UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.	SACV 10-1333 JVS (MLGx)	Date	January 20, 2012
Title	FTC v. Lights of America Inc., et al.		

Present: The Honorable	James V. Selna

Karla J. Tunis	Not Present
Deputy Clerk	Court Reporter

Attorneys Present for Plaintiffs:	Attorneys Present for Defendants:
Not Present	Not Present

Proceedings: (IN CHAMBERS)
Order Denying Defendants' Motion for Sanctions (Fld 11-30-11)

Defendants Lights of America ("LOA"), Usman Vakil, and Farooq Vakil (collectively "Defendants") move this Court to issue sanctions against Plaintiff Federal Trade Commission ("FTC") for the FTC's failure to implement a litigation hold in this matter when litigation became reasonably foreseeable. (Joint Stip., Docket No. 139.) Defendants allege that the FTC's failure to implement a litigation hold resulted in spoliation of evidence. Defendants seek terminating sanctions, or in the alternative, an adverse inference sanction. (Id. 2.) The FTC opposes the Motion.[1] For the following reasons, the Motion is DENIED.

I. Background

The underlying action in this case is a civil complaint brought by the FTC against Defendants for violations of section 5(a) of the FTC Act, 15 U.S.C. § 45(a), which prohibits "unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce." The FTC alleges that Defendants deceptively marketed LOA's LED lamps by overstating their claimed light output and lifetime, without substantiation. (First Amended Compl. "FAC" ¶¶ 90-95, Docket No. 42.) The FTC contends that these allegations are corroborated by independent test results published by the Department of Energy ("DOE") and Defendants' own testing. (Joint Stip. 2.)

[1] FTC has opposed this Motion via the Joint Stipulation, pursuant to Local Rules 37-1 and 37-2.

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No. SACV 10-1333 JVS (MLGx) Date January 20, 2012

Title FTC v. Lights of America Inc., et al.

In October 2011, Defendants attempted to add two affirmative defenses to their answer: (1) that the current action is an unreasonably discriminatory application of the FTC Act by the FTC that deprives Defendants of liberty and property without due process in violation of the Fifth Amendment to the United States Constitution and (2) that the current action is an invalid exercise of police power in violation of the Fifth, Ninth, and Tenth Amendments to the United States Constitution. (Declaration of Michael Thurman ("Thurman Decl.") ¶ 3, Docket No. 120-2.) The Court denied Defendants' motion for leave to amend to add these affirmative defenses because Defendants lacked good cause to assert these tardy defenses. (Order, Docket No. 135.)

Shortly thereafter, Defendants filed this Motion via a joint stipulation with Plaintiff's counsel, in accordance with Local Rules 37-1, 37-2. Defendants also filed a supplemental brief in support of their Motion, pursuant to Local Rule 37-2.3. (Redacted Supp. Br., Docket No. 151; Under Seal Supp. Br., Docket No. 155.)

II. Legal Standard

A party that has despoiled evidence can be sanctioned by a district court under two sources of authority: "the inherent power of federal courts to levy sanctions in response to abusive litigation practices, and the availability of sanctions under Rule 37 against a party who fails to obey an order to provide or permit discovery." Leon v. IDX Sys. Corp., 464 F.3d 951, 958 (9th Cir. 2006) (internal quotations and citations omitted). In this case, Defendants have not asserted that the FTC failed to obey a discovery order. Absent a failure to obey a discovery order, the Court does not have authority under Rule 37 to sanction a party. Kinnally v. Rogers Corp., 2008 WL 4850116 (D. Ariz. Nov. 6, 2008) (holding that Rule 37 sanctions were unavailable because the court did not issue a discovery order concerning the discovery disputes at issue). Accordingly, this Motion relies on the Court's inherent authority to levy sanctions.

Here, Defendant seeks a terminating sanction, or in the alternative, an adverse inference regarding the credibility of the Pacific Northwest National Laboratory ("PNNL") expert and the scientific credibility of its reports. (Joint Stip. 2.) These two sanctions are answered under different legal standards.

