1. An order from the Delaware Court of Chancery granting spoliation sanctions based on findings that the Defendants at least recklessly failed to preserve relevant text messages.

In *Goldstein v. Denner*, C.A. No. 2020-1061-JTL, 2024 WL 303638 (Del. Ch. Jan. 26, 2024), Vice Chancellor J. Travis Laster addressed the standards for spoliation sanctions under the rules of the Court of Chancery.

This action involved claims that the principal, Alexander Denner, of an activist hedge fund breached his fiduciary duties by engaging in insider trading related to an acquisition of Bioverativ, Inc., a publicly traded biotechnology company for which Denner was also a director. *Id.* at *1. Plaintiffs alleged that Denner received an offer from a third party related to the acquisition but delayed the acquisition so that he and others could acquire stock in Bioverativ for their own profit. Denner ultimately negotiated the acquisition on behalf of Bioverativ, which was announced on January 21, 2018. *Id.* at *2-3.

Three document-hold notices were issued in connection with events subsequent to the announcement of the Bioverativ acquisition. On February 21, 2018, Bioverativ's general counsel circulated a document-hold notice after stockholders filed putative class actions challenging the sufficiency of Bioverativ's proxy statement. *Id.* at *3. This hold notice instructed its recipients to preserve all documents related to the Bioverativ acquisition and expressly extended to texts and to "personally owned computers or devices (including cell phones, tablets, *etc.*)." The buyer likewise issued a document-hold notice related to the stockholder litigation on March 15, 2018. Vice Chancellor Laster noted that there was no evidence that Denner took any action in response to either hold notice.

On September 5, 2019, Defendants' general counsel circulated a third document-hold notice after Defendants received subpoenas from the Securities and Exchange Commission (SEC) related to the Bioverativ acquisition. *Id.* at *4. This notice also expressly extended to texts and mobile devices. In response to this hold notice, Defendants' internal and external counsel concluded that they would not collect text messages at that time, but outside counsel asked that text messages be preserved and that any recipients of the hold notice should "check with counsel before buying a new phone and transferring data to a new device." *Id.* at *5.

Defendants' general counsel claimed to have personally gone through Denner's phone looking for text messages relating to purchases of Bioverativ securities and found none, even though the SEC's subpoena sought a broader scope of documents. Vice Chancellor Laster pointed out that other parties to the litigation produced texts

from Denner relating to Bioverativ, so counsel either searched the texts too narrowly, missed them inadvertently, or consciously ignored them. Vice Chancellor Laster noted that this "manual self-collection by an inferably interested party" was the only collection of text messages by Defendants.

Defendants moved to dismiss the complaint. *Id.* at *6. After completing briefing, Plaintiff served document requests on September 27, 2021, and Defendants sought a stay of discovery. Vice Chancellor Laster explained that such stays are often granted based on the presumption that a stay "will not prejudice the plaintiff because the defendants will preserve potentially relevant evidence." Defendants argued that there was no "serious risk of currently-available information becoming unavailable while the Court considers the pending Motions to Dismiss." Vice Chancellor Laster denied Defendants' request for a stay on November 18, 2021, finding that "it appears highly unlikely that the motion to dismiss will be granted, much less dispose of the case in its entirety." *Id.* at *7. Vice Chancellor Laster also noted that Defendants' reference to "currently-available information becoming unavailable" now seemed "carefully worded."

According to Vice Chancellor Laster, it was only after he denied the motion to stay discovery on November 18, 2021, that "defense counsel began thinking about what sources of evidence would be responsive and should be identified, preserved, collected, reviewed, and potentially produced." He found "[t]hat was too late" because the current litigation was filed in December 2020 and defense counsel "should have started taking steps to identify and preserve information by at least then." Vice Chancellor Laster found that this delay was important because Denner lost all of his texts in October 2021, ostensibly when he upgraded his iPhone to a new model.

Vice Chancellor Laster also criticized Defendants' document collection efforts for the litigation. He noted that Defendants relied on the set of documents gathered in response to the SEC subpoenas in September 2019 and did not take any additional affirmative steps to identify custodians or sources. When Plaintiffs requested confirmation that the production would include Denner's mobile devices, defense counsel consulted with Defendants' general counsel and were told that Defendants had a policy against using text messages for business purposes and that the general counsel "did not believe that Denner had any responsive text messages." *Id.* at *8. Defense counsel collected and produced additional emails from Denner. Even though defense counsel was told that Denner did not have any texts before October 2021, this information was never communicated to Plaintiffs.

