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Thompson & Knight
ATTORNEYS AND COUNSELORS



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JACK SEWARD, DIGITAL FORENSIC ACCOUNTING TECHNOLOGIST

SYLLABUS

A. Basic Concepts – Discovery in the Digital Age

1. Word processed documents and databases
2. E-mail
3. Instant messaging
4. Voice messaging
5. Considering the costs of e-discovery

B. Types of Data – Hard copy, paper-like images – TIF or PDF, reasonably usable format – load file or access database, native format, hosted data

C. The Spoliation Challenge – How Data is Changed Or Lost When Handled

1. Imbedded macros and auto date function
2. Different fonts can change pagination and appearance
3. Review created data changes
4. E-mail created data changes

D. Remedial Actions

1. Require log of original system metadata
2. Limiting acquisition costs (native data may be prohibitively expensive to acquire)
3. Redaction of privileged information

E. Amendments To The FRCP Regarding Electronic Discovery – An Overview

1. The Meet and Confer Obligation
2. Retention and Destruction; Rule 37(f)
3. The Two-Tier System; Rule 26(b)(2)(B) – Accessibility
4. The Production of Privileged Documents Whether Inadvertent or Intentional (see also item F where the primary discussion of the privileges is located - and specifically item F. 4.)

5. Relevance, accessibility and costs
6. Interrogatories, Requests for Production and Subpoenas Involving ESI

F. The Evidentiary Privileges in Bankruptcy Cases

1. Overview of the evidentiary privileges and related privacy rights available to litigants.
Focus: The factual elements. Does state or federal law govern?
2. Who holds the privileges and related privacy rights to avoid the production of probative evidence and who can waive them?
Focus: Distinguish between the Debtor entity, its directors, officers, managers and other employees and successors to them.
3. Waivers of the Evidentiary Privileges.
Focus: Intentional and unintentional waivers, who has the ability to waive and the use of an employers computers, network servers and e-mail service and the like.
4. The evidentiary privileges and related privacy rights in the age of electronically stored data.
Focus: Identify some of the problems created by electronically stored data in relation to the evidentiary privileges and related privacy rights, including the volume of such data and waiver due to third party access to such data.
5. The new FRCP Rules relating to electronically stored data, focusing especially on new proposed Rule 502.
Focus: How do the new FRCP Rules operate to address the evidentiary privileges; identify problems the Rules try to resolve and where the Rules appear to succeed and where they seem to be lacking.

G. Conclusions.

H. Q & A.

HYPOTHETICAL

(Syllabus cross references in red)

The Farengi Fund aggressively participated in the run up of oil and natural gas prices in 2005 and early 2006, making millions of dollars on numerous trades. Much like Amaranth, Farengi aggressively bet on a continued rise in fuel prices. Alas, in the third quarter of calendar year 2006, Farengi's heretofore brilliant hedging strategy turned to ashes, resulting in losses exceeding \$6 billion.

On October 10, 2006, Farengi filed its voluntary Chapter 11 petition in the United States Bankruptcy Court for Southern District of Never Neverland. Farengi immediately moved to retain Zimmer & Hodges, LLP, as counsel, and Chu, Chu & Coleman, LLP, as restructuring consultants. Shortly thereafter, a Committee of Unsecured Creditors was appointed in the Chapter 11 case, and the Committee began investigating Farengi's business affairs, among other things, asking Farengi to voluntarily produce myriad documents. A.1., 2., 3., 4., 5. Farengi, by counsel agreed to deliver many of the documents, all of which were reviewed by Chu, Chu & Coleman, LLP, before delivery to Committee counsel. B.

On October 20, 2006, counsel for the Committee discovered that Howard Shemp, Farengi's CFO, completed numerous unauthorized trades using Farengi's accounts. The effect of the trades was to shift \$25,000,000.00 of losses to Farengi, leaving Shemp with a \$20,000,000.00 gain. Shemp, realizing that he "has a problem," retained civil and criminal defense counsel to represent him personally, as well as a forensic accounting firm possessing expertise in the area of commodities trading and derivatives. Shemp shared certain e-mails germane to Farengi's business affairs with his counsel and accountants to aide in the preparation of his personal defense. C. He also corresponded with his counsel and accountants using Farengi's e-mail system regarding his legal problems arising from his activities at Farengi. E.4.