A terminating sanction, such as dismissal, is appropriate only when "a party has engaged deliberately in deceptive practices that undermine the integrity of judicial

proceedings."[2] Leon, 464 F.3d at 958 (quoting Anheuser-Busch, Inc. v. Natural Beverage Distribs., 69 F.3d 337, 348 (9th Cir. 1995)). In determining whether dismissal is warranted, the Court must weigh the following factors: "(1) the public's interest in expeditious resolution of litigation; (2) the court's need to manage its dockets; (3) the risk of prejudice to the party seeking sanctions; (4) the public policy favoring disposition of cases on their merits; and (5) the availability of less drastic sanctions."[3] Id. (quoting Anheuser-Busch, Inc. v. Natural Beverage Distribs., 69 F.3d 337, 348 (9th Cir. 1995)). "Dismissal under a court's inherent powers is justified in extreme circumstances, in response to abusive litigation practices, and to insure the orderly administration of justice and the integrity of the court's orders." Halaco Engineering Co. v. Costle, 843 F.2d 376, 380 (9th Cir. 1988).[4]

An adverse inference is a sanction carried out as an instruction to the trier of fact that "evidence made unavailable by a party was unfavorable to that party." Lewis, 261 F.R.D. at 521 (quoting Nursing Home Pension Fund v. Oracle Corp., 254 F.R.D. 559, 563 (N.D. Cal. 2008)).[5] In order for the Court to impose an adverse inference LOA must establish that: "(1) the party having control over the evidence had an obligation to

---

[2] The thresholds for terminating sanctions under the Court's inherent power and under Rule 37 are largely identical. Under Rule 37, terminating sanctions are reserved for cases in which a party's noncompliance is due to "willfulness, fault, or bad faith." Computer Task Group, Inc. v. Brotby, 364 F.3d 1112, 1115 (9th Cir. 2003); In re Exxon Valdez, 102 F.3d 429, 432 (9th Cir. 1996).

[3] While this five-factor test is typically used to review the propriety of Rule 37 sanctions, e.g., Computer Task Group, Inc. v. Brotby, 364 F.3d 1112, 1115 (9th Cir. 2003), the same test was applied in Anheuser-Busch to review sanctions granted under a court's "inherent power." See 69 F.3d at 348; Leon, 464 F.3d at n. 4. Further, given that the Rule 37 sanctions and sanctions levied under the Court's inherent power both analyze the same factors, the Court finds case law regarding Rule 37 sanctions persuasive.

[4] Similarly, dismissal is warranted under Rule 37 only when "no lesser sanction is adequate to cure the prejudice from the offending conduct." Lewis v. Ryan, 261 F.R.D. 519, 522 (S.D. Cal. 2009) (citing In re Napster, Inc. Copyright Litig., 462 F. Supp. 2d 1060, 1072 (N.D. Cal. 2006)).

[5] The Ninth Circuit explained that the adverse inference sanction is based on two rationales: (1) "the common sense observation that a party who has notice that a document is relevant to litigation and who proceeds to destroy the document is more likely to have been threatened by the document than the party in the same position who does not destroy the document" and (2) the "prophylactic and punitive effect" of allowing the trier of fact to draw the adverse inference, which deters evidence destruction. Akiona v. United States, 938 F.2d 158, 161 (9th Cir. 1991).

preserve it; (2) the records were destroyed with a culpable state of mind; and (3) the destroyed evidence was relevant to the party's claim or defense." Id. (quoting Residential Fund'g Corp. v. De-George Fin. Corp., 306 F.3d 99, 107 (2d Cir. 2002)). The "culpable state of mind" includes negligence. Id.

III. Discussion

Defendants contend that the FTC destroyed, or negligently allowed to be destroyed, documents relevant to this action in violation of its duty to preserve such documents. The Court first examines whether the FTC violated its duty to preserve documents. Then, the Court turns to the appropriateness of sanctions. Because the Court finds insufficient evidence of spoliation, neither a terminating sanction nor an adverse inference is warranted.

A. The FTC's Duty to Preserve Relevant Documents

The FTC has a duty to preserve evidence it knew or should have known was relevant or may be relevant to future litigation. Sunrider Corp. v. Bountiful Biotech Corp., 2010 WL 4590766, at *29 (C.D. Cal. Oct. 8, 2010). The obligation to preserve relevant evidence attaches when litigation is "pending or reasonably foreseeable." Id. (quoting Zubulake v. UBS Warburg LLC, 220 F.R.D. 212, 216 (S.D.N.Y. 2003)); see United States v. Kitsap Physicians Serv., 314 F.3d 995, 1001 (9th Cir. 2002) (finding no spoliation because the defendant was not on notice of a "future, specific" lawsuit).

