

2. A U.S. District Court for the Southern District of New York opinion sanctioning defendants for intentionally destroying encryption keys needed to access an accounting system used in a bribery scheme because the defendants should have known the encryption keys would be relevant to future litigation

In *DoubleLine Capital LP v. Odebrecht Finance, Ltd.*, 2021 WL 1191527 (S.D.N.Y. March 30, 2021), U.S. Magistrate Judge Barbara Moses sanctioned several Defendants for intentionally destroying the encryption keys needed to access a “shadow” accounting system used in a bribery scheme, ruling that Defendants should have known the keys would be relevant to future litigation.

In this federal securities fraud action, Plaintiffs sought the sanction of a mandatory adverse inference instruction at trial against certain Defendants as a remedy for Defendants’ having intentionally destroyed the encryption keys needed to access the MyWebDay platform, an internal, “shadow” accounting system used to track the illicit bribe payments underlying the claims in the lawsuit. *Id.* at *2. After Defendants became aware of an investigation by Brazilian authorities into the suspected corruption and bribery scheme but before the litigations were filed, Defendants intentionally destroyed the physical encryption keys needed to access the system, which Plaintiffs contended contained crucial evidence regarding the scope and nature of the bribery scheme. *Id.* at *2-3.

Defendants did not deny they intentionally destroyed the encryption keys but argued that the motion for sanctions was premature because discovery had only just begun and that Plaintiffs could not demonstrate that “the information cannot be replaced or otherwise approximated through additional discovery.” *Id.* at *4. Defendants also argued that the relevant information from the MyWebDay system, namely the dollar amount of the bribes, could be addressed through a stipulation as to the amount of the bribes.

Magistrate Judge Moses began her analysis by describing the relevant standards for sanctions under Fed. R. Civ. P. 37(e). She noted that the sanctions permitted under Subsection (e)(1) of Rule 37, available upon a finding that the spoliation caused “prejudice to another party,” must be limited to “measures no greater than necessary to cure the prejudice.” *Id.* at 5. But to obtain the “particularly harsh” sanctions listed in Subsection (e)(2) — including adverse inference instructions and terminating sanctions — the court must first find that the party to be sanctioned acted with an “intent to deprive.” If such a finding is made, no separate showing of prejudice is required, because “the finding of intent [to deprive] ... support[s] ... an inference that the opposing party was prejudiced by the loss of information.” *Id.* (quoting Fed. R. Civ. P. 37(e) adv. comm. note to 2015 amendment).

Magistrate Judge Moses next addressed whether the encryption keys were destroyed after a duty of preservation arose, noting that “[t]he first element of the traditional spoliation test, which is also applicable to ESI under Rule 37(e), requires the moving party to demonstrate that the spoliating party had an obligation to preserve the evidence at the time it was destroyed.” *Id.* at *6 (internal quotations omitted). The obligation to preserve evidence arises when the party has notice that the evidence is relevant to litigation or when a party should have known that the evidence may be relevant to future litigation. Magistrate Judge Moses noted that Defendants could not have had specific notice of the current litigation at the time of the destruction of the encryption keys, because the litigation did not commence until a year later, but she nonetheless found that Defendants knew

or should have known that the evidence they destroyed “may be relevant to future litigation.” In particular, she found that Defendants were aware of the investigations into the international bribery scheme and other related information before the destruction of the encryption keys and that those kinds of investigations tend to lead to civil lawsuits. As a result, she found that Defendants “were on notice that litigation was likely and that the information would be relevant to that litigation.”

Magistrate Judge Moses next addressed whether Plaintiffs were prejudiced by the loss of the encryption keys. Plaintiffs argued they were prejudiced because the unavailable MyWebDay data would reveal the full scope and extent of the scheme, which affected several elements of their claim, including materiality, scienter, reliance, and loss causation. *Id.* at *7. Defendants argued that the only relevant issue affected by the loss was the total volume of bribe payments at issue, which could be resolved by a stipulation that Defendants would not raise any claim or defense on the basis that the total amount of bribe payments was any amount less than \$3.3 billion. Magistrate Judge Moses noted that Rule 37(e)(1) does not clearly define the meaning of the term “prejudice” but rather “leaves judges with discretion to determine how best to assess prejudice in particular cases.” *Id.* (citing Fed. R. Civ. P. 37(e)(1) adv. comm. note to 2015 amendments). Accordingly, she found that although Plaintiffs did not need the level of detail regarding the bribe payments they claimed to need, Plaintiffs had in fact been prejudiced because “the more granular and specific information that apparently resided in MyWebDay would be helpful to them in connection with establishing several elements of their securities fraud claims.”

Magistrate Judge Moses next found that the lost information could not be replaced through additional discovery. She noted that “[t]his is not a typical ESI spoliation case, in which the missing data — for example, emails improperly deleted from a party’s account — can be restored or replaced from another source, such as the accounts to or from which the missing emails were sent.” *Id.* at 8. She noted theoretical possibilities suggested by Defendants that employees may have emailed the secret MyWebDay information to one another unencrypted, or that another copy of the MyWebDay system may exist that is accessible without the destroyed physical encryption keys, but she discounted these and found that sanctions were warranted under Rule 37(e)(1) because “[t]here is ... every reason to believe that the information at issue here is permanently lost.”

Addressing the question of intent, Magistrate Judge Moses found that Plaintiffs could not demonstrate that the Rule 37(e)(2) sanctions they sought were appropriate because that required a finding that Defendants acted with the intent to deprive Plaintiffs of the information’s use in the litigation. She noted that the intent standard “is both stringent and specific: the intent contemplated by Rule 37 is not merely the intent to perform an act that destroys ESI but rather the intent to actually deprive another party of evidence.” Magistrate Judge Moses also noted that it was Plaintiffs’ burden to demonstrate that Defendants acted with the intent to deprive, not merely the intent to destroy. Ultimately, she found that Plaintiffs could not show that Defendants destroyed the physical encryption keys with the intent of depriving Plaintiffs in this litigation of that evidence, and that the more severe sanctions under Rule 37(e)(2), including the mandatory adverse inference instruction that Plaintiffs requested, were not warranted. *Id.* at *8-9.

Magistrate Judge Moses therefore addressed the appropriate sanction under Rule 37(e)(1). Because “discovery is not yet complete and the precise scope of the issues that will be presented to the jury is not yet known,” she found the appropriate sanction was to allow Plaintiffs to present evidence

and argument to the jury concerning Defendants' intentional destruction of the physical encryption keys needed to access the MyWebDay system, and the jury would be permitted to consider that evidence, along with all the other evidence in the case, in making its decision. *Id.* at *9. She found this sanction (as distinguished from a mandatory or permissive adverse inference instruction) is permitted under Rule 37(e)(1) without any predicate finding of intent to deprive.