NEW FEDERAL RULE OF EVIDENCE 502: A TOOL FOR MINIMIZING THE COST OF DISCOVERY

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On September 19, 2008, the President signed into law new Federal Rule of Evidence 502. Rule 502 reflects a bold attempt by Congress to enable litigants to minimize the extraordinary cost of civil discovery in federal proceedings without risking broad waiver of privileges in either federal or state proceedings. As anyone who has litigated a complex case knows, one of the biggest drivers of cost is the need to review documents, including voluminous electronically stored information ("ESI") such as emails, for privilege prior to production. Under the pre-Rule 502 approach, the inadvertent production of even one privileged document could lead to broad waiver of privilege regarding all documents relating to the same "subject matter," however broadly subject matter might later be deemed by a court. As a result, litigants often reviewed each and every document for privilege and withheld even marginally "privileged" documents lest the opposing party latch onto a handful of inadvertently produced documents to argue that there had been broad subject matter waiver. Alternatively, litigants sometimes adopted cost-saving shortcuts, such as relying on electronic searches to identify privileged documents or entering into claw-back agreements, knowing that such shortcuts came with substantial disadvantages that could increase the possibility of waiver. In either case, the result was a costly game of "gottcha" that made many significant disputes uneconomical to litigate.

In 2006, the Federal Rules of Civil Procedure were amended, including amendments aimed at enabling parties to minimize the need for scorched earth privilege review. However, as observed by Judge Paul Grimm in his decision in *Hopson v. The Mayor and City of Baltimore*, 232 F.R.D. 228 (D. Md. 2005), parties could not be confident that a non-waiver agreement between the parties or even a ruling by one federal court finding no waiver would be respected by other courts in matters brought by other litigation adversaries. Rule 502 is the direct response to that remaining exposure. Adopted by Congress pursuant to the Commerce Clause, Rule 502 provides that party agreements embodied in federal court orders, and federal court orders finding no waiver regarding disclosures made in a proceeding in that court, will be binding in all other federal *and state* proceedings.

Rule 502, however, does have its limitations. This article discusses the scope of Rule 502, ways in which litigants can use it to minimize cost, and potential pitfalls for the unwary.

Rule 502's Broad Scope

Rule 502's scope is very broad. It applies not just to electronic discovery, but to all discovery. Specifically, it applies to "disclosure" of all communications or information covered by the attorney-client privilege or work-product protection. Rule 502(g) provides that the rule applies to state proceedings and, notwithstanding Federal Rule of Evidence 501, applies even if state law provides the rule of decision. Rule 502(d) provides that a federal court may order that a privilege or protection is not waived "by disclosure connected with the litigation pending before the court, in which event the disclosure is also not a waiver in any other Federal or State proceeding." And Rule 502(e) provides that an agreement between the parties on the effect of disclosure in a federal proceeding is also binding on other proceedings, if incorporated into a court order.

Rule 502 applies to proceedings commenced after September 19, 2008, and may be applied by the courts to matters commenced before that date "insofar as is just and practicable." Although Congress provided no guidance on what circumstances may be "just and practicable," at least two courts have already applied Rule 502 proceedings commenced prior to September 19, 2008, and more will undoubtedly follow. *See Rhoads Industries, Inc. v. Building Materials Corp. of America*, No. 07-cv-04756 (E.D. Pa. Nov. 14, 2008); *Laethem Equipment Co. v. Deere and Co.*, No. 05-cv-10113 (E.D. Mich. Nov. 21, 2008).

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Restricted Subject Matter Waiver – Rule 502(a)

Rule 502(a) dramatically changes the scope of waiver resulting from disclosures in federal proceedings or to federal offices or agencies. Rule 502(a) provides that when disclosure waives the attorney-client privilege or the work product protection, that waiver will extend to undisclosed communications or information in a federal or state proceeding only if (1) the waiver was intentional; (2) the disclosed and undisclosed information concern the same subject matter, and (3) "they ought in fairness to be considered together." As the Judicial Conference Committee Notes to Rule 502 ("Explanatory Notes") make clear, "an inadvertent disclosure of protected information *can never result in a subject matter waiver."* (Emphasis added.) This changes the pre-Rule 502 black letter law that a waiver of the attorney-client privilege as to one document or communication – whether intentional or not – waived the privilege as to all other documents and communications relating to the same subject matter. *See, e.g., In re Sealed Case*, 877 F.2d 976 (D.C. Cir. 1989). As a result, parties no longer need to fear the nightmare scenario that the inadvertent production of one privileged email or piece of correspondence might result in the wholesale loss of privilege. As discussed below, Rule 502 also addresses under what circumstances a disclosure will be deemed "inadvertent" rather than intentional.