Defendants argue that the Court should levy a terminating sanction or impose an adverse inference because the FTC allegedly failed to (1) implement a timely and adequate internal litigation hold in connection with this matter, (2) suspend the FTC's 45-day auto-delete policy for all electronic mail communications at the FTC, (3) advise the DOE or PNNL of their obligation to preserve relevant documents and information, and (4) conduct an adequate search of the FTC's records for documents and information potentially responsive to Defendants' document demands in this action. (See Joint Stip. 5.) The Court addresses each argument in turn.

1. Whether the FTC Timely Implemented an Internal Litigation Hold

Defendants argue that the FTC failed to timely implement an internal litigation

hold because the FTC did not implement the hold until more than one year after it commenced a full-phase investigation of Defendants. (Joint Stip. 6-7.) Defendants contend that the FTC knew that litigation was "reasonably likely" as soon as it opened a full-phase investigation into LOA on April 24, 2009, and thus the FTC should have implemented its internal hold at that point. (Joint Stip. 6.) Alternatively, Defendants suggest that the FTC should have implemented an internal hold once it issued a Civil Investigative Demand ("CID") on August 24, 2009, demanding that Defendants "suspend any routine procedures for document destruction and take other measures to prevent the destruction of documents that are in any way relevant to this investigation." (Joint Stip. 7.) Defendants assert that the CID was effectively a litigation hold, and thus it was incumbent upon the FTC to follow its own instruction. (See Joint Stip. 6-7.) Defendants also argue that the FTC knew litigation was likely during the full-phase investigation, as evidenced by the FTC's privilege logs, in which the FTC asserted work product privilege over "emails and voicemail regarding analysis of investigation." (Joint Stip. 7.) Defendants contend that asserting a privilege premised on the anticipation of litigation over documents created during the investigation shows that the FTC anticipated litigation during the investigation.

Additionally, Defendants note that when the FTC did implement its internal litigation hold in April 2010, it failed to notify or place on litigation hold the only attorney handling the matter from the beginning of the LOA investigation through the FTC's issuance of the CID, Ms. Julie Mack, and the only investigator assigned to the FTC's investigation of LOA during this time, Mr. William Burton. (Joint Stip. 8.) The FTC did not place Ms. Mack or Mr. Burton on litigation hold until May 13, 2011, approximately eight months after it commenced the present action. (FTC's Response to F. Vakil's First Set of Interrogatories No. 17, Shortnacy Decl., Ex. H, Docket No. 139-10.)

The Court finds that the FTC was not obligated to impose a litigation hold at the commencement of the full-phase investigation or upon the issuance of the CID because litigation was not "reasonably foreseeable" at those points. Commencement of an internal investigation does not, per se, put an institution on notice of potential litigation. See Kitsap Physicians Serv., 314 F.3d at 1001 (9th Cir. 2002) (finding that a health care provider's initiation of an internal investigation did not put the provider on notice of a "specific, future . . . lawsuit," and thus the provider's failure to keep records from that point on did not constitute spoliation). The duty to preserve relevant documents attaches

