IN THE UNITED STATES COURT OF FEDERAL CLAIMS

FRANK P. SLATTERY, JR., *et al.*, **Plaintiffs,** **v.** **THE UNITED STATES,** **Defendant.**	**Civil Action No. 93-280 C** **(Chief Judge Smith)**

PLAINTIFFS MOTION FOR COURT TO DRAW ADVERSE INFERENCES DUE TO SPOLIATION OF EVIDENCE

INTRODUCTION

Plaintiff Frank P. Slattery, as the named plaintiff in this derivative action brought on behalf of Meritor Savings Bank, and by and through undersigned attorneys, hereby moves this Court for relief in the form of adverse evidentiary inferences against the United States for the wrongful and prejudicial redaction of highly material and probative evidence. As explained in more detail below, as a result of Defendants' unjustified redaction of documents on the grounds of an unsupportable and jettisoned privilege claim, Plaintiff has been prejudiced in that Plaintiff was denied evidence that could have been, and would have been, used to impeach the testimony of at least three witnesses: Paul Fritts, Sarah Hargrove and Robert Hartheimer. Plaintiff has further been prejudiced in that absent the redactions Plaintiff would have used the passages in deposition and deposed additional fact witnesses. Finally, Plaintiff has been prejudiced in that Plaintiff would have, but was denied the opportunity to, weave the revealed facts into its opening argument and into its case-in-chief.

Because the documentary alterations undertaken by Defendants have prejudiced Plaintiff's

ability to prepare and develop its case, this Court, in order to realign the evidentiary balance and restore Plaintiff to the same position it would have been in absent the spoliation, should draw the following adverse evidentiary inferences of fact against the Defendants: (1) the Secretary of Banking for the Commonwealth of Pennsylvania, Sarah Hargrove, was reluctant to seize Meritor at the time she in fact closed Meritor and appointed FDIC as its receiver; (2) Ms. Hargrove sought indemnification from the FDIC in the event of a lawsuit against her by one or more directors or shareholders of Meritor out of concern that regulatory treatment of Meritor s supervisory goodwill constituted a breach of the parties 1982 contract; (3) Ms. Hargrove s request for indemnification was a serious request, and not made flippantly or in jest ; (4) FDIC seriously and deliberately considered Ms. Hargrove s request for indemnification; (5) FDIC initiated proceedings under section 8(a) with the specific purpose of causing Ms. Hargrove to seize Meritor and appoint FDIC as its receiver; (6) FDIC's initiation of proceedings under section 8(a) in fact did proximately cause the seizure of Meritor; (7) but for FDIC s initiation of 8(a) proceedings, Ms. Hargrove would have accorded Meritor additional time to demonstrate its viability to her satisfaction before taking any action against it; (8) FDIC acted to increase the value of the receivership estate ; (9) FDIC knew as early as November 10 that Meritor s goodwill would officially be excluded from capital calculations in light of the agency s new interpretation of FDICIA; (10) FDIC s decision to initiate 8(a) proceedings thus was premised on the fact that Meritor could not include its supervisory goodwill as a component of its regulatory capital; (11) FDIC s Division of Supervision was inclined to exclude officially Meritor s goodwill from regulatory capital calculations even if FDICIA accorded the agency the flexibility to include it; (12) FDIC understood that public uncertainty regarding FDIC s treatment of Meritor s goodwill causes deposit outflow; (13) FDIC elected *not* to inform Meritor or the public that the agency had decided that supervisory goodwill would be excluded from all regulatory capital calculations after December 19, 1992, out of concern that disclosure of the new policy may precipitate deposit outflow; and (14) FDIC moved Meritor s anticipated closure date ahead by one week due to concern that the deal to sell Meritor to Mellon

might unravel.

BACKGROUND

A. Procedural Background

During the course of discovery, the government produced to Plaintiff a privilege log 94 pages long. Many of the documents identified therein were withheld or redacted on the basis of the so-called executive privilege. After a change in government counsel, and a subsequent meeting between counsel for the government and counsel for plaintiff, the government elected to drop most all of its assertions of executive privilege. The government nonetheless persisted in asserting the privilege with respect to the: (1) Minutes of the FDIC Board of Directors November 10, 1992 Meeting, now marked as PX 480; and (2) Minutes of the FDIC Board of Directors December 9, 1992 Meeting, now marked as PX 502.[1] Counsel for the government specifically reaffirmed the propriety of these redactions.

