Bad Facts Make Bad Law: Is Mt. Hawley A Step Backward for Rule 502(b)?

By John Tredennick, CEO
Catalyst Repository Systems, Inc.
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Bad Facts Make Bad Law: Is Mt. Hawley A Step Backward for Rule 502(b)?

By John Tredennick

In law school, we learned the old adage that bad facts often make bad law. What it means is that judges are human. When presented with compelling circumstances, or the fear that a bad guy might get away with something, judges sometimes get creative with the law. In an effort to do justice, they make rules and interpret things in ways that don't always make sense for later cases.

That may be what happened in Mt. Hawley Insurance Company v. Felman Production Inc., 2010 WL 1990555 (S.D.W.Va., May 18, 2010). Magistrate Judge Mary E. Stanley concluded that a privileged email that was inadvertently produced did not have to be returned because the privilege had been waived. Specifically, she found that counsel failed to take reasonable steps to search the production for privileged materials prior to delivering it to the other side.

What’s wrong with that? Several things. First, counsel in this case took a lot of steps (23 in fact) to screen for privileged materials, more than most take as a matter of course. If the judge wanted to raise the bar on requirements for screening privileged documents, she certainly could have done it proactively, giving counsel a warning rather than a ticket.

Second, there was a claw-back provision in place. Its technical requirements were met, as even the judge admitted. She seemed simply to ignore it. Why that happened could have ramifications for future cases and cause counsel to undertake even more protective (read “expensive”) steps in their reviews.

Ultimately, the decision seems contrary to the policies underlying revisions to the Federal Rules of Evidence—namely, to reduce discovery costs by taking some of the sting and uncertainty out of inadvertent productions. This decision does the opposite. Going forward, counsel will have to increase efforts to ensure privileged documents are not inadvertently produced, at substantial cost to their clients. I don’t believe that was what the drafters of Rule 502(b) had in mind.

Bad Facts?

At the heart of this case was the suggestion that plaintiff and its counsel were trying to swindle an insurance company by overstating the claim. The email at
issue seemed to support that contention. I suspect Judge Stanley’s desire to make sure the truth emerged guided her decision on waiver.

Felman, the plaintiff (Mt. Hawley later intervened), sued Industrial Risk Insurers on a property damage and business interruption claim relating to the failure of a furnace transformer. During discovery, Felman produced a May 14 email between the HR manager and outside counsel. The email suggested a plan to present and prosecute a false claim for the transformer failure.

Not surprisingly, the defense seized on the email, modifying their pleadings and asking about it during depositions. Upon learning of their mistake, Felman’s counsel promptly sought return of the May 14 email, along with another 377 documents that slipped out for which it also claimed privilege.

The defense objected, arguing Felman had failed to take reasonable precautions to prevent disclosure of allegedly privileged communications. They also tossed in the crime-fraud exception for good measure. For those of you who slept through your ethics courses, communications between lawyer and client in furtherance of a crime are not protected by the attorney-client privilege.

What About the Claw-Back?

Unlike the situation in the leading case of *Victor Stanley Inc. v. Creative Pipe Inc.*, 250 F.R.D. 251 (D.Md. 2008), the defense here had a claw-back agreement in place. A claw-back agreement is meant to protect both sides from inadvertent disclosure by allowing them to demand the return of a mistakenly produced item. The procedure was sanctioned in the recently amended FRE 502(e).

In this case, the claw-back said:

- A party may seek the return of any document produced that should have been withheld on grounds of privilege.
- The party must state the basis for withholding within 10 days of discovering the inadvertent production.
- After recall, the receiving party has five days to return the documents.
- The receiving party retains the right to challenge the privilege designation.

It closed with this key proviso:

Compliance by the producing party with the steps required by this Section H to retrieve an Inadvertently Produced Document shall be
sufficient, notwithstanding any argument by a party to the contrary, to satisfy the reasonableness requirement of FRE 502(b)(3).

Interestingly, the parties did not seek to make their stipulation an order of the court. FRE 502(e) suggests taking this step, particularly if you want to make your agreement binding on non-parties. No order is needed to make the stipulation binding as among the parties.

Reviewing the technical requirements, the judge found that Felman had taken the proper steps and that the defendants had failed to comply with their obligations. You would think that would be the end of the story. But it was not. The judge went on to assess the reasonableness of counsel’s efforts to screen for privileged materials before turning over the production.

What Happened?