when future litigation is "probable," which means "more than a possibility." Realnetworks, Inc. v. DVD Copy Control Ass'n, 264 F.R.D. 517, 524 (N.D. Cal. 2009) . In this case, the FTC issued a CID to LOA to determine whether LOA could substantiate its claims regarding its LED products. At oral argument, LOA argued that this CID should have triggered the FTC's own internal litigation hold because it was a "pre-litigation, discovery CID," and not an "investigatory CID"; however, a sworn FTC declaration makes clear that the FTC uses CIDs to obtain information "in furtherance of" its investigations. (Declaration of Robert S. Kaye "Kaye Decl." ¶ 3, Docket No. 139-37.) After receiving information in response to a CID, the FTC evaluates that data to determine whether an investigation warrants enforcement action. (Id.) In LOA's case, the FTC needed to evaluate LOA's response to the CID to determine whether LOA's claims were substantiated before it could decide whether the investigation warranted enforcement action. Because many FTC investigations involve the use of a CID conclude without litigation, the issuance of a CID does not make litigation "probable." LOA argues that, in this case, litigation was probable when the FTC issued the CID because at that point, the FTC already possessed the CALiPER test results for certain LOA products, which, LOA argues, put the FTC on notice of LOA's potentially false or unsubstantiated claims. Further, LOA asserted during argument that the FTC operates as a referral agency, prosecuting the claims referred to it from the DOE. However, the FTC is an independent agency that proceeds with enforcement action only once it has completed its own investigation. (See Kaye Decl. ¶¶ 3-6.) While the CALiPER testing suggested that certain LOA products did not perform at advertised levels, the testing did not answer the substantiation inquiry. The FTC needed to obtain information from LOA, in response to the CID, before it could determine whether LOA substantiated its claims. In sum, litigation was not "probable" at the time the FTC issued the CID.

Additionally, while the FTC's privilege logs may tend to show that the FTC conducted its investigation of Defendants "in anticipation of litigation," the FTC has since revoked its work product claim and has produced these documents to the extent they do not assert another privilege over them. (Joint Stip. 14.) The FTC asserts that the initial work product designation was overinclusive and was asserted by then-new trial counsel who had not worked on the matter prior to implementation of the litigation hold. (Joint Stip. 14.) The Court does not find that the 2011 privilege log, which has since been revised to exclude the documents related to the investigation, bears significantly on

the issue of whether the FTC foresaw litigation in 2009.[6] Accordingly, the FTC was not obligated to impose a litigation hold at the beginning of the full-phase investigation or the issuance of the CID.[7]

While the FTC erred in failing to place Ms. Mack and Mr. Burton under the litigation hold in April 2010, Defendants have not shown that this likely resulted in the loss of evidence. Defendants contend that the absence of the litigation hold on Ms. Mack and Mr. Burton has caused Defendants prejudice because the FTC cannot produce a complete set of its communications with the DOE and its contractors, including PNNL. (Joint Stip. 9.) However, Defendants have not substantiated this assertion. Mere speculation that documents must have been destroyed in the absence of a litigation hold is insufficient to show spoliation. Kinally, 2008 WL 4850116, at * 6. Moreover, in Kinnally, an adverse inference was not justified even though a defendant failed to implement a timely litigation hold, in part, because it appeared that the defendant had taken appropriate measures to preserve evidence. Id. Similarly, in this case, although Ms. Mack and Mr. Burton were not under formal litigation holds until May 2011, they have both stated under oath that they took measures to preserve all relevant emails related to this case. Ms. Mack stated that her practice was to preserve all relevant emails between herself and DOE, as well as any emails forwarded to her by Mr. Hampton Newsome, the FTC attorney working with DOE in the investigation of LOA. (Declaration of Julie A. Mack ("Mack Decl.") ¶ 4, Docket No. 139-34; Declaration of

[6] Defendants suggest that the FTC's revision of the privilege log is suspect given that it occurred shortly after Defendants first raised the issue of the FTC's failure to timely implement a litigation hold. (Joint Stip. n. 3.) However, this amendment is not inherently suspect. Indeed, Defendants' objection to the timeline of the litigation hold could have caused FTC to catch the error in the privilege log.

[7] In their Supplemental Brief, Defendants also point to an email sent from PPNL researcher Ms. Mia Paget to DOE employee Mr. James Brodrick in which Ms. Paget stated her belief regarding the LOA: "It is no longer just a question of [the LOA's] light output claims, but clearly false claims regarding product life." (Under Seal Supp. Brief, App. B.) An excerpt from this email, including the above quotation, was sent to Ms. Mack at the FTC on September 2, 2009. (Shortnacy Decl., Ex. L.) While the excerpt from the exchange between DOE and PNNL may have put Ms. Mack on notice that the FTC should investigate LOA's product life claims as well as its output claims, this email did not make litigation against LOA "reasonably foreseeable." Becoming apprised of data that encourages further investigation does not bear on the likelihood of litigation. At this point in September 2009, Defendants had not completed their CID production, which could have generated substantiating evidence for LOA's claims.