Plaintiff, not knowing the substance of the redactions, and deferring to the good faith and general competence of the government processes in determining privilege, had no basis at the time to request an *in camera* review of the documents. However, in light of Plaintiff s recent review of the same documents as produced to a Meritor shareholder through the Freedom of Information Act (FOIA), Plaintiff determined that at least certain of the redacted passages that were revealed in the FOIA-produced document were relevant, and in fact highly material, and not subject to any privilege. Indeed, as this Court may recall, Plaintiff relied on the FOIA-produced copies of the documents to introduce into evidence during the cross examination of Robert Hartheimer, FDIC s former Director of the Division of Resolutions, certain of the passages the government had redacted in discovery. At the conclusion of Mr. Hartheimer s testimony, counsel for Plaintiff requested the Court anew to review the two redacted documents *in camera.* Tr. at 4350-52. The Court instead

[1] PX 480 is attached hereto as Exhibit 1. The newly-produced version of the same document, referred to herein as PX 480B, is attached as Exhibit 2. PX 502 is attached as Exhibit 3. The newly-produced version of the same document, referred to herein as PX 502B, is attached as Exhibit 4.

directed the government to review the redactions with an eye toward producing relevant, nonprivileged material. *Id*. at 4354-55.

On January 19 and 21, 2000, the government produced new copies of PX 480 and PX 502, this time with only very select redactions. However, review of the passages previously redacted reveals that the government s heretofore refusal to produce said material was unjustified, and that the government s failure to produce these materials in a timely fashion has significantly prejudiced Plaintiff. By way of illustration, the government has argued, and Ms. Hargrove has testified, that the decision of Pennsylvania to seize Meritor was her decision alone, and that she, and not the FDIC, caused Meritor s closure. Tr. at 1952-56, 1968-69. According to heretofore redacted portions of the Minutes, however, Ms. Hargrove expressed her intent only to close Meritor at some undetermined later date, thus according the institution additional time to implement its strategic plan, if the Corporation [FDIC] did not initiate proceedings for termination of deposit insurance. PX 502B (Exhibit 4) at 48270. FDIC thus initiated the insurance termination proceedings to cause Ms. Hargrove to seize Meritor immediately. And while Ms. Hargrove insisted that her request for indemnification was made only in jest, Tr. at 1868, and while Mr. Fritts claimed not to remember the request at all, the redacted passages plainly demonstrate that the FDIC, including Mr. Fritts, considered the request at great length, with Mr. Fritts concluding that indemnification of up to $300,000 would be appropriate because it would cause seizure more immediately and, in his view, save the FDIC insurance fund scarce resources. *Id*. at 48278; *see also id*. at 48280 (Fritts sought to increase the value of the receivership estate).

Nor was Ms. Hargrove concerned about the possibility of litigation merely because of litigation against the State in unrelated closures, as she testified during trial. Tr. at 1867-68, 1889-90. Rather, Ms. Hargrove s concern was that the closure would be challenged on the basis of the correct interpretation of Federal Deposit Insurance Act and the Corporation s regulations related to capital. Exh. 4 at 48277.

Other examples abound. While the government contends that the FDIC took its contractual

commitments seriously, the Minutes reflect that the Division of Supervision would not be inclined to allow Meritor to continue to treat its supervisory goodwill as capital *even if the FDIC had the discretion under FDICIA to permit it.* PX 480B (attached as Exhibit 2) at 48077. And while the government would have this Court believe that any deposit outflows in 1992 were caused by Meritor s financial condition, Fitzgerald, Tr. at 1606, 1608-09, the documents plainly demonstrate FDIC s belief that public uncertainty regarding prospective treatment of Meritor s supervisory goodwill causes depositors to withdraw their funds. PX 480B (Exh. 2) at 48077. In other words, to the extent deposit withdrawal was a problem, it was anticipation of the government s breach that caused the problem!