We have to start with the judge’s characterization of the production itself. The production involved over a million pages of documents. The judge seemed critical of the plaintiff for having taken five months to amass and review these documents. She seemed upset that a large portion of the production involved documents that were “irrelevant,” as much as 30% according to the court. (She called them “junk” documents.) The judge was also upset that every page had been stamped “Confidential,” which she called a clear violation of the court’s protective order.

The May 14 email was only the “tip of the iceberg,” she also noted. Felman produced another 980 potentially privileged communications. After further review, Felman’s counsel sought the return of 377 of the documents, apparently concluding that the others were not privileged.

To paraphrase Ralph Losey, who wrote an excellent post about this case, “So what?” It may properly have taken five months to collect and review over a million pages of documents. To be sure, we’ve seen it done more quickly, but there were no factual findings suggesting delay or prejudice.

In addition, the fact that 30% of the production was “irrelevant” isn’t that far out of line. First, the standard for discovery that I recall is “relevance to the subject matter.” That is a much broader standard than relevance for admission of evidence. In the paper discovery days, we called it “backing up the trucks.” It made some people mad but I never saw it cause a waiver of privilege.

Stamping everything confidential always used to bother me when I was on the receiving end in a case. I don’t blame the judge for finding Felman’s counsel in
violation of the protective order she had in place. However, I don't see it as the basis for a privilege waiver. Something more direct and attuned to the infraction would make more sense to me.

The production of 980 privileged documents is bound to be bothersome to some judges. However, in this electronic age, the mistake that can lead to production of one privileged document can easily lead to the production of hundreds or thousands. In *Victor Stanley*, the inadvertent production involved 165 documents. Perhaps by comparison, this production seemed worse. Maybe it should, but that is not clear to me based on what I read.

The bottom line here is that the judge was clearly upset with the Felman team, perhaps because of the potential for insurance fraud or perhaps because she thought counsel was playing games in the production. Without much discussion, she moved right past the ESI stipulation and started into reasonableness considerations.

What happened to the express agreement among the parties not to challenge reasonableness of an inadvertent production? The judge didn't say. But FRE 502(e) clearly states:

> An agreement on the effect of disclosure of a communication or information covered by the attorney-client privilege or work product protection is binding on the parties to the agreement, but not on other parties unless the agreement is incorporated into a court order.

The Advisory Committee notes explain:

> Subdivision (e) codifies the well-established proposition that parties can enter an agreement to limit the effect of waiver by disclosure between or among them. Of course such an agreement can bind only the parties to the agreement. The rule makes clear that if parties want protection against non-parties from a finding of waiver by disclosure, the agreement must be made part of a court order.

Why wasn’t the ESI stipulation binding and dispositive here? I can't answer that question. What I can say is that the judge simply moved over to a discussion of reasonableness and proceeded to impose tough standards on the Felman team and, by force of possibly persuasive precedent, on future litigants as well. Read on and see what I mean.
How Reasonable Must You Be?

Notwithstanding the claw-back, the judge framed the question as whether the Felman team took reasonable steps to prevent disclosure, citing FRE 502(b)(3). Under Rule 502, a party trying to recall a privileged document has to establish three facts:

1. The disclosure was inadvertent.
2. The party took reasonable steps to prevent disclosure.
3. The party promptly took reasonable steps to rectify the error.

Felman’s counsel might have felt reassured when the judge quickly and favorably disposed of items one and three. She found the disclosure to be inadvertent and she found that Felman took prompt and reasonable steps to rectify the error.

That’s where the fun ended. On the middle requirement, Judge Stanley sided with the defense, finding that the Felman team did not take reasonable steps to prevent disclosure. Without a finding of reasonableness (and with the ESI claw-back neutered) privilege was waived—for the May 14 email and, by suggestion, for many or all of the other 377 documents that slipped out.

What is Reasonableness?

In Victor Stanley (which had no claw-back and was before Rule 502), Magistrate Judge Grimm set out a five-factor test to determine reasonableness:

1. The reasonableness of the precautions taken to prevent inadvertent disclosure.
2. The number of inadvertent disclosures.
3. The extent of the disclosure.
4. Any delay in measures taken to rectify the disclosure.
5. Overriding interests in justice.

Here, after listing these factors, Judge Stanley cited the Advisory Committee note on reasonableness:

The rule does not explicitly codify that test, because it is really a set of non-determinative guidelines that vary from case to case. The rule is flexible enough to accommodate any of those listed factors.
Other considerations bearing on the reasonableness of a producing party’s efforts include the number of documents to be reviewed and the time constraints for production. Depending on the circumstances, a party that uses advanced analytical software applications and linguistic tools in screening for privilege and work product may be found to have taken “reasonable steps” to prevent inadvertent disclosure. The implementation of an efficient system of records management before litigation may also be relevant.