Hampton Newsome III ("Newsome Decl.") ¶ 4, Docket No. 139-36.)) Ms. Mack also stated that she stored those emails in an archive folder to prevent deletion, that she had no communication with PNNL, and that after she transferred the matter to FTC attorney Ms. Robin Spector, she continued to preserve emails by either storing them in the archive folder or forwarding them to Ms. Spector. (Mack Decl. ¶¶ 4-5.) Mr. Burton stated that he never had any email correspondence with DOE or PNNL, and that he forwarded or copied all email related to the LOA investigation to the attorney working on the matter. (Burton Decl. ¶¶ 4-5.)

Defendants have not offered sufficient evidence to show that the FTC failed to preserve email correspondence after its duty to preserve evidence attached. Defendants offer three examples of emails between PNNL and FTC that were produced by the DOE, but that the FTC failed to produce.[8] (Joint Stip. 9.) All three chains were exchanged prior to the litigation hold, and thus the FTC had no obligation to preserve them. Moreover, all of the emails merely discussed arranging a phone conference to talk about the November 2008 CaliPER Benchmark Report "Performance of Incandescent A-Type and Decorative Lamps and LED Replacements," without any mention of LOA. (Shortnacy Decl. Ex. I (Nov. 6, 2009); Ex. J (Nov. 10, 2009); Ex. K (Jan. 21, 2010), Docket No. 139-11.) While Defendants claim that the November emails contradict the FTC's interrogatory response that states that the first written communication between the FTC and a PNNL agent concerning Defendants was on January 21, 2010, no contradiction is established because the November emails do not even mention LOA. Thus, it is not clear whether these emails "concern" Defendants.

In sum, the Court concludes that (1) the FTC's litigation hold was not untimely; and (2) there is insufficient evidence to show that the FTC's failure to place certain FTC custodians under the litigation hold in a timely fashion resulted in spoliation.

[8] To the extent that the FTC failed to produce any of these documents (which the FTC disputes, see Joint Stip. n. 7), the fact that these emails were available through other sources lessens the likelihood of prejudice to Defendants. Ahcom, Ltd. v. Smeding, 2011 WL 3443499, *9 (N.D. Cal. Aug. 8, 2011). Defendants argue that these are merely examples of lost correspondence that could prejudice their case, but they do not explain how this correspondence could impair their defense or their ability to raise affirmative defenses. Rather, the evidence seems to show that Defendants' own lumen depreciation tests confirm the PNNL results. (Under Seal Declaration of Kimberely L. Nelson ("Nelson Decl."), Ex. Z-BB, Docket No. 150.) Both the existence and potential prejudice of the alleged lost correspondence is speculative.

2. Whether the FTC's 45-Day Auto-Delete Policy Resulted in Spoliation

While Defendants contend that the FTC's auto-delete policy caused the deletion of email communications relevant to Defendants' claims and defenses (Joint Stip. 21), the policy provides for the proper storage of communication subject to a litigation hold, and Defendants have not produced any evidence of spoliation due to this policy. The FTC's E-Discovery Guidelines provide that relevant electronically stored information ("ESI") must be preserved in the Outlook Archive, and that duplicates must be deleted. (Shortnacy Decl., Ex. R.) Accordingly, the FTC's auto-delete policy is consistent with its duty to preserve relevant material.

The FTC's E-Discovery Guidelines and the archiving practices employed by the FTC attorneys working on this case, discussed infra section III.A.1, show that the FTC's policies and practices were consistent with its duty to preserve relevant evidence. Moreover, to the extent that the auto-delete policy caused the inadvertent loss of any relevant email correspondence, that is not a sanctionable offense. Federal Rule of Civil Procedure 37(e) instructs that, "[a]bsent exceptional circumstances, a court may not impose sanctions under these rules on a party for failing to provide electronically stored information lost as a result of the routine, good-faith operation of an electronic information system." (emphasis supplied). Similarly, the inadvertent deletion of some emails due to the good-faith operation of an electronic information system is not a ground for issuing sanctions under this Court's inherent power to sanction. There is no evidence suggesting that the FTC's retention policy operates in bad faith. The auto-delete system is a function of the computer information system's finite storage capacity and the desire to avoid needless retention of documents, which slows the system. (Nelson Decl., Ex. Y at Bates No. FTCvLOA00002262, Docket No. 150-4.) Contrary to Defendants assertion, there is no evidence suggesting the FTC's retention policy systematically deletes discoverable evidence.