Now, with discovery complete, with opening statement delivered long ago, with Plaintiff s case-in-chief aging, and with but two government witnesses to be completed, and with Paul Fritts, Sally Hargrove and Robert Hartheimer all having already testified, the government has, belatedly, produced PX 480 and PX 502 in a form that Plaintiff could have used, perhaps repeatedly, during trial and certainly during the discovery phase of the litigation. Delivery of the unaltered evidence comes much too late.

The redactions undertaken by the United States constitute an improper alteration of documentary evidence, which constitutes an act of spoliation. Because the spoliation of highly probative documents -- from the highest decision-making body in the FDIC -- has prejudiced Plaintiff's ability to develop the facts of its case or to rely on this evidence for witnesses who have already testified, it is appropriate for this Court to fashion relief in the form of drawing adverse inferences, or otherwise finding as fact certain propositions, identified above, all of which are supported by the two exhibits in question.

ARGUMENT

A. The Spoliation Doctrine

Spoliation is the "destruction or significant alteration of evidence . . in pending or reasonably foreseeable litigation." *West v. Goodyear Tire & Rubber*, 167 F.3d 776, 779 (2d Cir.

1999); *see also* Lang, Clancy & Flesher, *Spoliation of Evidence: The Continuing Search for a Remedy and Implications for Aviation Accident Investigations*, 60 J. Air. L. & Com. 997, 1000 (1995) (the term "spoliation of evidence" refers to "the loss, destruction or material alteration of tangible evidence, whether negligent or intentional"); Phoebe L. McGlynn, *Spoliation in the Product Liability Context*, 27 U. Mem. L. Rev. 663, 664 n.2 (1997) (Spoliation defined as the "destruction or the significant and meaningful alteration of a document"). A federal court may impose sanctions under Fed. R. Civ. P. 37(b) when a party spoliates evidence during the course of a lawsuit. *West*, 167 F.3d at 779; *Turner v. Hudson Transit Lines Inc.*, 142 F.R.D. 68, 72 (S.D.N.Y. 1991).[2]

Before a party can be entitled to relief for the spoliation of evidence, the party must prove: (1) the destruction or material alteration; (2) of potentially relevant evidence; (3) where the potential for relevance is known or should be known by the alleged spoliator; (4) with resulting prejudice to the non-offending party. *See White v. Office of the Public Defender*, 170 F.R.D. 138, 147 (D. Md. 1997); *Capellupo v. FMC Corp.*, 126 F.R.D. 545, 551 (D. Minn. 1989). Bad faith "is not essential" to the entry of sanctions against a spoliating party because even if evidence "is mishandled through carelessness, and the other side is prejudiced, . . . the district court is [still] entitled to consider imposing sanctions . . . ." *Sacramona v. Bridgeston/Firestone, Inc.*, 106 F.3d 444, 447 (1st Cir. 1997); *Turner*, 142 F.R.D. at 76 ("The evidentiary imbalance caused by the spoliation does not depend on the party's intent . . . [B]ad faith . . . should not be an absolute prerequisite to drawing an adverse inference."). Even if the alteration of documentary evidence is negligent, a remedy is

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[2] A federal court, exercising its inherent power to control litigation, may impose sanctions against a party even in the absence of ongoing discovery in a pending case. *See Chambers v. NASCO, Inc.*, 501 U.S. 32, 43-45 (1991); *see also Shepherd v. American Broadcasting Co.*, 62 F.3d 1469, 1472 (D.C. Cir. 1995) ("As old as the judiciary itself, the inherent power enables courts to protect their institutional integrity and to guard against abuses of the judicial process with contempt citations, fines, awards of attorneys' fees, and such other orders as they find necessary, including even dismissals and default judgments."). When the rules of court alone do not provide courts with sufficient authority to protect the integrity and prevent abuses of judicial process, the inherent power fills the gap. *See Chambers*, 501 U.S. at 46.

appropriate because "it makes little difference to the party victimized . . . whether that act was done willfully or negligently." *Donato v. Fitzgibbons*, 172 F.R.D. 72, 83 (S.D.N.Y. 1997); *see also Pressey v. Patterson*, 898 F.2d 1018, 1024 (5th Cir. 1990) (negligent or reckless alteration of documentary evidence may warrant sanction); *Turner*, 142 F.R.D. at 75 n.3 (spoliation sanction properly acts as a deterrent to negligent acts of spoliation).[3]

B. Spoliation has occurred in this case

First, there is no question that the documents were significantly and meaningfully altered by Defendants' redaction. Defendants originally redacted more than 50% of the text of PX 480, and about 40% of the text of PX 502.