After Plaintiff received text messages involving Denner from other parties, Plaintiff informed defense counsel that Denner appeared to have texted for business

purposes and requested that Defendants produce documents from additional custodians. It was only at this point that defense counsel finally had one of its lawyers inspect Denner's devices. The inspection confirmed that Denner did not have any text messages from before October 2021.

Defense counsel discussed the issue of texts with Defendants' general counsel and its chief compliance officer but were again told that the relevant individuals adhered to Defendants' policy of not texting for business. *Id.* at *9. Defense counsel accepted that representation and again decided against imaging phones. At this point, in October 2022, defense counsel responded to interrogatories informing Plaintiff that Denner replaced his iPhone "on or around October 2021" and that process "inadvertently caused his text messages prior to that date to no longer be accessible or retrievable from his current device." Vice Chancellor Laster noted that this explanation "made no sense" because "data is transferred to the new iPhone" during an upgrade. He noted that Defendants' response was also misleading because it did not reference the fact that texts were missing from other custodians as well. *Id.* at *10.

Plaintiff ultimately moved for sanctions. Vice Chancellor Laster permitted Defendants to file an affidavit in connection with the motion describing their preservation and collection plan and how they carried it out. Defendants filed two affidavits in response, one from defense counsel detailing the collection efforts and one from Defendants' general counsel recounting his loss of texts as a result of dropping his phone in his swimming pool. *Id.* at *11. After further inquiry by Vice Chancellor Laster, defense counsel reported that no data was backed up to the cloud or available from other devices, but they did not describe what they did, or when, to make this determination. Vice Chancellor Laster commented that this was "a further example of defense counsel's lack of transparency and parsimony regarding the release of information" that "has undermined their credibility on the spoliation issues."

Turning to the legal standards governing Plaintiff's motion for spoliation sanctions, Vice Chancellor Laster first explained that spoliation "is the destruction or significant alteration of evidence, the failure to preserve evidence properly for another's use, or the improper concealment of evidence." He noted that text messages are a form of ESI and "fit comfortably within the scope of materials that a party may request under Court of Chancery Rule 34."

Vice Chancellor Laster next explained that Court of Chancery Rule 37(e), which reflects longstanding public policies, addresses sanctions for failure to preserve ESI:

> If ESI that should have been preserved in the reasonable anticipation of or actual notice of imminent litigation is lost because a party failed to take reasonable steps to preserve it, and it cannot be restored or replaced through additional discovery, the court: (1) upon finding prejudice to another party from loss of information, may order measures no greater than necessary to cure the prejudice; or (2) only upon finding that the party acted recklessly or with the intent to deprive another party of the information's use in the litigation, may, among other things: (A) presume that the lost information was unfavorable to the party; or (B) dismiss the action or enter a default judgment.

Vice Chancellor Laster noted that Court of Chancery Rule 37(e) "closely resembles Federal Rule of Civil Procedure 37(e)" with two main differences. *Id.* at *12. The first is that Court of Chancery Rule 37(e) omits the reference to instructing a jury that it "may or must presume the information was unfavorable," because the Court of Chancery does not have juries. The second is that Court of Chancery Rule 37(e) authorizes the court to impose sanctions requiring a culpable mental state if the party "acted recklessly or with the intent to deprive another party of the information's use in the litigation (Ct. Ch. R. 37(e)(2)) whereas the federal version requires that the party have acted "with the intent to deprive another party of the information's use in the litigation" (Fed. R. Civ. P. 37(e)(2)). *Id.* at *13.

Vice Chancellor Laster rejected an argument by Defendants that Plaintiff's sanctions motion was premature until trial or just before trial. Surveying the relevant Court of Chancery rules, he explained that there was no rule or requirement to delay adjudicating Plaintiff's motion. Rather, "when to address a spoliation issue depends on a variety of factors, including the nature of the issue, the stage of the case, the court's ability to provide case-specific relief, and any scheduling order that might apply." *Id.* at *14. Vice Chancellor Laster found that Plaintiff sought sanctions "that will frame the issues for trial" and therefore the "proper time to consider [P]laintiff's motion is now."

Turning to his analysis under Court of Chancery Rule 37(e), Vice Chancellor Laster adopted the "step-by-step framework for analyzing spoliation issues" established by federal courts.