In sum, the Court concludes that the FTC's auto-delete policy is consistent with its duty to preserve relevant evidence.

3. Whether the FTC Had an Obligation to Issue a Litigation Hold on DOE and PNNL

The FTC had no obligation or right to issue a litigation hold on DOE or PNNL

because it did not have possession or control over their documents. MGA Entm't, Inc. v. Nat'l Prods. Ltd., 2011 WL 4550287, at *2 (C.D. Cal. Oct. 3, 2011). "The party seeking production of the documents . . . bears the burden of proving that the opposing party has such control." Id. (quoting United States v. Int'l Union of Petroleum and Indus. Workers, AFL-CIO, 870 F.2d 1450, 1452 (9th Cir. 1989)). Here, Defendants have failed to show that the FTC exercises control over DOE or PNNL's documents.

Defendants argue that the FTC should have warned the DOE and PNNL that they should preserve information relevant to the LOA investigation because the FTC knew it would be relying on DOE and PNNL studies in this case. Defendants rely on the decision in World Courier v. Barone, 2007 U.S. Dist. LEXIS 31714, at *2-3 (N.D. Cal. Apr. 16, 2007), to argue that the FTC had an obligation to impose a litigation hold on DOE and PNNL's documents; however, in World Courier, the defendant and the third party were married and the defendant "at least had access to or maintained indirect control over" the spoliated evidence, and thus she had a duty to preserve it. Here, in contrast, the FTC is an agency entirely independent of the DOE or PNNL, and the FTC does not have access or control–direct or indirect–over those agencies' records.

Because Defendants have failed to show that the FTC has access or control over DOE or PNNL's records, the FTC was not obligated to issue a litigation hold on those entities.

4. Whether the FTC Failed to Conduct a Reasonable or Diligent Search for Relevant Documents and Information

Defendants argue that the FTC failed to conduct a reasonable or diligent search for relevant documents because the FTC refused to run electronic searches using Defendants' proposed search terms or any other terms. (Joint Stip. 26-27.) Defendants claim that an electronic search was critical given the FTC's "late implementation of the litigation hold in this case . . . and the constant operation of the 45-day auto-delete policy." (Joint Stip. 27.) Defendants' position, however, is illogical: an electronic search would not produce emails sent before the implementation of the litigation hold in April 2010 because those documents would have been automatically deleted 45 days later. Accordingly, this proposed method for retrieving allegedly lost documents would not produce any emails or electronic documents created prior to the litigation hold.

Again, Defendants have not offered any evidence that the FTC failed to produce

relevant documents. The FTC responded to Defendants' requests for production by identifying the employees who worked on the LOA matter, and then each person completed a file inventory form to identify whether and where they stored documents related to this matter. (Nelson Decl., Ex. U, Kaye Dep. p. 187-189.) Defendants have not given any reason why this collection method was inadequate in producing relevant documents.

In sum, the Court finds that a search of the FTC's electronic information systems was not necessary for the FTC to satisfy its duty to preserve and produce relevant evidence.

B. The Appropriateness of Sanctions

In this case, there is no evidence that the FTC "engaged deliberately in deceptive practices that undermine the integrity of judicial proceedings." Leon, 464 F.3d at 958 (quoting Anheuser-Busch, Inc. v. Natural Beverage Distribs., 69 F.3d 337, 348 (9th Cir. 1995)). Because the Court finds no evidence of the FTC's purposeful wrongdoing, the Court declines to levy a terminating sanction. Further, there is insufficient evidence to show that the FTC spoliated relevant documents or, to the extent that any relevant document was inadvertently lost, that Defendants suffered any prejudice at a result. Accordingly, an adverse inference is also unwarranted.

IV. Conclusion

For the foregoing reasons, the Motion is DENIED.

IT IS SO ORDERED.

The Court directs counsel to meet, confer and submit, forthwith, a Stipulation and proposed Order setting forth a briefing schedule and hearing date for any summary judgment motions to be filed.

00 : 00

Initials of Preparer kjt