Second, spoliation requires "some showing" indicating that the altered evidence "would have been relevant to the contested issue." *Kronisch v. United States*, 150 F.3d 112, 127 (2d Cir. 1998). That Plaintiff actually relied on certain of the redacted materials (through the FOIA-obtained versions) itself establishes that the alterations were of a kind to eliminate relevant and admissible evidence. The production of the most recent versions revealed more widespread abuse. As noted above, the redacted portions reveal (1) that the primary regulator would close Meritor at

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[3] In *Eaton Corp. v. Appliance Valves Corp*., 790 F.2d 874 (Fed. Cir. 1986), the court suggested that bad faith was necessary before sanctions may be assessed. But because the originals of the destroyed document had been produced to opposing counsel prior to a company employee s destruction of a copy, the court found that the destruction caused no prejudice, and thus denied the requested relief. *Id*. at 878. The court s reference, therefore, to the necessity of bad faith is therefore *dicta.* Further, in light of the lack of prejudice suffered in *Eaton*, the court never reached the issue as to whether it could draw from the fact that a party has destroyed [or altered] evidence that the party did so in bad faith. *Id*. at 878 (citation omitted). Here, such an inference is most appropriate. As noted above, the government dropped its executive privilege claims in most all instances but nonetheless persisted in asserting the claim with respect to the documents here, even though these documents are arguably the most important documents in the proceeding as they represent the official position of the FDIC Board of Directors. Here, also, government counsel had previously certified that the redactions were appropriate. Nor can the government explain why it produced other internal memoranda and correspondence while so heavily redacting these documents. In light of all of these circumstances, Plaintiff submits that the Court may infer bad faith -- to the extent even necessary -- within the meaning of the doctrine of spoliation. To be certain, the effect of the redactions here is more than negligible, *id.* at 878, and certainly not harmless. *Id.*

a *later* date . . . if the Corporation did not initiate proceedings for termination of deposit insurance, PX 502B (Exh. 4) at 48270; (2) the extent to which the Pennsylvania Secretary of Banking was concerned that closure would precipitate a lawsuit specifically regarding the regulators treatment of supervisory goodwill, *id.* at 48277; (3) the extent of FDIC s concern that the Mellon transaction might unravel, *id*. at 48273; (4) the extent to which FDIC considered Ms. Hargrove s request for indemnification, *id*. at 48277-78; (5) Mr. Fritts and Mr. Hartheimer s role in transmitting and analyzing Ms. Hargrove s request for indemnification, *id*. at 48277-80; (6) Acting Chairman Hove s and Director Steinbrink s role in considering Ms. Hargrove s request, *id*., which information would certainly have led to the taking of their depositions; (7) the Division of Supervision was not inclined to allow Meritor to continue to carry goodwill on its books as regulatory capital even if FDICIA accorded the agency the discretion to do so, PX 480B (Exh. 2) at 48077; (8) FDIC chose not to inform Meritor of its decision to exclude its supervisory goodwill in calculating capital under FDICIA until the day of seizure notwithstanding the fact that the agency had already decided to exclude it, *id*.; and (9) FDIC understood that the uncertainty regarding regulatory treatment of goodwill causes deposit outflow. *Id.*

The Minutes also make it clear that FDIC, no later than November 10, had concluded that Meritor s goodwill would be excluded under FDICIA. PX 480B (Exh. 2) at 48075. That, in turn, explains why other FDIC documents prepared in the November and December 1992 time frame, *i.e.*, PX 482, PX 491 and PX 500, all excluded Meritor s supervisory goodwill when assessing regulatory action in December 1992. That is because the section 8(a) action was evaluated on the basis that Meritor would not be able to include its supervisory goodwill as a component of its regulatory capital.

