Document Retention/Destruction Policies:
TICKING TIME BOMB FOR YOUR FIRM?

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David Duncan sat in the 37th floor conference room, the one with the large plate glass windows looking out onto the blue water outside. All around him were symbols of success. Duncan, a partner with twenty years at the professional services firm, was a rising star. He was the partner in charge of one of the firm's fastest growing and most profitable accounts. He was admired and respected by his peers, a devoted father and husband, and was by all accounts, a skilled professional. The date was October 23, 2001, and it was a day like any other at the office. Except David Duncan was about to destroy his career, his reputation, his means of supporting his family, his firm, and the jobs of all of his coworkers. How was it to happen? Was it a power struggle gone bad? Massive theft? Murder? No. It was done with a document retention/destruction policy.

A document retention policy is a company wide policy, which provides for the systematic identification, retention and destruction of documents, both in paper or electronic form, received or created in the course of business. A document retention policy will identify both paper and electronic documents that need to be maintained and will contain guidelines to keep them for as long as these documents are needed, but not longer, and provides for the storage and management of those documents in a way that makes them accessible when needed.

Document retention/destruction is a necessary and difficult aspect to every business, and it is progressively becoming more complicated. Companies commonly struggle with how and where to store their records and documents, and exactly how long they need to be retained. It is difficult to establish a standard policy for document retention. Different types of records require different procedures. Laws and statutes vary from state to state. Definitions of what constitutes a record are changing. Telecommuting causes records to be located in employee's homes and other offsite locations. Furthermore, there are additional complications, such as for companies that conduct business in different states or countries, companies that hire consultants with differing retention requirements, or companies that engage in several types of work, with the differing types of work each being governed by different retention requirements. And yet it is crucial that businesses have an established and properly administered document retention policy that is in compliance with all applicable requirements. Improper record management can result in censure or fines, increased litigation costs, reduced market capitalization for public companies, regulatory suspension, vulnerability to large judgments in the state and federal courts, or, as in the case of David Duncan, even worse outcomes.

Duncan's firm was that old lion of accounting firms, the Arthur Andersen Company. The Anderson Company was planning its preparations to celebrate the upcoming centennial anniversary of its founding by the father of the modern public accounting firm, Arthur E. Anderson. Mr.Anderson had developed his reputation in the 1920's by pushing both audit standards and auditors to look "beyond the numbers" in performing their public company work. He cemented that reputation by single-handedly keeping a conglomerate of companies that included Commonwealth Edison, People's Gas, the Northern Indiana Public Service Co., and a network of electric railroads and interurban streetcar systems that would become the Chicago Transit Authority, from financial dissolution during the Great Depression. But the Arthur Anderson Company's centennial plans, and the reputation its founder had worked so diligently to build, were about to end up on the scrapheap: the firm's fastest growing client, David Duncan's star client, was Enron. Enron's financial house of cards was in the process of imploding. As Duncan walked out of that 37th floor conference room, he was about to embark on a voyage into catastrophe. Days before, Anderson's in house counsel had told Duncan of the firm's document retention/destruction policy, circulated copies and requested that attention be devoted to it. Late in realizing the consequences of an examination of the firm's records in an extensive legal investigation, Duncan then directed an effort to shred or delete files that could have been destroyed months or years before. When the subpoenas arrived, tons of paper documents had been destroyed, and thousands of emails and computer files had been deleted. Duncan later testified that the company had been acting, belatedly, in accordance with its standard practice to destroy unnecessary files. To the government, the timing and nature of the document destruction was plain evidence of a cover up. The Chicago jury agreed, and convicted Arthur Anderson of a criminal violation of the federal witness tampering statutes. The effect of the conviction was the defacto destruction of the firm. Now, nearly six years later, the Enron implosion continues to reverberate, like ripples in a pond, impacting further and further away from the source.

In the aftermath, federal and state laws have been tightened as to the restrictions accounting firms and public companies must adhere to in preserving documents and electronic material. Regulations including occupational safety under OSHA, employment and medical records under HIPPA, public companies under Sarbanes-Oxley, and FDA requirements affecting the pharmaceutical industry all currently contain stringent record keeping requirements. Smaller firms doing business with public companies are similarly affected. But for many companies and firms, large and small, the biggest risk does not come from the various regulators, but from the threat of civil litigation. In the courts, new rules have been implemented that affect all potential litigants, meaning just about every business, large or small, in serious and potentially highly damaging ways. We now all live in the post Enron era.

Have you ever wondered how long is long enough? How long to keep contracts, tax returns, medical records, banking statements or employee records, and instead kept every single bill, tax return, and invoice? You are not alone. Many firms and businesses are unsure as to how long they should retain business documents and records. The Enron/Arthur Andersen meltdown certainly raised public awareness about the pitfalls of

how documents are to be handled in the face of massive fraud and an SEC investigation. However, a recent survey showed that approximately 70% of company executives polled admitted that they where either unfamiliar with or needed more training on their document retention policies.