The first step in his analysis was to address whether the ESI "should have been preserved" because "Rule 37(e) does not apply ... when information or evidence is lost before a duty to preserve attaches." Vice Chancellor Laster explained that "[a] party in litigation has an affirmative duty to preserve potentially relevant evidence … as soon as the party either actually anticipates litigation or reasonably should have anticipated litigation." He added that this inquiry is an objective one: "whether a reasonable party in the same factual circumstances would have reasonably

foreseen litigation." *Id.* (*quoting* The Sedona Conference Commentary on Legal Holds, Second Edition: The Trigger & The Process 354 (2019)). Vice Chancellor Laster also quoted from the Advisory Committee notes to Federal Rule 37(e), which explain that the duty to preserve arises when litigation is "reasonably foreseeable" and that "a variety of events may alert a party to the prospect of litigation." Applying these standards, Vice Chancellor Laster found that Defendants had a duty to preserve evidence starting at least on February 21, 2018, when Bioverativ's general counsel circulated the initial document-hold notice that extended to all the relevant custodians and data sources at issue in Plaintiff's motion, including text messages and mobile devices. *Id.* at *16-17.

The second step under Rule 37(e) is to determine whether the ESI "is lost" and "cannot be restored or replaced through additional discovery." *Id.* at *17. Vice Chancellor Laster explained that "[i]nformation is lost for purposes of Rule 37(e) only if it is irretrievable from another source, including other custodians." He noted the parties' agreement that most of the custodians' texts were lost and could not obtained from other sources or recovered. Vice Chancellor Laster detailed Plaintiff's unsuccessful efforts to secure the missing messages from other parties. He also found that deposition testimony was not a sufficient substitute for the text messages because Denner could not recall details about his text messaging during his deposition. *Id.* at *17-18. Vice Chancellor Laster concluded that "[t]he texts are well and truly lost."

The third step under Rule 37(e) is to determine whether the ESI was lost "because a party failed to take reasonable steps to preserve it." Vice Chancellor Laster explained that "[w]hen a duty to preserve evidence arises, a party must act reasonably to preserve the information that it knows, or reasonably should know, could be relevant to the litigation, including what an opposing party is likely to request." He further explained that the standard for such preservation is reasonableness and requires the party to "identify the information that should be collected and preserved" by "locating the relevant people and the locations and types of ESI." With respect to identifying custodians, Vice Chancellor Laster added that "[t]he relevant people are the individuals who have custody of the relevant ESI or the ability to obtain the ESI," and he stated that "[c]ounsel must interview them to learn the relevant facts regarding ESI and to identify, preserve, collect, and produce the relevant ESI." *Id.* at *19.

Vice Chancellor Laster detailed counsel's duty in this regard. He explained that "[i]dentifying custodians and locations requires an intentional and systematic approach that includes custodian interviews," which is "not merely a theoretical best practice." He stated that "a proper and thorough custodian interview is

mandated by the Federal Rules of Civil Procedure and the Rules of Professional Conduct" and "[t]he same is true under this Court's rules."

Vice Chancellor Laster further explained that "simply circulating a litigation hold is not enough" to meet an organization's obligation to preserve documents because the organization "must take steps to ensure that the recipients of the hold understand what it means and abide by it" as well as suspending or modifying routine document retention or document destruction policies so that evidence is not lost. Vice Chancellor Laster added that individuals have the same obligations, including to "disable auto-delete functions that otherwise would destroy emails or texts" and to "back up data from personal devices before disposing of them." *Id.* at *20. He concluded that "[f]ailing to either disengage the auto-delete setting or to back up messages before deleting them is sufficient to show that a defendant acted unreasonably."

Based on his various expositions of the relevant rules, Vice Chancellor Laster summarized that "in cases involving ESI, to satisfy their preservation duties, parties must investigate and disable autodelete functions on email accounts (client and webbased) at the onset of litigation if those accounts reasonably contain relevant information and it is reasonable under the circumstances of the case to do so." He added that "[c]ounsel's role in this process is essential. The obligation to preserve evidence runs first to counsel, who has a duty to advise his client of the type of information potentially relevant to the lawsuit and of the necessity of preventing its destruction."

