a plaintiff demands millions of e-mails, the request is a form of blackmail, corporations argue.

Companies including Microsoft Corp. and Exxon Mobil Corp. are lobbying federal courts to adopt rules governing electronic evidence that would, among other things, give them more protection in the case of inadvertent destruction of electronic documents. But the proposals are far from being approved.

Until then, litigants are guided by recent court opinions. For companies and the law firms that defend them, the Morgan Stanley case serves as a cautionary tale.

Perelman, the chairman of cosmetics firm Revlon Inc., is suing Morgan Stanley for $2.7 billion in punitive and compensatory damages.

When he sold Coleman he received $680 million in Sunbeam stock that eventually became worthless when the company went bankrupt in 2001 following the disclosure of its accounting problems.

Soon after the Perelman suit was filed in May 2003 his attorneys, who include Jerold Solovy of Chicago's Jenner & Block, asked to review all documents connected to the Sunbeam transaction, including e-mails. They initially received more than 8,000 pages of documents but only a handful of e-mails, according to court documents.

In answering a second request for more e-mails, Morgan Stanley complained that Perelman wanted the court to order "a massive safari into the remote corners" of the company's e-mail backup systems that would cost at least hundreds of thousands of dollars.

The firm later asserted that it no longer had backup tapes with e-mail from 1997 and 1998.

As part of disaster-recovery plans, companies typically take periodic snapshots of everything in their computer servers and burn the information onto magnetic tapes for storage. Some information, such as employment data and records related to financial audits, must be retained for certain periods of time as required by state and federal laws.

The amount of electronic information stored at large companies is staggering. An Exxon Mobil lawyer estimates that it stores 800 terabytes of information, which equates to 400 billion typewritten pages.

The company generates 121,000 backup tapes a month, which it routinely recycles according to its records-retention policies. If a judge ordered it to stop recycling tapes to preserve data, the cost just for buying extra tapes would be $1.9 million a month, the company said. In the Morgan Stanley case Judge Maass ordered the company to search its oldest backup tapes for each of 36 employees involved in the Sunbeam deal and review e-mails during a two-month period in 1998.

Morgan Stanley's recovery effort, according to court papers, called for the company to hunt down backup tapes in storage warehouses and turn them over to another company to read them. The data would then be uploaded to a new e-mail archive to be searched for the required messages.

Morgan Stanley turned over another 1,300 pages of e-mails on May 14, 2004, and later certified that it had complied with the judge's order.

That was just the beginning of Morgan Stanley's deceptions, the judge said.

At some point prior to May 6, Morgan Stanley's technology team knew that 1,423 tapes were sitting in a Brooklyn warehouse and had yet to be read. The tapes contained e-mail dating back to the late 1990s. The company also dragged its feet in restoring e-mails from 738 tapes at another facility.

Kirkland attorney Thomas Clare did not inform Perelman's attorneys of the additional tapes, which he labeled "newly discovered," until November, six months after the May deadline. Even then, he failed to disclose how many tapes were found, when they were found or when they would be searched, the judge said. Kirkland has declined to comment, citing client confidentiality.

Morgan Stanley continued to find hundreds of backup tapes earlier this year, in some cases openly stored in places used to hold tapes.

In February the company told the court that it did not turn over all e-mail attachments because of a flaw in the software used to search old e-mails. It also disclosed mistakes made in the search of employees with a Lotus Notes platform.

"The prejudice to [Perelman] from these failings cannot be cured," the judge wrote in a March 23 ruling. She went on: "The judicial system cannot function this way."A Morgan Stanley spokesman said: "We respectfully disagree with the court's ruling. Far from being a part of the Sunbeam fraud, Morgan Stanley was a victim of that fraud, losing $300 million. In the event of an adverse verdict, we believe we have grounds for appeal and intend to pursue them to the fullest extent."

Judge Maass suggested that one of the reasons Morgan Stanley withheld information was because it wanted to hide a probe by the Securities and Exchange Commission into its e-mail retention policies. The SEC requires securities firms to preserve e-mails for two years.

Last week the company disclosed that the SEC is considering enforcement action against it for failing to retain e-mail and violating a 2002 cease-and-desist order relating to e-mail. Morgan Stanley said it believes enforcement action is not justified.

Now that the judge has allowed the inference that Perelman was a victim of fraud, Perelman may only have to prove that he relied on information provided by Morgan Stanley and that he suffered damages. In seeking punitive damages, the judge said, he also can argue that Morgan Stanley's behavior is "evidence of its malice or evil intent."

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Punishments expensive for document failures

- A federal magistrate judge in Cleveland recommended that PricewaterhouseCoopers LLP pay $345 million in fines for its apparent foot-dragging in producing documents related to its financial audit of Telxon Corp., a manufacturer of scanners and handheld computers. The judge found that PWC resisted court orders to provide work papers, e-mails and software used in the audits, despite repeatedly assuring the court that it had submitted all relevant materials.

- In a sex discrimination suit against investment bank UBS Warburg, the judge instructed the jury that it could conclude that the destroyed e-mails contained information adverse to UBS. On Wednesday the jury ordered UBS to pay more than $29 million in damages to the former saleswoman, Laura Zubulake.

- After determining 11 employees of Philip Morris USA failed to preserve e-mails (as required by the company's retention policy and the court's preservation order) the court slapped the company with $2.75 million in sanctions, or $250,000 per employee.