On October 31, 2006, the Committee, by its counsel, commenced an Adversary Proceeding against Shemp to recover all of the money that allegedly rightfully belonged to Farengi, together with compensatory and punitive damages. F.1. Also, on October 31, 2006, Shemp resigned as Farengi's CFO. The principle claims set forth in the Committee's Complaint are common law fraud and conversion. F.1. On November 1, 2006, the Committee served a Summons and

Complaint on Shemp, together with a notice to take his deposition and for the production of documents pursuant to the applicable F. R. Bankr. P. **E.1.-6**. The document request included all Farengi's paper documents and all electronically stored information, e-mails, voice messages, and instant messages (collectively, "ESI") relating to Shemp's activities as Farengi's CFO and all trading records. **D.1.,2.,3**.

After receipt of the document production requests, Shemp consulted with Farengi's director of IT, who then audited Farengi's computer system and discovered that Farengi's trading records consisted of more than five million documents, including e-mails, voice recordings and instant messages. **B., C.1.-4. and D.1.-3**. The results of the audit were provided to counsel for Farengi and Shemp's personal counsel in the Adversary Proceeding. Later that afternoon, counsel for Farengi contacted Committee counsel to advise that Farengi could not afford to comply with the document demand. **E.1.-6**.

The case was converted to Chapter 7 on November 23, 2006, and Rob Grabbit was appointed Chapter 7 Trustee. Shortly thereafter, Grabbit retained counsel and accountants to investigate Farengi's financial affairs and review its books and records to determine if facts existed to support litigation claims to be asserted on behalf of the estate. Grabbit instructed his accountants to focus on transactions involving Howard Moe, F. Larry and Howard Curley, former officers and directors of Farengi, all of whom also traded for Farengi before its collapse.

When the case was converted to Chapter 7, Moe, Larry and Curley were out of town, but they contacted Grabbit and asked him how to proceed. After consulting with his accountants, Grabbit told Moe, Larry and Curley to have an employee lock up Farengi's premises, leave all of Farengi's property, including its laptops, PDA's, desktop computers, electronic media, books and records and financial information, in place and send the keys to Grabbit's office. **A.1.-5., B., C.1.-4**. None of Moe, Larry, nor Curley returned to Farengi's premises after conversion of the case, however, they contacted Gripeline.com., a third party vendor of secure communications, to terminate the services Gripeline provided to Farengi, including the maintenance of Farengi's telephone service and of a website made available to individuals for the purpose of contacting Farengi with complaints regarding Farengi's corporate conduct and governance. Soon thereafter, Grabbit's accountants took possession of all of Farengi's hard copy books and records and its entire computer network, including individual PCs, laptops, PDA's, network servers and backup tapes that

had been stored “off site” and which were being maintained by a third party vendor. E.1, 2, 3.4., F.2., 3.

On December 12, 2006, Grabbit’s attorney served an Order pursuant to F.R. Banks P. 2004 for the examination of each of Moe, Larry and Curley and for the production of documents, including all ESI relating to Farengi’s assets, liabilities and financial affairs. The Order directed that all ESI should be produced in “native” form and all Metadata and embedded data should be fully preserved. B. On December 15, 2006, counsel for Grabbit sent counsel for Moe, Larry and Curly a letter seeking a meeting of counsel to discuss discovery issues, including issues related to the production of ESI. E.1.-4. Additionally, on the same date, counsel for Grabbit sent counsel for Shemp a letter seeking a meeting of counsel for Shemp in the Adversary Proceeding a letter seeking a meeting of counsel to discuss similar. E.1.-4.

In November 2006, counsel for Moe, Larry and Curley learned that certain ESI and print copy documents containing allegedly privileged communications were left behind at Farengi’s premises. F.3.4. Counsel for Moe, Larry and Curley and counsel for Shemp then asked counsel for Grabbit to segregate such ESI and hard copy documents and treat them as being subject to the evidentiary privileges and certain other ill defined privacy rights. F.3.4.