Vice Chancellor Laster concluded that Defendants failed to take reasonable steps in response to the three document holds issued in this case. He found that Defendants had a legal duty to preserve evidence, including ESI, relating to the Bioverativ transaction. Denner, in particular, "[a]s a highly sophisticated party and the principal of an activist hedge fund, … was obligated to consult with counsel about his preservation obligations, identify likely sources of information, and take steps to preserve them." He noted that "[i]n a world where people primarily communicate using personal devices, it will almost always be necessary to image or backup data from phones," and he concluded that Defendants should have taken steps to do so here. He explained that if Defendants had done so, they would have lost less data by turning off the auto-delete function on relevant devices, and they would have data from the phones belonging to the relevant custodians. *Id.* at *22.

Vice Chancellor Laster again addressed outside counsel's role in the preservation process. He noted that Defendants' failure to fulfill their preservation obligations by not imaging or backing up data from mobile phones occurred because Defendants' general counsel "pushed outside counsel to 'table' the collection and imaging of

personal devices by stressing that [Defendant's] policies prohibited using texts for business and by representing that he reviewed Denner's phone and did not identify responsive texts." *Id.* at *23.

Vice Chancellor Laster specified that "outside counsel needed to be more assertive" and that "[r]elying solely on the client to identify the universe of relevant information, without reasonable inquiry to verify that the client accurately captured that universe, can lead to sources of information being overlooked." He added that "[a]n attorney may not simply rely on custodian self-collection of ESI. Instead, counsel must test the accuracy of the client's response to document requests to ensure that all appropriate sources of data have been searched and that responsive ESI has been collected — and eventually reviewed and produced." Vice Chancellor Laster further explained the risks of self-collection, which include that "clients may not remember or understand where ESI can be located, may not collect ESI correctly, or may not find or provide counsel with all responsive documents" and may "result in the conscious or subconscious omission of damaging documents." Here, Vice Chancellor Laster concluded that outside counsel should have given little weight to the general counsel's representation that no one used texts because it was contrary to policy and should have reviewed the phones. These reasonable steps would have resulted in counsel's imaging or backing up the phones.

In addition to their failures to implement the document holds, Vice Chancellor Laster found that Defendants failed to take reasonable steps to meet their obligations to preserve documents in response to the litigation, including by identifying potential existing and new sources of evidence and taking steps to preserve them. *Id.* at *24. He further found that Defendants compounded their failures by being "reactive" in the sense that they merely responded to Plaintiff's inquiries as opposed to seeking to fulfill their discovery obligations. *Id.* at *25. Vice Chancellor Laster singled out defense counsel in this regard, noting that they should have disclosed the preservation issues earlier because "[a] problem like spoliation rapidly festers."

Finally, Vice Chancellor Laster turned to the issue of determining the appropriate sanction for Defendants' conduct. He explained that Rule 37(e), like its federal counterpart, "authorizes sanctions to cure prejudice, then conditions an adverse inference or a default judgment on a culpable mental state." He added that "the Advisory Notes to the federal rule observe that sanctions for curing prejudice should not include or have the same effect as an adverse inference or a default judgment unless the requisite mental state is shown."

Vice Chancellor Laster next detailed that Rule 37(e) establishes a framework for ESI-related sanctions requiring a finding of prejudice before sanctions can be

imposed. The rule does not identify the possible sanctions that could be warranted, but he noted that "the Advisory Notes to the federal rule refer to orders forbidding a party from putting on certain evidence, permitting other parties to present evidence, or authorizing arguments to the factfinder about the loss of evidence." He added that "Delaware decisions have identified additional possibilities, including orders establishing certain facts as true, precluding the use of certain evidence, striking particular pleadings or claims, modifying the burden of proof for particular issues, allowing additional discovery, entering default judgments, or awarding attorneys' fees and costs."

Vice Chancellor Laster also explained that Rule 37(e)(2) requires a finding of mental culpability for two sanctions: A court may presume that the lost information was unfavorable or enter a default judgment only if a party "acted recklessly or with the intent to deprive another party of the information's use in the litigation."

Here, Plaintiff sought a number of sanctions for Defendants' conduct, including that the court (1) presume Denner's stock purchases were motivated by the buyer's initial expression of interest; (2) preclude any testimony, from fact witnesses or experts, that would disavow *scienter*; (3) preclude any testimony about alternative reasons for Defendants' trades, such as a pre-existing plan ; and (4) infer that the destroyed texts would have supported Plaintiff's argument that the sale process fell outside the range of reasonableness because Denner maneuvered to secure a near-term sale that would lock in the profits from his insider trading. *Id.* at *26. Vice Chancellor Laster stated that these sanctions were sufficiently significant to require both prejudice and a culpable mental state.

