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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA-WESTERN DIVISION

<p>WINGNUT FILMS, LTD.,</p> <p style="text-align: right;">Plaintiff,</p> <p style="text-align: center;">v.</p> <p>KATJA MOTION PICTURES CORP.; NEW LINE CINEMA CORP.; NEW LINE PROD., INC.;</p> <p>and DOES 1 through 20, inclusive,</p> <p style="text-align: right;">Defendants.</p>	<p>)</p> <p>)</p> <p>)</p> <p>)</p> <p>)</p> <p>)</p> <p>)</p>	<p>CV 05-1516-RSWL (SHx)</p> <p>FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER PARTIALLY GRANTING PLAINTIFF'S MOTION FOR SANCTIONS; ORDER DENYING DEFENDANTS' CROSS- MOTION</p>
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Presently before this Court is Plaintiff Wingnut Films, Ltd.'s Motion for Sanctions, and Defendants' Cross-Motion for Sanctions, both heard on August 15, 2007. The following documents from plaintiff's Appendix to its current Motion are incorporated by referenced to this Order:

<u>Tab</u>	<u>Description</u>
A	Joint Stipulation Re Renewed Motion to Enforce Discovery

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- Orders and for Sanctions, filed on January 16, 2007
- B Plaintiff Wingnut Films, Ltd.'s First Request for the Production of Documents to Defendants Katja Motion Pictures Corp., New Line Cinema Corp., and New Line Productions, Inc.
- C Defendants' Response to Plaintiff Wingnut Films, Ltd.'s First Request for the Production of Documents
- D Defendants' Supplemental Response to Plaintiff Wingnut Films, Ltd.'s First Request for the Production of Documents
- E July 14, 2006 Order on Plaintiff's Motion to Compel Production of Documents
- F July 14, 2006 Order Re Plaintiff's Motion to Compel Production of Documents
- G July 13, 2006 Order Re Plaintiff's Motion to Compel Production of Redacted Documents
- H Plaintiff Wingnut Films, Ltd.'s Second Request for the Production of Documents to Defendants Katja Motion Pictures Corp., New Line Cinema Corp., and New Line Productions, Inc.
- I Defendants' Response to Wingnut Films, Ltd.'s Second Request for the Production of Documents
- J August 23, 2006 Order Granting Plaintiff Wingnut Films, Ltd.'s Motion To Compel Production Of Documents In Response To Plaintiff's Second Set of Requests For Production
- K Transcript of the September 18, 2006 Hearing before Judge Lew

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- 1 L Joint Stipulation Under Local Rule 37-2 Re Plaintiff's Motion
- 2 to Compel, filed on October 12, 2006
- 3
- 4 M Transcript of the November 6, 2006 Hearing before this Court
- 5 N November 7, 2006 Order Re Plaintiff's Motion to Compel
- 6 O November 30, 2006 letter from Bradley Parr to Robert Klieger
- 7 P January 24, 2007 Order Re Plaintiff Wingnut Films, Ltd.'s
- 8 Renewed Motion to Enforce Discovery and for Sanctions
- 9 Q February 4, 2007 letter from Robert Klieger to Victor Jih
- 10 R Plaintiff's Report on Custodian of Records Depositions and
- 11 Request for Further Relief
- 12 S Transcript of the February 8, 2007 deposition of Ken Horowitz
- 13 T Transcript of the February 8, 2007 deposition of Dain Landon
- 14 U Defendants' Report Regarding Compliance with this Court's
- 15 January 24, 2007 Order
- 16 V Transcript of the March 1, 2007 Telephonic Hearing before this
- 17 Court
- 18 W February 28, 2007 letter from Robert Klieger to Victor Jih
- 19 X Transcript of the March 28, 2007 deposition of Ken Horowitz
- 20 Y Transcript of the March 28, 2007 deposition of Dain Landon
- 21 Z Defendants' Supplemental Responses to Plaintiff Wingnut
- 22 Films, Ltd.'s Second Set of Requests for Production
- 23
- 24 AA August 18, 2006 letter from Kara McDonald to Christopher
- 25 Frost
- 26 BB August 21, 2006 letter from Bradley W. Parr to Kara McDonald
- 27 CC Transcript of the January 23, 2007 Hearing before this Court
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DD February 9, 2007 letter from Bradley Parr to Robert Klieger, enclosing the Declaration of Ken Horowitz.

