

### **3. A decision from the U.S. District Court for the Southern District of New York denying an adverse inference sanction for spoliation where a bankruptcy trustee had negligently discarded a server from the bankruptcy estate containing electronically stored information (ESI) that was relevant to the claims against the Defendant.**

In *Convergent Distributors of Texas, LLC v. Alexander Capital, LP*, No. 21-cv-1355 (JSR), 2023 WL 2751541 (S.D.N.Y. March 31, 2023), U.S. District Court Judge Jed S. Rakoff addressed whether spoliation sanctions were appropriate against the assignee of claims in bankruptcy related to a lost computer server that the bankruptcy trustee had failed to preserve.

Plaintiff, the assignee of claims in the bankruptcy proceeding of a pharmaceutical company called Inpellis, brought this adversary proceeding alleging breach of contract and fraud claims against Defendants related to their work on Inpellis' failed initial public offering. *Id.* at \*1. After discovery, Defendants moved for an adverse inference instruction under Federal Rule of Civil Procedure 37(e)(2) based on Plaintiff's failure to preserve one of Inpellis' servers and the electronic records contained on it after suing Defendants. *Id.* at \*6.

The Inpellis server at issue became the property of the bankruptcy trustee as part of Inpellis' bankruptcy proceedings. *Id.* at \*7. While Plaintiff represented that neither it nor the bankruptcy trustee "ever accessed the server" and that neither party had "possession of the server," it was unclear from the record whether the bankruptcy trustee or Plaintiff ever had actual, physical control over or access to the Inpellis server at any time.

An officer of Inpellis's parent company who was under investigation by the SEC for conduct related to the bankruptcy had at one time accessed the server and downloaded documents from the server to a hard drive in connection with a subpoena to the parent company in the bankruptcy proceeding. That officer had decided which documents to download from the server at the direction of his own counsel. A copy of the hard drive containing the documents downloaded from the Inpellis server was later turned over to the bankruptcy trustee, and Plaintiff used the hard drive during discovery in this adversary proceeding.

After documents were downloaded from the Inpellis server, it was somehow disposed of or placed into a storage unit controlled by the bankruptcy trustee. The bankruptcy trustee later "abandoned the storage unit after representing to the bankruptcy court that the unit only contained miscellaneous outdated records not necessary to the administration of the case, and used office and laboratory furniture and equipment, including a small number of chairs, desks, and obsolete computers and monitors."

In connection with Defendant's spoliation motion, Judge Rakoff found that the bankruptcy trustee "made zero effort to access, copy, preserve, or otherwise review Inpellis's computer server," notwithstanding the "obvious likelihood that the server would contain material highly relevant" to the potential claims against Defendants. He agreed with Defendants that the bankruptcy trustee "entirely abdicated" its duty, and "contented itself with incomplete copies of the server made by a third party" whose conduct "contributed significantly to Inpellis' bankruptcy in the first place." Judge Rakoff further found that the Inpellis server likely would

have contained relevant email accounts and financial records that were not included in any production Plaintiff made based on the incomplete hard drive.

Based on these facts, Judge Rakoff easily concluded that Plaintiff “failed to take even basic steps to preserve the [Inpellis] server, which almost certainly contained relevant evidence the destruction of which may well have prejudiced” Defendants. *Id.* at \*6. But he noted that this conclusion did not suggest which measures were needed to cure any resulting prejudice. *Id.* at \*8. Judge Rakoff explained that Rule 37(e)(1) permits courts to “order measures no greater than necessary to cure the prejudice,” including “forbidding the party that failed to preserve information from putting on certain evidence, permitting the parties to present evidence and argument to the jury regarding the loss of information, or giving the jury instructions to assist in its evaluation of such evidence or argument.” *Id.* at \*8 (quoting Fed. R. Civ. P. 37, advisory committee’s notes to the 2015 amendment).

Judge Rakoff noted, however, that Defendants requested an adverse inference instruction under Rule 37(e)(2), which explicitly limits a court’s power to issue adverse inference instructions based on the failure to preserve ESI to situations where the court finds “that the party acted with the intent to deprive another party of the information’s use in the litigation....” *Id.* (quoting Fed. R. Civ. P. 37(e)(2)).

Judge Rakoff found that the record did not support an inference that the bankruptcy trustee or Plaintiff intentionally allowed the Inpellis server to be lost or destroyed so as to deprive Defendants of evidence contained on it, as the bankruptcy trustee never accessed or reviewed the server or had knowledge of what information may have been contained on it, separate and apart from the information downloaded to a hard drive. Judge Rakoff concluded that Rule 37(e)(2) did not permit an award of an adverse inference where the bankruptcy trustee’s behavior was “clearly negligent and arguably grossly negligent.”

Judge Rakoff rejected Defendant’s argument that adverse inference instructions may be given upon a mere finding that the spoliating party acted with a “culpable state of mind.” He explained that the Advisory Committee’s notes to the 2015 amendment to Rule 37(e) make clear that Rule 37(e)(2)’s requirement of an intent to deprive another party of information in specific litigation is meant to reject the award of adverse-inference instructions based on a finding of negligence or gross negligence. Because Defendants demonstrated at most gross negligence, Judge Rakoff concluded that he lacked the power to impose an adverse inference instruction, although he expressed openness to imposing other appropriate spoliation sanctions with respect to Plaintiff’s ability to introduce specific evidence, Defendants’ ability to refer to the loss of evidence, or with respect to other aspects of jury instructions. *Id.* at \*9.