She also went on to cite a letter from the Committee on Rules of Practice and Procedure of the Judicial Conference setting forth reasons for changes to Rule 502:

In drafting the proposed Rule, the Advisory Committee concluded that the current law on waiver of privilege and work product is responsible in large part for the rising costs of discovery, especially discovery of electronic information. In complex litigation the lawyers spend significant amounts of time and effort to preserve the privilege and work product.

Ironically (to me at least), she closed the discussion by tipping her hat to the introductory statement in the Federal Rules of Civil Procedure that these rules “should be construed and administered to secure the just, speedy, and inexpensive determination of every action and proceeding.”

**Did the Felman Team Act Reasonably (Enough)?**

Judge Stanley said the Felman team did not do enough to prevent disclosure. You be the judge. Here is what they did:

1. Negotiated the ESI stipulation with defendants.
3. Discussed with Felman’s IT department the company’s computer network structure and identified potential sources of relevant ESI.
4. Visited Felman’s West Virginia plant to coordinate and oversee ESI collection.
5. Decided to collect data using forensic imaging.
6. Directed the vendor to collect ESI from the current server and the backup server.
7. Collected 1,638 gigabytes of data.

8. Downloaded emails from 29 custodians for processing by its law firm, Venable.

9. Hired a new vendor to process Felman’s Oracle and Soloman databases.

10. Identified the first six workstations to be processed and learned that each contained more data than anticipated.

11. Examined methods to cull non-relevant materials.

12. Selected search terms to retrieve documents responsive to defendants’ document requests.

13. Tested the search terms against the Felman emails and added additional search terms.

14. Tested the search terms, including the additional terms, against the Felman emails, tagged responsive documents, and set them aside for privilege review.

15. Produced 17,064 Excel spreadsheets.

16. Selected privilege search terms” to identify materials which are potentially privileged and relevant.


18. Tested the privilege search terms against Felman’s emails.

19. Retrieved native files of all images and examined thumbnails.

20. Conducted “eyes-on” review of all documents identified both as relevant and potentially privileged.

21. Decided to use a vendor to complete the processing of Felman’s emails.

22. Produced ESI in native or TIF format, with 36 fields of metadata.

23. Produced more than 346 gigabytes of data without sampling for relevancy, over-inclusiveness or under-inclusiveness.
The Felman team did not stop there. They also submitted affidavits showing the following, which helped explain why the mistake happened. The judge also accepted these steps and incorporated them into her findings:

- The vendor Innovative Discovery processed Felman’s ESI, applied the relevance search terms and then posted the responsive data as 13 Concordance database files to a secure website for Venable to download and apply privilege search terms.

- The fourth Concordance database file was processed in a manner similar, if not identical, to other database files, and privilege search terms were applied to it.

- The May 14 email originated from the fourth Concordance database file.

- After learning of the inadvertent disclosure, investigation revealed that the fourth Concordance database file inexplicably built an incomplete index of potentially privileged materials.

- The manufacturer of the Concordance software, Lexis-Nexis, was not able to explain why the index was incomplete.

- When defendants contended that 966 documents produced by Felman were potentially privileged, Felman and Venable determined that 377 of those documents were privileged and that 328 came from the fourth Concordance database file.

Reading between the lines, it looks like at least some of the problem stemmed from a bad Concordance database file. If counsel and their consultants believed they were searching all of their documents but some failed to index, problems like these can happen easily. Typically there is no warning light that goes on to tell you your index is faulty. You just don’t get returns on those documents. For all practical purposes, they become invisible.

What Wasn’t Reasonable?

This case is interesting because Felman lost. The Venable firm was forced to deal with the ramifications of a significant privilege waiver. Given all the steps they took to look for privileged documents (23 steps after all) and the fact that most of the documents inadvertently produced seemed to come from a corrupt search database, why did they lose this motion? I don’t have a satisfactory answer.
Judge Stanley started with these findings:

- Felman over-produced documents by more than 30%.
- Felman produced 377 documents that it later claimed were privileged.
- The production of those 377 documents was not solely attributable to the problem with the fourth Concordance database file.
- Some documents on Felman’s privilege log were produced and not clawed-back.
- Some documents claimed by Felman to be privileged were not on the original privilege log.
- Felman and Venable failed to perform critical quality control sampling to determine whether their production was appropriate and neither over-inclusive nor under-inclusive, even though Venable was counsel in the Victor Stanley case.
- Felman and Venable apparently failed to perform simple keyword searches to locate copies of the May 14 email which were produced and to identify documents which comprise attorney communications.
- Felman’s post-production claw-backs appeared to be based on notifications by defendants and not on its own review.