EE Defendants' Supplemental Brief in Opposition to Plaintiff's Motion to Compel Compliance with Discovery Orders

FF April 3, 2007 letter from Robert Klieger to Victor Jih

GG April 4, 2007 letter from Victor Jih to Robert Klieger

HH Defendants' Post-Deposition Report and Request for Sanctions

II March 12, 2007 letter from Bradley Parr to Robert Klieger, enclosing Ken Horowitz's signature and changes to the transcript of his February 8, 2007 deposition

JJ February 7, 2007 letter from Brad Parr to Robert Klieger

KK Excerpts of the Transcript of the June 20, 2006 Deposition of Michael Lynne

LL February 26, 2007 email from Bradley Parr to Robert Klieger

MM March 12, 2007 letters from Brad Parr to Robert N. Klieger, enclosing Ken Horowitz's and Dain Landon's signatures and changes to the transcripts of their February 8, 2007 depositions

Having considered all other papers submitted by the parties and the arguments of counsel, as well as the transcript of the hearing on the present motions, and for good cause shown, this Court finds as follows:

I. PROCEDURAL BACKGROUND

1. Wingnut propounded its First Set of Requests for Production of Documents to Defendants on July 6, 2005. **Tab B** (Plaintiff Wingnut Films, Ltd.'s First Request for the Production of Documents to Defendants Katja Motion Pictures Corp., New Line Cinema Corp., and New Line Productions, Inc.). New Line

1 initially refused to produce any documents other than those that Wingnut already
2 possessed in the ordinary course of business, claiming that the vast majority of
3 requests were "simply too objectionable to permit any response." **Tab C**
4 (Defendants' Response to Plaintiff Wingnut Films, Ltd.'s First Request for the
5 Production of Documents) at 18:26 & *passim*.

6
7 2. Five months later, after a series of meet and confers, New Line served
8 supplemental responses and two boxes of documents. **Tab D** (Defendants'
9 Supplemental Response to Plaintiff Wingnut Films, Ltd.'s First Request for the
10 Production of Documents). New Line then engaged Wingnut in a series of meet
11 and confers over a period of months.

12
13 3. In June 2006, Wingnut filed the first of what would become a series of
14 motions to compel. This Court granted Wingnut's motion in an order dated July 14,
15 2006 in which this Court compelled New Line to produce all of the sales and
16 licensing, merchandising, and third-party participation documents relating to *Lord*
17 *of the Rings*. **Tab E** (7/14/06 Order on Plaintiff's Motion to Compel Production of
18 Documents) ("July 14 Order"). This Court rejected New Line's boilerplate
19 objections to Wingnut's requests as "unsupported" and "without merit" and ordered
20 New Line to produce documents "forthwith on a 'rolling' basis as documents are
21 located" and to complete its production "no later than August 10, 2006." *Id.* at 4.¹

22
23 ¹ On the same date, this Court issued a second Order, which required New Line to
24 produce, inter alia, all documents regarding communications with Time Warner or other Time
25 Warner subsidiaries, including Warner Bros., regarding the lawsuit and the disputes that are the
26 subject thereof and damages-related documents for all accounting periods through the date of
27 trial. **Tab F** (7/14/06 Order Re Plaintiff's Motion to Compel Production of Documents). A day
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1 4. Wingnut propounded its Second Requests for Production of Documents
2 on May 5, 2006. **Tab H** (Plaintiff Wingnut Films, Ltd.'s Second Set of Requests
3 for the Production of Documents to Defendants). New Line again refused to
4 produce documents in response to virtually every request. **Tab I** (Defendants'
5 Responses to Wingnut Films, Ltd.'s Second Request for the Production of
6 Documents).

