Minnesota Bankruptcy Court Imposes "Death Penalty" Sanction for Discovery Abuses

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E-discovery continues to be a major issue in litigation and the stakes are getting higher as evidenced by some recent decisions (one of which involved a prevailing party represented by Gray Plant Mooty).

Earlier this year, Judge Shira Scheindlin (the judge that issued the famous Zubulake decisions2) revisited the standards applicable to a party's obligation to preserve and produce information, and appropriate sanctions for the failure to do so. Pension Comm. of Univ. of Montreal Pension Fund v. Banc of Am. Secs. LLC.3 In a 109-page opinion, the Court evaluated the level of culpability (i.e., negligence, gross negligence, or willful conduct), the duty to preserve evidence and spoliation of evidence, the burden of proof to obtain sanctions for failure to preserve evidence, and the appropriate remedy for harm caused by spoliation. In Pension Committee, a group of investors brought an action under federal and state securities laws to recover $550 million arising out of the liquidation of two hedge funds. The Court evaluated the acts or omissions of 13 plaintiffs with respect to their duty to preserve, collect, and produce relevant information in discovery. For example, the Court noted that one of the plaintiffs "took no action to collect or preserve electronic documents prior to 2007, did not produce a single email or electronic document until 2008, and then dumped thousands of pages on the Citco defendants only when it faced the prospect of sanctions."4 Finding such conduct "grossly negligent," the court imposed sanctions. While the defendants sought the ultimate "death penalty"5 of dismissal of the complaint, the court instead chose an "adverse inference" jury instruction as the appropriate sanction for those plaintiffs who were "grossly negligent" in discharging their discovery obligations.6

Recently, Minnesota Bankruptcy Judge Robert Kressel addressed a similar situation, but went a step further and awarded the most severe sanction possible (a default judgment or the "death penalty") for discovery abuse, including repeated misrepresentations regarding access to and failure to produce thousands of emails and other electronically stored information. *Chrysler Financial Services Americas LLC v. Hecker (In re Hecker*).7 Discovery disputes and sanctions motions, in particular, tend to be fact intensive, so a brief description of the background and procedural history is essential.

Chrysler Financial provided financing to a number of auto dealerships, car rental operations and other businesses owned and operated by Dennis Hecker. When Hecker and his entities defaulted on their

obligations, Chrysler Financial brought suit against Hecker in state court and obtained a $477 million judgment against him. Shortly thereafter, Hecker filed Chapter 7 bankruptcy. As a result, Chrysler Financial filed an adversary proceeding against Hecker under 11 U.S.C. § 523(a), seeking to have approximately $83 million of its previous judgment determined to be non-dischargeable in bankruptcy because it was obtained through the use of false pretenses, false representations, fraud, defalcation, and embezzlement.

In his bankruptcy schedules filed early in the case, Hecker asserted that "law enforcement officials seized from debtor's offices numerous records that are essential to the full and accurate completion of the Schedules of Assets and Liability, Statement of Financial Affairs, and other statements […]."8 The Court noted that "[t]his explanation for Hecker's inability to produce documents to the court and to the chapter 7 trustee has been repeated throughout Hecker's bankruptcy case, including Chrysler Financial's adversary proceeding."9

In his initial response to Chrysler Financial's written discovery, "Hecker claimed that most of the discovery requests 'were impossible to understand' stated general boilerplate objections, and stated that he was refusing to respond to requests until the court ruled on his motion to stay and for a protective order."10 After the court denied Hecker's motion for a stay and a protective order, the parties agreed to exchange documents by a specified date. When Hecker failed to produce documents on the agreed upon date, Chrysler Financial brought a motion to compel discovery. In response to that motion, Hecker once again asserted that he was "'making ongoing attempts to obtain requested information that was confiscated from his various business locations and by the various investigating authorities'" and that the "'majority of the requested documents were either in the possession and control of the U.S. Attorney's Office or other third parties.'"11 He also asserted that to the extent that he currently had possession of responsive documents, they were produced. The court granted Chrysler Financial's motion to compel discovery which, among other things, ordered Hecker to provide full, complete, and unequivocal answers to Chrysler Financial's written discovery, not assert any "boilerplate" objections, overruled his Fifth Amendment privilege objection to document requests, required him to produce a privilege log for documents withheld from production, and barred Hecker from pursuing any offensive discovery activities until he complied with the order.12 The order specifically provided that failure to comply could result in sanctions under Fed.R.Civ.P. 37(b)(2)(A).13

On the deadline date for complying with the court's order, Hecker provided supplemental responses to written discovery and several disks containing information obtained from the government. His document production was deficient in a number of respects, including the paucity of emails authored by Hecker himself.14 In response to a letter from Chrysler Financial's counsel detailing the deficiencies in the production, Hecker's counsel asserted that "'We believe the production is complete.'"15

At the request of Chrysler Financial's counsel, Hecker provided with his supplemental production a "search warrant inventory," which is a list of the items seized by the government during its raids on Hecker's

businesses. The search warrant inventory revealed that, contrary to his previous representations, the government had not "seized" most of Hecker's computers (servers, hard drives, and the like), but rather had made "images" or copies of the servers and hard drives. In other words, Hecker retained possession and control of electronically stored information throughout the course of his bankruptcy.