Moe, Larry nor Curley has complied with the discovery demands served by Grabbit’s counsel. Shemp has not complied with the discovery served in the Adversary Proceeding. Moe, Larry, Curley and Shemp each contend that certain documents, including ESI, sought by Grabbit as Trustee, and by Grabbit as Trustee and successor Plaintiff in the Adversary Proceeding, are covered by the attorney-client, work product and joint defense privileges. F.1.2.3.4. On January 2, 2007, Moe, Larry and Curley provided the Trustee with a privilege log covering the ESI and print documents. In lieu of a formal privilege log Shemp has claimed that any documents he may possess or control responsive to the document demand are protected by the evidentiary privileges. F.2., 3., 4.

The Trustee has moved to compel production asserting, first, the documents requested are not subject to any evidentiary privilege nor to any other right that would allow Moe, Larry Curley and Shemp not to produce the documents requested, and, second, Moe, Larry, Curley and Shemp waived the privileges, if any existed, since the documents were stored on Farengi’s computer network

or in Farengi's offices. F.1., 2., 3., 4. On the other hand, Moe, Larry, Curley and Shemp assert, first, the privileges and related privacy rights absolve them from producing the documents sought, and, second, they never waived such privileges, although the records sought by the Trustee were all stored on Farengi's computer network and hardcopies all were left in Farengi's offices when possession of Farengi's assets were turned over to the Trustee. F.1., 2., 3., 4.

During his ongoing investigation, Grabbit became aware that the Farengi computer system maintained detailed, "computer audit logs" of business activities on all transactions with the associated and related threads of electronic communications, including e-mails, instant messages and video conference sessions, etc. These items were all capable of being systematically stored and indexed so they readily could be searched by authorized individuals if necessary. At all times relevant, Moe, Larry, Curly and Shemp were aware that Farengi's IT Department could avail itself of such search and review capability. F.3., 4.

Oh yes, on January 2, 2007, the United States Attorney for the District of Never Neverland commenced her investigation regarding the collapse of Farengi and the respective roles of various parties regarding such collapse. On January 7, 2007, the Office of the U.S. Attorney issued document subpoenas seeking copies of all Farengi documents, including all ESI relating to Farengi's trading activities. E.4., F.5

MODEL QUESTIONS IMPLICATED BY THE HYPOTHETICAL

1. Does the Debtor have a document retention policy in place? How does the Chapter 11 filing affect that policy? What is the extent of counsel's obligations to prevent the destruction of ESI? What are the Debtor's duties under the Bankruptcy Code, if any, concerning the preservation of ESI?
2. How does the consultant's review of the documents affect the privileges?
3. Does sharing corporate documents with the individuals counsel affect the privileges? Who holds the privileges?
4. Does it matter that Shemp used Farengi's e-mail system to correspond with his personal counsel? How will that affect his personal defense?
5. Does federal common law or state law govern the assertion of privileges in the adversary proceeding by the defendant?
6. What is ESI? What types of data is stored by most business? What is "reasonably usable format"? What is "native format"? What is "hosted data" format? How is ESI cost or changed when handled? How can ESI be preserved?
7. How do you manage costs?
8. Why were phone calls made by counsel (the meet and confer obligation)?
 - ◆ Retention and destruction: Rule 37(f)
 - ◆ Accessibility Rule 26(b)(2)(B) – the two tiered system
9. What will accountants typically seek from a Debtor and "insiders: in terms of data?
10. How are the privileges affected by an entity's methods of using and storing ESI, including the use of third party providers?



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Mr. Herman is a past Chair of the Committee on Bankruptcy Law for the Business Law Section, current Chair for the Bankruptcy and Debtor and Creditor Law CLE Programs, and member of the New York State Bar Association. He is a member of the New York City Bar Association, a member of the Steering Committee for the NYC Bankruptcy Assistance Project, and a member of the Bankruptcy Administration Committee and Real Estate Committee of the American Bankruptcy Institute. He is admitted to practice in the Second Circuit of the U.S. Court of Appeals, and the U.S. District Courts for the Southern, Eastern, Western, and Northern Districts of New York.

Mr. Herman has been the Chair, Moderator, and Speaker of several conferences for the New York State Bar Association, New York County Lawyers' Association, American Bankruptcy Institute, American Conference Institute, and many others. He is an Adjunct Professor at St. John's School of Law in the Bankruptcy LL.M. program, and on the Board at Westchester Hebrew High School.

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SPECIAL KUDOS

Special kudos to Jack Seward for providing his incites on the topics covered by this program and these materials. Without his advice and expertise, none of this would have been possible.

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