7 5. Following this Court's ruling on the first motions to compel, New Line
8 changed course and said that it would produce documents responsive to Wingnut's
9 second set of requests. However, New Line refused to memorialize this
10 commitment in a stipulation, and Wingnut therefore asked this Court to order the
11 documents produced. This Court granted Wingnut's request over New Line's
12 objection and, by order dated August 23, 2006, compelled New Line to produce or
13 log documents responsive to fifty-six requests contained in the Second Set of
14 Requests within ten days of the order. **Tab J** (8/23/06 Order Granting Plaintiff
15 Wingnut Films, Ltd.'s Motion To Compel Production Of Documents In Response
16 To Plaintiff's Second Set of Requests For Production) ("August 23 Order").

17 6. New Line's production of documents in response to the discovery orders
18 coincided with the discovery and motion cutoff date. Within weeks of New Line's
19 production, Wingnut identified what it believed to be gross deficiencies in the
20 production. Wingnut promptly brought these deficiencies to New Line's attention.
21 New Line dismissed Wingnut's concerns and asserted that it had fully complied
22 with this Court's orders. Because the motion cutoff had passed, Wingnut was
23 unable to file a motion to enforce the discovery orders. However, on September 18,
24 2006, Judge Lew granted Wingnut leave to file a motion to enforce the discovery
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26 _____
27 earlier, this Court had granted Plaintiff's Motion to Compel Production of Non-Redacted

28 Documents. **Tab G** (7/13/06 Order Re Plaintiff's Motion to Compel Production of Redacted

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1 orders. *See* **Tab K** (Transcript of September 18, 2006 Hearing).

2 7. Wingnut filed its Motion to Compel Compliance with Discovery
3 Orders on October 12, 2006. **Tab L** (Joint Stipulation Under Local Rule 37-2 Re
4 Plaintiff's Motion to Compel Compliance with Discovery Orders) ("October 12
5 Joint Stipulation."). In its motion, Wingnut identified substantial gaps in New
6 Line's production and sought an order requiring, *inter alia*, that New Line produce
7 its custodian(s) of records for deposition. New Line disputed that any significant
8 work remained to be done. Indeed, New Line's counsel advised this Court that,
9 with two minor exceptions, "[w]e can certify on the record right now...[that]
10 everything else has actually been produced." **Tab M** (11/6/07 Hearing Transcript)
11 at 15. Wingnut's counsel expressed skepticism and addressed the sanctions that
12 should follow in the event that counsel's certification proved to be false:
13

14 [I]f they make a certification that they've produced everything . . . and
15 then we find out through a custodian of records deposition, or through
16 a custodian of records witness at trial, or through any other trial
17 testimony that there [are] these whole categories of documents that
18 they were ordered to produce and have not, there should be serious
19 consequences for them.

20 *Id.* at 40.

21 8. In this Court's Order dated November 7, 2006, this Court directed New
22 Line to confirm by November 30, 2006 that all responsive documents had been
23 produced in accordance with the discovery orders, but the Court declined to order
24 custodian of record depositions at that time. **Tab N** (11/7/06 Order Re Plaintiff's
25 Motion to Compel) ("November 7 Order").

26 9. By letter dated November 30, 2006, New Line confirmed in writing
27 that it had complied with this Court's discovery orders and that all non-privileged
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1 documents encompassed within those orders had been produced. **Tab O** (11/30/06
2 Letter from Brad Parr to Robert N. Klieger) ("11/30/06 Parr Letter").

3 10. Wingnut discovered facts that led it to believe that a number of New
4 Line's representations to this Court were false, and Wingnut filed a Renewed
5 Motion to Enforce Discovery Orders and for Sanctions. **Tab A** (Joint Stipulation
6 Re Renewed Motion to Enforce Discovery Orders and for Sanctions) ("January 16
7 Joint Stipulation").

8 11. Following oral argument on Wingnut's motion, this Court ordered New
9 Line to make its custodian of records available for deposition "for examination
10 regarding defendants' record-keeping policies and procedures with respect to the
11 categories of documents defendants have been ordered to produce in this action,
12 including both paper and electronic documents and defendants' search for and
13 collection of documents for production." **Tab P** (1/24/07 Order Re Plaintiff
14 Wingnut's Renewed Motion to Enforce Discovery and for Sanctions) ("January 24
15 Order"). This Court took Wingnut's request for monetary sanctions under
16 submission pending completion of the custodians' depositions. *Id.*

17 18 12. New Line declined to produce its custodians for deposition in Los
19 Angeles. Instead, New Line insisted that Wingnut's counsel travel to New York for
20 the depositions. **Tab JJ** (2/7/07 Letter from Brad Parr to Robert Klieger). In
21 advance of the depositions, and to ensure that New Line's custodians were
22 adequately prepared and that the trip was not wasted, Wingnut's counsel identified
23 the specific categories of documents about which Wingnut intended to inquire at
24 the depositions. **Tab Q** (2/4/07 Letter from Robert N. Klieger to Victor Jih).

