On October 16, 2002, the former Big Five accounting firm, Arthur Andersen, LLP, received the maximum criminal penalties - a $500,000 fine and five years’ probation - for destruction of documents relating to its client, Enron. Why should this concern you? All companies must and do destroy documents. With the increased focus and reduced tolerance toward improper destruction arising from the Arthur Andersen indictment and conviction, exemplified particularly by the enactment in July 2002 of the Sarbanes-Oxley Act, any such activities may be examined with heightened scrutiny. Post-Arthur Andersen, many companies are re-examining and revising their document retention practices and policies. In the current climate, while these measures may be implemented in good faith, the attendant risks of accusations and sanctions for improper destruction of documents have never been higher.

What Happened to Arthur Andersen?

In March 2002, the federal government indicted Arthur Andersen for obstruction of justice. The indictment alleged that Arthur Andersen continued to shred documents and delete computer files relating to its audit client, Enron, after it was aware that civil litigation and government investigations were imminent and even after Enron had received an informal request for information from the Securities and Exchange Commission. According to the indictment, Arthur Andersen's destruction of Enron documents ceased only after it was served with a subpoena from the SEC. Arthur Andersen claimed, among other responses, that destruction of the Enron information was performed pursuant to Arthur Andersen's document retention policy. On June 15, 2002, a jury convicted Arthur Andersen. (Interestingly, reports of post-trial interviews with jurors indicate that the jurors did not focus on shredded or deleted documents or computer files to convict the company. Rather, jurors said they based their decision on a single e-mail from Arthur Andersen's in-house attorney to an Arthur Andersen partner that suggested changes to language in a memorandum regarding an Enron press release.) On October 16, 2002, Arthur Andersen received the maximum possible sentence.

What Should Companies Do to Avoid Such a Situation?

Develop proper document retention/destruction rules and practices and adhere to them. The obvious way to avoid Arthur Andersen-type accusations is to develop and adhere strictly and conscientiously to legal and proper document retention and destruction rules and practices. The problem, however, is that clear guidance regarding these rules and practices is somewhat elusive.

Understand your fundamental obligation to preserve information for litigation and in compliance with federal and state regulations. It is absolutely clear that companies have a fundamental obligation to preserve information for litigation. In other words, a company is not permitted to destroy information relevant to pending or potential litigation, including government investigations, regulatory actions, subpoenas and similar proceedings. This obligation must trump all other provisions of any document retention policy and all document destruction practices.

Do not rely on your document retention/destruction policy as a shield. When destruction of information takes place pursuant to a document retention policy, the policy may provide a defense to claims for improper destruction of relevant information, but it does not guarantee absolution.

In determining whether information should have been retained despite a document retention policy, courts will consider:

- whether the document retention policy is reasonable considering the facts and circumstances surrounding the documents;
- whether lawsuits concerning claims related to the documents at issue have been filed, the frequency of such claims and the magnitude of the claims; and
- the reasons for institution of the document retention policy, particularly any indications of bad faith.
However, even where a document retention policy passes these criteria, destruction of information in accordance with such a policy may not provide a defense if it was not the company's usual practice to comply with the policy, or if there are other particular circumstances surrounding a specific document destruction that are unusual or suspicious.

What Are the Potential Consequences?

Civil Sanctions
The potential consequences for improper destruction of relevant information are wide-ranging and may be severe. A court may assess attorneys' fees and other costs associated with related motions as a sanction. Courts also may draw an adverse inference against the party responsible for the destruction, usually on a finding of willfulness, bad faith or fault. Default judgment can also be entered as an ultimate sanction if (a) relevant evidence is destroyed willfully and in bad faith; (b) the requesting party is prejudiced by the destruction of the evidence; and (c) alternative sanctions are ineffective.

Criminal Charges - Prior Law
Obstruction of justice laws also preclude a party from destroying documents related to official proceedings and investigations and impose criminal sanctions for violations. Prior to July 2002, the federal obstruction of justice statute, in pertinent part, prohibited "corruptly persuading" another person, or attempting to do so, with intent to cause or induce the person to withhold records, documents or other objects from official proceedings, or with the intent to cause the person to alter, destroy, mutilate or conceal an object with intent to impair the object's integrity or availability for use in an official proceeding.

Criminal Charges - Under the Sarbanes-Oxley Act
The Sarbanes-Oxley Act, which was passed in response to the Arthur Andersen/Enron debacle, expanded the potential scope of criminal liability for the destruction of documents and objects. The Act adds a new obstruction of justice offense, making it illegal for anyone to corruptly alter, destroy, mutilate or conceal a record, document or other object, or attempt to do so, "with the intent to impair the object's integrity or availability for use in an official proceeding." This subsection expands criminal liability from only those "corruptly persuading" to those persons actually altering or destroying documents.

The Act also makes it a crime for anyone to knowingly alter, destroy, mutilate, conceal, cover up, falsify or make a false entry in any record, document or tangible object "with the intent to impede, obstruct or influence the investigation or proper administration of any matter within the jurisdiction" of any federal department or agency or any case filed under the Chapter 11 bankruptcy statute. This provision broadens the scope of the statute beyond destruction of information for use in "official proceedings" to include destruction of information related to investigations or merely administration of matters within the jurisdiction of federal departments. The reach of this section is unclear and significantly muddies determination of when document destruction should be suspended. (For example, when does the "proper administration of a matter" by a federal agency begin? When should a company be aware that it has begun?)

As demonstrated in the Arthur Andersen case, criminal sanctions may include fines of up to $500,000 for organizations ($250,000 for individuals) and imprisonment for up to 20 years, or both.

Be Aware of the Risks and Proceed With Caution
The indictment, conviction and penalties imposed on Arthur Andersen highlight the risks and potential consequences of improper document destruction. With the current close public and political attention to document retention and destruction issues, extra caution and conservatism should overlay any corporate document destruction or policy, particularly large-scale or unusual destruction initiatives.

Additional Information
This Update is intended as a general description of the issues. You are encouraged to contact your service provider to discuss your specific situation.

The Arthur Andersen indictment is available at http://news.findlaw.com/hdocs/docs/enron/usandersen030702ind.html. You can find discussion of other recent laws, regulations and rule proposals of interest to public companies on our website.

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