As to intentional disclosures, subject waiver occurs only if two other circumstances are satisfied: the undisclosed communications concern the "same subject matter" as the disclosed ones, and they "ought in fairness be considered together." Although the Rule does not define "fairness," the Explanatory Notes state that subject matter waiver should be applied sparingly and should be "reserved for those *unusual situations* in which fairness requires a further disclosure of related, protected information, in order to prevent a selective and misleading presentation of evidence." (Emphasis added.) Thus the "fairness" prong limits broader waiver to cases in which the court determines that the disclosure was intentionally made on a selective basis and further disclosure is necessary to prevent misleading the factfinder.

Rule 502(a) makes one other notable change to pre-Rule 502 waiver doctrine. Under the traditional approach, subject-matter waiver was applied to waiver of the attorney-client privilege, but was not usually applied to waiver of work product protections. *See David M. Greenwald, Edward F. Malone, Robert R. Stauffer,* §2:24 "Scope of Waiver," TESTIMONIAL PRIVILEGES (3d ed. 2005, update through 2008) (Thomson West). Rule 502(a) now opens the door for courts to consider subject matter waiver regarding intentional disclosures of work product material. One can hope that the courts will be guided not only by Rule 502(a)'s limitation of subject matter waiver to "unusual situations," but also by the well-established doctrine of heightened protection, and in many jurisdictions absolute or near absolute protection, for opinion work product.

Inadvertent Disclosures – Rule 502(b)

Rule 502(b) establishes the "middle of the road" test for determining whether inadvertent disclosure of privileged or protected material will result in a finding of waiver. Prior to Rule 502, federal courts used three different approaches in determining whether an inadvertent production of a privileged document waived the privilege A minority of courts, including the D.C. Circuit, applied a strict approach under which the production constituted a waiver regardless of the circumstances. *See e.g.*, *In re Sealed Case*, 877 F.2d 976 (D.C. Cir. 1989). A different minority of jurisdictions applied a lenient approach under which the production of a privileged document did not waive privileges unless the client had knowingly and intentionally waived the privilege, meaning that counsel's inadvertent disclosure did not result in waiver. *See, e.g.*, *Gray v. Bicknell*, 86 F.3d 1472 (8th Cir. 1996) (discussing lenient approach). The majority of courts applied the "middle of the road" approach, which considered a variety of factors relating to the reasonableness of the conduct of the producing party. *See, e.g., Gray v. Bicknell*, 86 F.3d 1472 (8th Cir. 1996) (adopting the middle of the road approach).

Rule 502(b) adopts the majority approach, providing that a "disclosure does not operate as a waiver in a Federal or State proceeding if: (1) the disclosure is inadvertent; (2) the holder of the privilege or protection took reasonable steps to prevent disclosure; and (3) the holder promptly took reasonable steps to rectify the error, including (if applicable) following Federal Rule of Civil Procedure 26(b)(5)(B)."[2]

Rule 502 does not provide specific guidance on what constitutes "reasonable steps to prevent disclosure." The Explanatory Notes indicate that the rule is flexible and they cite prior case law identifying several factors that may be considered by a court on a case-by-case basis. Significantly, the Explanatory Notes suggest that a party who uses "advanced analytical software applications and linguistic tools in screening for privilege 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." But what are "advanced analytical software applications" and "linguistic tools?" Will those technological tools be considered more "reasonable" than an old-fashioned document-by-document privilege review?

Two recent decisions – one pre-Rule 502 and one post-Rule 502 – hold that merely using software applications or keyword searches may not be sufficient to ensure that privileged documents are culled from a production. In *Victor Stanley, Inc. v. Creative Pipe, Inc.*, 250 F.R.D. 251 (D. Md. 2008), the defendant conducted a keyword search to identify privileged documents, but failed to identify 165 privileged documents that were then produced. Among the failures that led to these documents slipping through the keyword search were that the defendant did not convert non-text searchable ESI into text searchable documents prior to running the keyword search, and defendant failed to conduct adequate quality testing prior to production. In the absence of a non-waiver/ "claw back" provision, and in light of the unreasonable steps taken prior to production, Judge Grimm held that the defendant had waived otherwise applicable privileges. The court noted, however, that the outcome likely would have been different if Rule 502 were applicable, and if the parties had entered into a non-waiver agreement that was adopted by the court. 250 F.R.D. at 259, n.5. The court warned generally about the use of technology alone to identify privileged ESI:

> [W]hile it is universally acknowledged that keyword searches are useful tools for search and retrieval of ESI, all keyword searches are not created equal; and there is a growing body of literature that highlights the risks associated with conducting an unreliable or inadequate keyword search or relying exclusively on such searches for privilege review.