That the United States knew or should have known that the redacted information was relevant and, in fact, *material*, is evident by the very nature of the redactions.

To establish prejudice as a result of the act of spoliation, a party must demonstrate merely that the destroyed evidence "may have" been helpful in presenting its case. *Dillon v. Nissan Motor*

Co., 986 F.2d 263, 267 (8th Cir. 1993). Prejudice "means injury or detriment to a party," *White*, 170 F.R.D. at 151, and can take the form of the inability to address an issue or set of issues because of the lost or altered evidence. *Id.* at 151.

Here, the hidden evidence affirmatively establishes key elements of Plaintiff s case, *i.e.*, that FDIC s initiation of insurance revocation proceedings was, at a minimum, a significant contributing factor to Pennsylvania s closure of Meritor. Indeed, the evidence now establishes that without the FDIC s approval to commence the 8(a) proceedings, Ms. Hargrove would have accorded Meritor additional time before deciding to take action against the bank. Moreover, the redacted passages also could have been used to impeach the testimony of Messrs. Fritts and Hartheimer with respect to their denials of certain events. *See*, *e.g.*, Tr. at 4311-12 (Hartheimer denies that FDIC sat on its decision regarding regulatory treatment of Meritor s goodwill under FDICIA); Tr. at 2984-85 (Fritts denies recall of Ms. Hargrove s request for indemnification). The redacted portions (as well as Ms. Hargrove s interrogatory responses in related litigation) also refute Ms. Hargrove s claim that she made the decision to close Meritor independent and apart from the FDIC.

Plaintiff was further deprived of the opportunity to explore these issues with these and other witnesses *during discovery*. Further still, had Plaintiff known of the stated positions of certain of the FDIC directors as articulated in PX 480B and PX 502B, Plaintiff would have taken their depositions. Finally, Plaintiff has been prejudiced in that he has had to incur substantial *unnecessary* legal fees as counsel for the Plaintiff has spent innumerable hours seeking to establish certain of the facts the redacted Minutes now establish. Simply, production of such probative evidence *after* discovery, *after* plaintiff s case-in-chief, and *after* all but two of the government s witnesses has left Plaintiff with few options to utilize the information wrongfully withheld.

C. The Remedy: Adverse Factual Inferences

Because the acts of spoliation here involved the redaction of relevant information which has prejudiced Plaintiff, this Court should provide relief in the form of drawing an adverse inference of

fact against Defendants.

A trial court "has broad discretion" in crafting a proper sanction for spoliation. *Kronisch*, 150 F.3d at 126; *Dillon*, 986 F.2d at 268. The trial court's imposition of a spoliation sanction is reviewed for abuse of discretion. *Sylla-Sawdon v. Uniroyal Goodrich Tire Co.*, 47 F.3d 277, 280 (8th Cir. 1995). In fashioning a sanction, the remedy must not "go beyond what is necessary to cure the prejudice," *SDI Operating Partnership v. Neuwirth*, 973 F.2d 652, 655 (8th Cir. 1992), but rather achieve what is necessary to "fully protect" the non-offending party from prejudice. *West*, 167 F.3d at 780. The sanction should be "commensurate with the . . . fault and prejudice present." *Schmid v. Milwaukee Elec. Tool Corp.*, 13 F.3d 76, 81 (3d Cir. 1994).

Sanctioning a party for spoliation of evidence involves the balancing of numerous goals, including: (1) the deterrence of parties from engaging in spoliation; (2) placing the risk of an erroneous judgment on the party who wrongfully created the risk; and (3) restoring the prejudiced party "to the same position he would have been in absent" the wrongful act. *Kronisch*, 150 F.3d at 126. The sanction should be based on the "thoughtful consideration" of all factors, including the bad faith of the offending party, the degree of prejudice suffered by the non-offending party, the importance of the spoliated evidence, the ability of the court to cure the prejudice, and the need for deterrence. *White*, 170 F.R.D. at 152.