On an every day business basis, why do companies keep records at all? It has been observed that habit, inertia and inattention account for much of what accrues in the file room, individual computer, desk drawer, warehouse, or firm server. These are all valid reasons why any good document protocol is actually about document destruction. The primary valid reasons to keep documents are preservation of organizational knowledge, compliance with statutory and regulatory duties, and in anticipation of future litigation. The retention portion of a document retention/destruction policy should be concentrated on these aspects. It would be prudent for all companies to either create, if none exists, or revisit their existing document retention policies, to assess how they have been complied with and enforced in practice, and consider ways to improve both the policy and actual implementation. More specifically, it would help to have a clearer explanation of what is to be discarded at what intervals and how the program is monitored and kept up-to-date. With more businesses entering the digital age and generating many of their documents on the computer, document retention/destruction has also substantially changed in the context of what is being retained/destroyed.

The federal judiciary recently enacted new Federal Rules of Civil Procedure provisions, which address computer generated documents that are sought by opposing parties during discovery. Just like paper documents, a company has an obligation to disclose computer, or any other electronic files upon the opposing party's request. This can include electronic documents, e-mails, voicemails, and even instant messages. According to the provisions, the responsibility is on the company to conform to the new rules, and few are prepared to handle these new regulations. Analysts have said that this could pose a major cost to businesses in making the required changes to their record-keeping procedures. On the other hand, non-compliance can have even worse results.

There are three Federal Rules of Civil Procedure that have been amended to accommodate for electronic discovery. The first amendment discusses the pre-trial conference, and states that the parties may address the "disclosure and discovery of electronically stored information." (Fed. R. Civ. Proc. 16). There is also a new provision that includes "electronically stored information" as a category of required initial disclosures. (Fed. R. Civ. Proc. 26(a)(1)(B)). In addition, the new rules exclude any documents from disclosure that would not be reasonably accessible because of undue burden or cost. However, the courts have not construed this amendment in a way that would give comfort to a defendant facing a motion for sanctions for failure to produce records that could prove relevant. Limited production of back up tapes have been viewed as a middle ground in reaching what constitutes "undue burden or cost." (Fed. R. Civ. Proc. 26(b)(5)(B)). Finally, electronically stored information may qualify as business records from which answers may be ascertained. (Fed. R. Civ. Proc. 33(d))

When a company reasonably anticipates litigation, it has a duty to preserve relevant information. The obligation to preserve evidence applies to electronically stored information and electronic records as well. A company's duty to preserve relevant documents arises when the company knows, or should know, through notice that the documents will become material to litigation or an investigation at some point in the future. Circumstances constituting such notice may include, but are not limited to: an inquiry from the government, service of a complaint or petition commencing litigation or a third-party request for documents. Courts consider the "totality of the circumstances" when determining if a reasonable person or company would have anticipated the litigation based on the information available. The duty to preserve, therefore, may attach even before a party has formed an intent to sue.

In a case that showed how closely courts will focus on a case's particular facts to determine if a reasonable company would have anticipated litigation and whether it acted in bad faith, the defendant company knew that accidents which caused certain types of injuries were likely to lead to lawsuits, and that its audio tapes were the only source of certain relevant information. The court held that it was bad faith for the company to destroy audio tapes after learning that this type of accident had occurred, even though no lawsuit had been filed at the time the tapes were destroyed. The courts can and do enter orders requiring companies to pay thousands of dollars in discovery costs even when the case against the company on its face does not appear to be strong. Worse, where discovery violations are proven, the court's can effectively direct a decision against the company by using evidentiary presumptions at trial.

Document retention is a problem that all businesses face, and to which few have developed more than a minimally adequate solution. The new Federal Rules of Civil Procedure only complicate the matter more, presenting new burdens and responsibilities for companies. Businesses now must retain many electronic files and data, which were not previously required, and the consequences for not complying with the new rules involve stiff penalties. Smart employers should : (1) create and maintain document retention/destruction polices that are current and consistent with all applicable laws, and that are designed to limit the data that must be preserved; (2) develop email and personal communication (instant messaging, voicemail) that automatically discards its contents after a reasonable period, but that can be suspended when required; (3) assign at least two manager level employees with appropriate training and give them full authority to administer the firm's document retention/ destruction policies, and finally, (4) limit the use of off network electronic portable storage devices, including home personal computers.

The key here is to properly manage your documents, or they will most certainly manage you, as they ultimately did to David Duncan and the Arthur Andersen Company.

Lynam & Associates serves as general counsel to smaller companies, including nonprofit corporations and entrepreneurs, from offices in Chicago and Barrington, Illinois. They have advised both ASPE and ASPERF as our general counsel since 2001. Mr. Lynam can be reached toll free at (888) 230-3835.