250 F.R.D. at 256-57.

In *Rhoades Indus.*, No. 07-cv-04756 (E.D. Pa. Nov. 14, 2008), the first post-Rule 502 decision, despite using software that was intended to identify and segregate potentially privileged documents, the producing party produced more than 800 privileged emails. The court discussed several failures in the way the software was used, including failing to search for the names of outside counsel, searching only the address lines and not the body of emails, and failing to conduct careful quality assurance testing prior to production. Although the court found that the producing party had not used reasonable steps to prevent inadvertent disclosure, the court concluded that the overriding interest of justice favored protecting the privilege and found that inadvertent production did not result in waiver.

Rule 502(b) provides more concrete guidance on what satisfies the third prong – "prompt reasonable steps to rectify the error." According to the Explanatory Notes, Rule 502(b) "does not require the producing party to engage in a post-production review to determine whether any protected communication or information has been produced by mistake." Instead, the Rule requires the producing party "to follow up on any obvious indications that a protected communication or information has been produced inadvertently." This means that, while a producing party may need to conduct quality assurance testing prior to production, post-production review is not necessary as a pre-requisite for retrieving inadvertently produced material.

Rule 502 Enables Parties To Use The Entire Federal Discovery Toolkit.

The 2006 amendments to the Federal Rules of Civil Procedure provided a number of tools that parties could use to minimize the cost of privilege review. For example, Rule 16(b) provides a framework for the parties to address privilege issues in a Scheduling Order. Scheduling orders may provide for discovery that is proportionate to the amount in controversy, sensible time limits that enable the parties to conduct

thoughtful, phased discovery, and non-waiver/ "claw back" or "quick peek" provisions. Under a non-waiver/"claw back" agreement, the parties agree to return inadvertently produced documents, and that inadvertent production will not result in waiver. Under a "quick peek" agreement, a party allows the other side to review its documents without prior privilege review and to decide what materials it wants copied, and only then does the party review the selected documents for privilege.[3] Prior to Rule 502, however, an agreement between the parties in one matter may not bind a third party litigant in a different proceeding, even if adopted by court order. As a result, if a party inadvertently disclosed a privileged document in Case A, and successfully recovered it with a finding of no waiver, there was no assurance that a court in Case B against a different adversary would not find that there had been a waiver, and even subject matter waiver as a result of a voluntary disclosure in the earlier proceeding. *See Hopson*, 232 F.R.D. at 239-40.

Rule 502(d) solves this problem by providing that a Federal court "may order that the privilege or protection is not waived by disclosure connected with the litigation pending before the court – in which event the disclosure is also not a waiver in any other Federal or State proceeding." And Rule 502(e) makes agreements between the parties binding on all other proceedings if incorporated into a court order. The Explanatory Notes state that subpart (d) provides parties with predictability – meaning that they can "plan in advance to limit the prohibitive costs of privilege and work product review and retention."

Interaction with State Law

Rule 502's reach extends beyond federal court and agency proceedings in some circumstances.

First, as discussed above, when a party discloses privileged communications or information in a federal proceeding and a waiver occurs, the federal court's ruling as to the scope of the waiver is binding on subsequent state proceedings under Rule 502(a).

Second, if the disclosure occurs in a state proceeding "and is not the subject of a State-court order concerning waiver," Rule 502(c) provides that there is no waiver in a subsequent federal proceeding if the disclosure (1) would not be a waiver under federal law; or (2) would not be a waiver under the law of the state "where the disclosure occurred." Thus if federal and state law differ, the law that disfavors waiver will apply.

Third, if a disclosure occurs in a state proceeding, Rule 502 does not govern the effect of the waiver in subsequent proceedings in another state.

"Disclosure" vs. "Use"

Rule 502 addresses "disclosure" of privileged material, but it does not address "use" of privileged material. Although mere disclosure of a privileged document may not lead to subject matter waiver, the producing party's *use* of that document may. One commentator has recommended that protective orders specifically provide that, once a producing party uses its own privileged materials, pre-Rule 502 subject matter waiver analysis should be applied, resulting in broad waiver with respect to related privileged material. *See* Gregory P. Joseph, *"The Impact of Rule 502(d) on Protective Orders,"* http://www.josephnyc.com/articles/viewarticle.php?/59. Rule 502 also does not address "implied waiver," such as reliance on the advice of counsel as an affirmative defense, which may result in "at issue" waiver.