Appropriate sanctions include the drawing of an adverse inference of fact against the spoliating party. *West*, 167 F.3d at 780; *Kronisch*, 150 F.3d at 126; *Shepherd v. American Broadcasting Co*, 62 F.3d 1469, 1475 (D.C. Cir. 1995); *Sylla-Sawdon*, 47 F.3d at 280; *Dillon*, 986 F.2d at 268-69; *Boyd v. Ozark Air Lines*, 568 F.2d 50, 53 (8th Cir. 1977); *Donato*, 172 F.R.D. at 84. The drawing of an adverse inference serves two purposes: remediation in that the prejudiced party is placed "in the same position" with regard to its ability to prove its case as it would have been absent the documentary alteration; and punitive in that the party responsible for the alteration is directly punished. *Donato*, 172 F.R.D. at 82 (citations omitted); *Turner*, 142 F.R.D. at 74. The drawing of an adverse inference, in sum, "provides the necessary mechanics for restoring the

evidentiary balance." *Turner*, 142 F.R.D. at 75.

The sanction of a factually adverse inference can be levied "whenever a preponderance of the evidence establishes that a party's misconduct has tainted the evidentiary resolution of the issue." *Shepherd*, 62 F.3d at 1478. Such is the case here.[4]

CONCLUSION

For the reasons set forth above, Plaintiff respectfully requests that this Court, as a remedy for the spoliation by the United States in connection with PX 480 and PX 502, draw the following adverse factual inferences against Defendants: (1) the Secretary of Banking for the Commonwealth of Pennsylvania, Sarah Hargrove, was reluctant to seize Meritor at the time she in fact closed Meritor and appointed FDIC as its receiver; (2) Ms. Hargrove sought indemnification from the FDIC in the event of a lawsuit against her by one or more directors or shareholders of Meritor out of concern that regulatory treatment of Meritor s supervisory goodwill constituted a breach of the parties 1982 contract; (3) Ms. Hargrove s request for indemnification was a serious request, and not made in jest; (4) FDIC seriously and deliberately considered Ms. Hargrove s request for indemnification; (5) FDIC initiated proceedings under section 8(a) with the specific purpose of causing Ms. Hargrove to seize Meritor and appoint FDIC as its receiver; (6) FDIC's initiation of proceedings under section 8(a) in fact did proximately cause the seizure of Meritor; (7) but for FDIC s initiation of 8(a) proceedings, Ms. Hargrove would have accorded Meritor additional time to demonstrate its viability to her satisfaction before taking any action against it; (8) FDIC acted to increase the value of the receivership estate ; (9) FDIC knew as early as November 10 that Meritor s goodwill would officially be excluded from capital calculations in light of the agency s new interpretation of FDICIA; (10) FDIC s decision to initiate 8(a) proceedings thus was premised on the fact that Meritor could not include its supervisory goodwill as a component of its regulatory capital; (11) FDIC s Division of Supervision was inclined to officially exclude Meritor s goodwill

[4] In a dispute between private parties, fees may also be assessed. Because that remedy is not available against the government, *see* Advisory Committee Notes to Fed. R. Civ. P. 37, the relief requested here is particularly appropriate.

from regulatory capital calculations even if FDICIA accorded the agency the flexibility to include it; (12) FDIC understood that public uncertainty regarding FDIC s treatment of Meritor s goodwill causes deposit outflow; (13) FDIC elected *not* to inform Meritor or the public that the agency had decided that supervisory goodwill would be officially excluded from all regulatory capital calculations after December 19, 1992, out of concern that disclosure of the new policy may precipitate deposit outflow; and (14) FDIC moved Meritor s anticipated closure date ahead by one week out of concern that the deal to sell Meritor to Mellon could unravel.

Plaintiff also requests that the government be prohibited from offering evidence purporting to demonstrate, or otherwise arguing, that any of the identified inferences are untrue.[5]

Respectfully Submitted,

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[5] This Court also has the inherent authority to initiate a judicial inquiry to determine why the documents were redacted in such an offensive manner. To be certain, regardless of the cause, the redactions have proven harmful and the Department of Justice should take such measures as are necessary to ensure that procedures are implemented to avoid such problems in the future.