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WTC Insurer and Its Counsel Hit with E-Discovery Sanctions

The perils of e-discovery once again made headlines last month – this time in connection with the insurance coverage battles resulting from the September 11, 2001 terrorist attack on the World Trade Center. On June 18, United States District Judge Alvin K. Hellerstein, for the Southern District of New York, sanctioned Zurich American Insurance Company (“Zurich”) and its counsel, the law firms of Wiley Rein LLP and Coughlin Duffy LLP, \$1.25 million upon finding that Zurich (i) asserted unsupported defenses, (ii) deleted electronic evidence, and (iii) delayed the production of a 62-page insurance policy (“the 9/11 document”) and other relevant documents. *In Re: September 11th Liability Insurance Coverage Cases*, No. 03-332 (S.D.N.Y. June 18, 2007).

At the heart of this complex insurance coverage action is the question whether the Port Authority of New York and New Jersey (“Port Authority”) and Westfield Corporation, Inc. (“Westfield”) are named insureds under a general liability policy issued to World Trade Center Properties LLP (“WTCP”). Zurich alleged that they were not. Zurich ultimately changed its position, however, when it produced documents that proved otherwise, long after those documents were first requested. These critical documents were in Zurich’s counsel’s possession for almost three years before they were produced. Concerned about the appearance of pleading and discovery abuses, the Court permitted the Port Authority and Westfield to seek sanctions under Rules 11 and 37 of the Federal Rules of Civil Procedure.

Factual Contentions “Utterly Lacking in Support”

Federal Rule of Civil Procedure 11 requires, among other things, that attorneys certify that the papers and pleadings they present to the court:

- 1) are not being used for improper purpose, such as to cause unnecessary delay or needless increase in the cost of litigation;
- 2) contain factual contentions that have evidentiary support; and
- 3) contain denials of factual contentions that are warranted on the evidence or are reasonably based on a lack of information or belief.

Judge Hellerstein observed that “[a] baseless factual contention poses a greater threat to justice than a baseless legal contention,” slip op. at 17, because factual evidence is oftentimes exclusively within the control of the attorney or his or her client. Additionally, baseless factual contentions can unnecessarily delay and run up the cost of litigation. The Court further commented that the judicial system cannot function when attorneys cannot be trusted to make factual representations supported by evidence.

Zurich alleged in its First Amended Complaint that there was an “absence of evidence” that the Port Authority and Westfield were intended to be named insureds on the WTCP policy. Zurich further alleged that WTCP was attempting, after the attack, to add the two entities to the policy through a “complex web” of leasing agreements that were not disclosed to Zurich during the policy negotiations or during the issuance of the policy binder that occurred pre-9/11. Slip op. at 21.

Shortly after Zurich's First Amended Complaint was filed, and before any discovery had taken place, the Port Authority moved for judgment on the pleadings. The Court denied the Port Authority's motion on the basis of Zurich's defenses and bold denials. For example, counsel for Zurich represented vociferously to the Court at the Rule 12(c) hearing that he had "plenty of evidence" to help refute that the Port Authority was a named insured.

In light of the discovery that followed, Judge Hellerstein found that these contentions by Zurich "were either dishonest, or objectively unreasonable, or the product of a failure to make reasonable inquiries." Slip op. at 22. This finding was based upon evidence that (1) Zurich and its counsel had the 9/11 document as early as 2003 and, by counsel's own admission, had reviewed the file box in which the document was contained but had not identified it as relevant despite discovery requests for production of all drafts of the Zurich policies; and (2) despite interviewing several Zurich employees prior to their depositions where they readily admitted that the Port Authority was an intended additional insured, Zurich's counsel "stubbornly maintained its [contrary] position." Judge Hellerstein surmised that counsel either did not ask the right questions or "simply 'forgot'" the answers provided. Slip op. at 24. The Court concluded that "the factual contention that Zurich did not intend to extend 'Additional Insured' status to the Port Authority is objectively without rational basis; indeed, it is utterly lacking in support." On the basis of this conclusion, the Court granted the Port Authority's motion for Rule 11 sanctions and imposed a joint and several payment obligation of \$750,000 on Zurich and its counsel.

Failure to Produce "Negligence or Worse"

Federal Rule of Civil Procedure 37 authorizes sanctions for an attorney's failure to comply with Rule 26 disclosure requirements, including the failure to:

- 1) produce a copy of all relevant documents in the party's control; and
- 2) amend any prior discovery responses if the party learns that the response is incomplete or incorrect and the additional or corrective information has not been made known to the other parties during the discovery process.

Moreover, pursuant to Rule 26, attorneys are obligated to disclose this information without awaiting a discovery request and in a timely manner absent substantial justification for delay. Courts may issue sanctions if a party is found to have even negligently breached these obligations causing injury to the other party. Here, the Court found inapt counsel's explanation at the sanctions hearing that Zurich's failure to produce was due to inadvertence. "A finding of negligence or worse would appear to be a more appropriate characterization, and I so find." Slip op. at 30.

The Court was particularly troubled by Zurich's deletion of the electronic version of the 9/11 document which further appeared to have occurred even after counsel had instructed that all underwriting communications were to be preserved. The Court also took umbrage at Zurich's "slow and inadequate responses" to repeated document requests and related court orders. Slip op. at 29. Zurich failed to turn over the "clearly responsive" 9/11 document until February 18, 2005, *i.e.*, years after it was first requested. Judge Hellerstein found that "Counsel's failure to recognize the importance of the document, and to produce it timely, especially when alerted to its possible existence by opposing counsel," was blameworthy and sanctionable. Slip op. at 30. Thus, the Court further granted the Port Authority's motion for Rule 37 sanctions and imposed an additional joint and several payment obligation of \$500,000 on Zurich and its counsel.

Conclusion

There is no substitute for care and diligence in the discovery process. The large volumes of records now maintained in electronic format multiply discovery risks and the corresponding risk of sanctions. Here, Zurich's conduct and that of its counsel was found to have increased the cost of the litigation and the number and length of the proceedings, wasting Court time, wasting the parties' time and misleading the public in this high-stakes, high-profile case. It is certainly not surprising that the Port Authority and Westfield sought sanctions, and, in the perilous world of e-discovery, it is increasingly common that such motions are finding favor with the courts.

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