Open Issues and Important Reminders

While Rule 502 is a significant and ambitious stride toward controlling costs and uncertainty in discovery, it leaves many issues unanswered. For example:

- Rule 502 does not change the law regarding "selective waiver." Generally disclosure of privileged communications to one third party waives the privilege as to all others. However, largely on policy grounds, the Eighth Circuit created the doctrine of "selective waiver," in which a party may disclose privileged material to a government agency, such

as the DOJ or the SEC, without waiving privilege as to other third party litigants. *Diversified Indus., Inc. v. Meredith*, 572 F.2d 596 (8th Cir. 1977). This approach has been rejected by a majority of federal jurisdictions, which hold that waiver as to the government results in waiver to all other third parties. *See, e.g., In re Qwest Communications Int'l. Sec. Litig.*, 450 F.3d 1179 (10th Cir. 2006); *In re Columbia/HCA Healthcare Corp. Billing Practices Litig.*, 293 F.3d 289 (6th Cir. 2002). A proposal to include a provision in Rule 502 permitting selective waivers was considered and rejected by the Advisory Rules Committee after lengthy debate.

- In situations where a federal government agency is conducting an investigation, but there is no pending "proceeding," Rule 502 does not provide a means for entering into a non-waiver agreement with the government that will be binding on potential third party litigants. One commentator has suggested that Rule 502 may put a burden on those who will be responding to a government inquiry in the awkward position of needing to demand a subpoena and to initiate a formal proceeding in order to take advantage of the protections afforded by Rule 502. *See* Gregory P. Joseph, *"The Impact of Rule 502(d) on Protective Orders," supra*. As Joseph explains, this may mean that the price for obtaining the protections of Rule 502(d) is making public what would otherwise be a non-public investigation.

- Despite the protections of Rule 502, parties still cannot "put the genie back in the bottle" once information has been disclosed – even inadvertently. Attorneys retain a duty to their clients to safeguard confidential information, and the Rule does not eliminate that duty. Attorneys should ensure that their clients are fully informed regarding the risks of any review methodology other than a document-by-document privilege review.

- Rule 502 does not provide any mechanism for reducing the burden of preparing detailed privilege logs. For better or worse, privilege logs will still play a critical role in litigation, and failure to comply with Fed. R. Civ. Pro. 26(b)(5)(A) may result in waiver.

Perhaps the most important benefit of Rule 502 is that it provides an incentive and a mechanism for parties in any federal proceeding (and state proceedings that adopt Rule 502 or where a judge may be convinced of its application) to negotiate a comprehensive discovery management order prior to embarking on significant discovery. The order may address issues of inadvertent production, document retention requirements, search protocol issues, and the level of detail required on privilege logs. Courts will likely support the parties' efforts, which will minimize costs and later discovery disputes. If the parties cannot agree on a comprehensive order, the court may enter a discovery management order on its own to establish specific terms of engagement, including with respect to privilege. (The Explanatory Notes state that "a confidentiality order is enforceable whether or not it memorializes an agreement among the parties to the litigation. Party agreement should not be a condition of enforceability of a federal court's order.")

Finally, the adoption of Rule 502 provides an excellent opportunity for counsel to work with their clients at the outset of litigation to conduct a cost-benefit analysis of various discovery approaches, including use of iterative privilege search protocols and quality assurance testing in lieu of document-by-document review. In cases with less value or lower exposure, the risk of inadvertently disclosing privileged material may be outweighed by the significant cost savings. In more significant matters, a full privilege review may be justified.

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[2] Fed. R. Civ. Pro. 26(b)(5)(B) provides:

> "If information produced in discovery is subject to a claim of privilege or of protection as trial-preparation material, the party making the claim may notify any party that received the information of the claim and the basis for it. After being notified, a party must promptly return, sequester, or destroy the specified information and any copies it has; must not use or disclose the information until the claim is resolved; must take reasonable steps to retrieve the information if the party disclosed it before being notified; and may promptly present the information to the court under seal for a determination of the claim. The producing party must preserve the information until the claim is resolved."

[3] Although the authors have employed non-waiver/ "claw back" agreements, while recognizing their limitations, we have not produced documents to an opponent for a "quick peek." As discussed in more detail below, it is impossible to "unring the bell" once your opponent has reviewed privileged material. Although you may be able to get the privileged material back from your opponent, they will use what they have learned, including structuring further discovery, such as requests to admit, to take advantage of the disclosed privileged material.