As a result of Hecker's failure to comply with the court's order, Chrysler Financial moved for sanctions under Fed.R.Civ.P. 37(b)(2)(A), as specifically provided for in the order compelling discovery. In response to the sanctions motion, Hecker's counsel "admitted for the first time that he had 'computers containing literally hundreds of thousands of emails from the Hecker offices,' and invited Chrysler Financial's counsel to come to his office to view them."16 Just three days after representing to the court that he had provided Chrysler Financial with "everything," Hecker delivered two more disks containing information. Then, the day before the sanctions hearing, Hecker delivered an external hard drive that contained approximately 1.1 million files and folders. The data on the hard drive was scrambled so that Chrysler Financial could not identify the author, recipient, or date of any of the emails.

Judge Kressel carefully analyzed the procedural history of the case and found that:

After months of repeated assurances by Hecker that he has fully responded to Chrysler Financial's discovery requests, I am convinced of the truth of Chrysler Financial's allegations. Hecker has behaved dishonestly in his representations to Chrysler Financial and to this court. Although the law favors deciding matters on their merits, the behavior of the defendant and his counsel in this case is shocking. * * * [T]he defendant repeatedly represented to Chrysler Financial and to this court that he could not comply with Chrysler Financial's discovery requests because the government was in possession of his records. In fact, throughout these proceedings, the hard drives and servers (which contain the majority of the documents Chrysler Financial has been seeking) remained in Hecker's possession. * * * Despite his knowledge that he remained in possession of the computers and servers, Hecker repeatedly stated, directly and by implication, that he had produced everything. That representation was dishonest. * * * Hecker has intentionally withheld relevant, admissible evidence in order to delay and obfuscate.17

Ultimately, the court concluded that Hecker had "acted in bad faith and willfully abused the discovery process."18 After considering the range of potential sanctions under Fed.R.Civ.P. 37(b)(2)(A), the court concluded that the factors weighing against a default judgment were not present and, because the court was "certain that no order of this court would secure Hecker's cooperation in this proceeding, the entry of a default judgment is the most appropriate sanction under the circumstances."19 The $83 million judgment awarded against Hecker is non-dischargeable in bankruptcy.

The Hecker decision vividly demonstrates the severe sanctions that might befall a party who does not take its discovery obligations seriously and compounds the problem by making misrepresentations to the court

about compliance with those obligations. Parties must thoroughly evaluate the sources of electronically stored information and make timely production of relevant information in response to discovery requests. Under no circumstance should a party make unsupportable representations to the court about discovery compliance.

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1 Mr. Nierengarten, a principal at Gray Plant Mooty, is one of the attorneys representing Chrysler Financial with respect to the bankruptcy of Dennis E. Hecker, including its adversary proceeding against Mr. Hecker. Chrysler Financial Services Americas, LLC v. Dennis E. Hecker, Adv. No. 09-05019. Nierengarten has over 30 years of experience in commercial litigation and dispute resolution, including contracts, environmental, insurance coverage, intellectual property, products liability, and real estate. He is a member of the firm's litigation group.

2 *Zubulake v. USB Warburg LLC*, 216 F.R.D. 280 (S.D.N.Y. 2003); 217 F.R.D. 309 (S.D.N.Y. 2003); 220 F.R.D. 212 (S.D.N.Y. 2003); 229 F.R.D. 422 (S.D.N.Y. 2004).

3 *Pension Comm. of Univ. of Montreal Pension Fund v. Banc of Am. Secs. LLC*, 05 Civ. 9016 (SAS), 2010 U.S. Dist. LEXIS 4546 (S.D.N.Y. Jan. 15, 2010).

4 Id., at *63

5 See *Gateway Senior Housing, Ltd., v. MMA Financial, Inc.,* No. 1:06-CV-458, 2008 U.S.Dist. LEXIS 109947, at *38 (E.D.Tex. Dec. 4, 2008) (describing the entry of a default judgment or striking of pleadings or defenses for discovery abuse as the "death penalty" sanctions).

6 Pension Committee, supra. Note 3, at *104-109.

7 *Chrysler Financial Services Americas LLC v. Hecker (In re Hecker),* No. 09-5019, 2010 WL 654151 (Bankrcy. D. Minn. Feb. 23, 2010).

8 Id., at *1 (quoting note that accompanied Hecker's bankruptcy schedules).

9 Id.

10 Id., at *2.

11 Id., at *3 (quoting Hecker's submission to the court).

12 Id.

13 Fed.R.Civ.P. 37(b)(2)(A) provides that the court may issue an order providing any of the following: (i) directing that the matters embraced in the order or other designated facts be taken an established for purposes of the action, as the prevailing party claims; (ii) prohibiting the disobedient party from supporting or opposing designated claims or defenses, or form introducing designated matters in evidence; (iii) striking pleadings in whole or in part; (iv) staying further proceedings until the order is obeyed; (v) dismissing the action or proceeding in whole or in party; (vi) rendering a default judgment against the disobedient party; or (vii) treating as contempt of court the failure to obey any order except an order to submit to a physical or mental examination.

[14] Id., at *4 (noting that "the production consisted entirely of scanned images of printed documents, despite Chrysler Financial's request that they be provided in native format (see Fed.R.Civ.P. 34(b)(1)(C))….").
[15] Id. (quoting Hecker's counsel).
[16] Id.
[17] Id., at *6.
[18] Id.
[19] Id.

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