Vice Chancellor Laster first addressed whether Plaintiffs had established the requisite prejudice and the necessary sanctions to cure any such prejudice. He began by noting that "[p]rejudice exists when spoliation prevents a party from obtaining and potentially using relevant evidence." Surveying prior decisions discussing the burden of proof for this inquiry, he concluded that a plaintiff seeking to establish prejudice under Rule 37(e) "must provide a plausible explanation as to why the evidence could have been relevant such that the failure to preserve is prejudicial." At that point, the party that failed to preserve the ESI "must convince the court that the lost material could not have been relevant, would not have been admissible or potentially have led to the discovery of admissible evidence, or otherwise could not have been used by the requesting party to its advantage." *Id.* at *26-27.

Vice Chancellor Laster concluded that Plaintiff had established prejudice. He noted that the record was devoid of evidence regarding both Defendants' purchase of Bioverativ stock and the later acquisition. He noted that the missing texts would have addressed questions such as why Defendants increased their stake in

Bioverativ before the acquisition and the particulars of the negotiations regarding the acquisition. Vice Chancellor Laster stated that in addition to not being able to use the texts to prove their affirmative case, Plaintiffs also could not use them to cross-examine the defense witnesses and impeach their story. *Id.* at *28. Finally, Vice Chancellor Laster noted that Defendants had no "credible response" to Plaintiff's showing of prejudice.

Vice Chancellor Laster next turned to the sanctions necessary to cure the prejudice caused by Defendants' conduct. He noted that Rule 37(e)(1) authorizes the court to impose sanctions as necessary to cure the prejudice, and doing so would require him to address the lack of evidence that Plaintiff had to prove its affirmative case and compensate for the greater ability of Defendants to testify with impunity. To address the first issue, Vice Chancellor Laster stated that he would presume at trial that Defendants traded based on the buyer's initial approach and that the lost texts would have supported Plaintiff's position that the sale process fell outside the range of reasonableness because Denner maneuvered to secure a near-term sale that would lock in the profits from his insider trading, although both presumptions would be rebuttable.

Vice Chancellor Laster noted that the sanctions he was imposing were meaningful because "the presumption could be outcome-determinative" in a situation where Plaintiff could not carry its normal burden of persuasion because the evidence was in "equipoise." *Id.* At *29. In such a situation, the presumption would help "remedy the problem created by the absence of evidence." But he also noted that the presumption would not remedy the difficulties that Plaintiff would face cross-examining Defendants' witnesses without contemporaneous documents. To address that issue, Plaintiff asked for preclusion orders, but Vice Chancellor Laster denied that request and instead imposed the sanction of raising Defendants' standard of proof by one level on any issue where it had the burden.

Vice Chancellor Laster also granted Plaintiff the reasonable attorneys' fees and expenses incurred pursing the spoliation issue, including the correspondence relating to that issue, a subpoena issued to Denner's cell carrier, and the briefing of the motion.

Vice Chancellor Laster next addressed Defendants' state of mind because he could impose presumptions that were adverse to Defendants only if Defendants acted "recklessly or intentionally." He found that Defendants acted at least recklessly. He explained that under Delaware law, "intentional conduct means conduct that a person undertook with a knowing desire or with a conscious objective or purpose," and "reckless conduct reflects a knowing disregard of a substantial and unjustifiable risk." He noted that a court can find recklessness for spoliation purposes when "an

actor is under a duty to preserve evidence and takes part in the destruction of evidence while being consciously aware of a risk that he or she will cause or allow evidence to be spoiled by action or inaction and that risk would be deemed substantial and unjustifiable by a reasonable person."

Applying this standard, Vice Chancellor Laster found that Defendants knew about their obligation to preserve texts on their personal devices, had received advice about preserving texts, but took no steps to do so. *Id.* at *30. He pointed out in particular that Defendants lost texts through inexplicable failures of their phones to back up their texts from the cloud and under unusual circumstances that left text message data missing but did not affect other kinds of data such as photos. *Id.* at *31. Vice Chancellor Laster also found that Defendants "had ample motive to delete their texts" because the texts violated Defendants' internal policies and federal recordkeeping laws. Vice Chancellor Laster ultimately concluded that "the findings regarding recklessness satisfy the requirements of Rule 37(e)(2) for purposes of the sanctions that the court finds necessary to cure the plaintiff's prejudice."