Out of this list, sampling appears to be the key factor for Judge Stanley. As she started her discussion on reasonableness, the judge cited a key provision in Victor Stanley:

The Court notes that in Victor Stanley, Magistrate Judge Grimm remarked that “[t]he only prudent way to test the reliability of the keyword search is to perform some appropriate sampling of the documents determined to be privileged and those determined not to be in order to arrive at a comfort level that the categories are neither over-inclusive nor under-inclusive.” Victor Stanley, 250 F.R.D. at 257. Felman’s counsel participated in the Victor Stanley case “after all the events that are relevant … had taken place.” Id. at 255 n. 4.
All I can say is, “Wow!” This whole thing seems to turn on sampling and the fact that Felman’s counsel participated after the fact in *Victor Stanley*. What the judge doesn’t explain is how sampling might have helped in this case. The problem wasn’t about the efficacy of key words. Rather, it seems to have been about an index failure. How would key word sampling have addressed that issue?

Key word sampling isn’t defined in this opinion, but the practice can be described reliably. The idea is to run searches and do statistical samples of both the hits and the documents that aren’t returned. If the hits contain a high percentage of privileged documents, that suggests the key words are working. Conversely, if the non-hits are found to contain additional privileged documents, then the search may need to be broadened.

There is no magic to this or any generally accepted sampling procedures yet. Had the Felman team sampled, they might have found documents from the faulty Concordance database file or they might not have. Had they looked at documents from the faulty database file, they may or may not have found the ones that were privileged.

Equally important, it appears that the Felman team did sample. Specifically the court expressly found that they took the following steps:

- Selected search terms to retrieve documents responsive to defendants’ document requests.
- Tested the search terms against the Felman emails and added additional search terms.
- Tested the search terms, including the additional terms, against the Felman emails, tagged responsive documents, and set them aside for privilege review.
- Selected privilege search terms to identify materials which were potentially privileged and relevant.
- Tested the privilege search terms against Felman’s emails.
- Conducted “eyes-on” review of all documents identified both as relevant and potentially privileged.

That sounds like sampling to me. Maybe had the Felman team called what they did “sampling,” this would have gone a better way.
Application of Victor Stanley

Notwithstanding the ESI stipulation, the claw-back and the 23 steps taken by the Felman team, the court found that “Felman and Venable did not take reasonable steps to prevent disclosure of the May 14 email.” Specifically, the judge applied the five-factor Victor Stanley test and concluded:

1. The precautions to prevent inadvertent disclosure were not reasonable—failure to test key word searches was deemed imprudent.

2. The number of inadvertent disclosures was twice that of Victor Stanley. The May 14 email was significant (bad), “a bell that cannot be unrung.”

3. The extent of the disclosures was not known to the court because the other 377 documents had not been presented to the court.

4. There has been a delay in measures taken to rectify the disclosure. In seeming contravention to Rule 502, the court found it important that the defense found the inadvertently-produced documents.

5. Finally, Felman pointed to no “overriding interests in justice” which would excuse the waiver.

A tough ruling—although perhaps the bad guys got their due. Trying to cheat on insurance claims is bad business. Creating emails to set out the plan is bad business too.

A Bad Precedent

If this decision stands, you can bet it will be used against other litigants who inadvertently produce privileged materials. With millions of electronic documents being produced routinely in litigation, it has become all but impossible to ensure that privileged files don’t slip through the cracks. Rule 502(b) was amended to provide a safe harbor, both by allowing the parties to create simple claw-back agreements and by setting reasonable standards for the doctrine of inadvertent waiver. Discovery has become a multi-billion-dollar horse collar on the justice system and at least some including the drafters of FRE 502 are trying to reign it back in. In my opinion, Mt. Hawley is the two-steps back that we always hear about.

At the least, there is a lot to be learned from this case. Standards surrounding search of discovery materials are just starting to gel, with the early foundation being laid by Magistrate Judge John M. Facciola in U.S. v. O’Keefe, 537 F.Supp.2d 14 (D.D.C. 2008), and Magistrate Judge Paul W. Grimm in Victor...
Stanley. If *Mt. Hawley* is the next step in setting standards for search, lawyers everywhere need to pay close attention—and be sure to sample.

A complicated checklist of steps is starting to emerge that may ultimately control the procedures that need to be followed in every case. If you don’t follow those steps, you too may be at risk (and soon speaking with your malpractice carrier).