25 13. New Line designated two custodians of records to address the listed
26 topics – Ken Horowitz, New Line's Vice President, Participations and Contract
27 Accounting; and Dain Landon, New Line's Senior Counsel. When these witnesses
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1 appeared for deposition on February 8, 2007, they were unable to answer many
2 basic questions regarding New Line's record-keeping policies or its collection of
3 documents for production, and the answers that Messrs. Horowitz and Landon were
4 able to provide suggested significant defects in New Line's production. **Tab R**
5 (Plaintiff's Report on Custodian of Records Depositions and Request for Further
6 Relief) ("Wingnut Report"); **Tab S** (2/8/07 Transcript of Deposition of
7 Ken Horowitz) ("2/8/07 Horowitz Depo."); **Tab T** (2/8/07 Transcript of Deposition
8 of Dain Landon) ("2/8/07 Landon Depo.").

9
10 14. On February 12, 2007, New Line filed a "Report Regarding
11 Compliance with this Court's January 24, 2007 Order." **Tab U**. Wingnut
12 responded with its own "Report of Custodian of Records Depositions and Request
13 for Further Relief," in which it detailed what had transpired at the custodians'
14 depositions. **Tab R** (Wingnut Report).

15 15. On March 1, 2007, this Court ordered New Line to produce its
16 custodians for a second round of depositions in which Wingnut's counsel could seek
17 information that the witnesses had been unable to provide at their first depositions.
18 **Tab V** (3/1/07 Hearing Transcript) at 8-10. The follow-on depositions were
19 scheduled for March 28, 2007.

20 16. More than three weeks before the depositions, Wingnut provided New
21 Line a two-page list of the specific subjects that Wingnut understood to be within
22 the scope of the follow-on depositions and about which it intended to inquire. **Tab**
23 **W** (2/28/07 Letter from Robert N. Klieger to Victor Jih). Nonetheless, New Line's
24 custodians apparently waited until literally the day before the follow-on depositions
25 to make any effort to gather the information they had been unable to provide at their
26 first depositions. Mr. Horowitz spent "five or maybe ten minutes" gathering
27 additional information about New Line's search of its audit files. **Tab X** (3/28/07
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1 Transcript of Deposition of Ken Horowitz) ("3/28/07 Horowitz Depo.") at 174:24-
2 175:13 & 181:25-182:15. Mr. Landon spoke with eleven individuals to prepare for
3 his deposition, but all eleven conversations occurred the day before the deposition
4 and lasted less than 45 minutes in total. **Tab Y** (3/28/07 Transcript of Deposition
5 of Dain Landon) ("3/28/07 Landon Depo.") at 234:6-263:25. The custodians
6 remained unable to answer critical questions regarding New Line's production, and
7 the testimony they did provide demonstrates New Line's failure to comply with the
8 discovery orders.

9
10 **II. NEW LINE'S DISCOVERY FAILURES**

11 17. From the start, Wingnut identified significant gaps in New Line's
12 document production and expressed concerns about its completeness. Wingnut's
13 counsel raised these concerns again and again, both in correspondence and meetings
14 with New Line's counsel and in submissions to the Court. New Line's counsel
15 represented again and again that a diligent search had been conducted and all
16 responsive documents had been produced. Whenever Wingnut fortuitously
17 discovered the existence of specific responsive documents that had not been
18 produced, New Line would make disjointed searches, each time coming up with a
19 few more documents, and each time representing that that was all they had. All the
20 while, New Line's counsel persisted in belittling Wingnut's concerns as "paranoia"
21 and "harassment." The Court eventually granted Wingnut leave to take discovery
22 regarding New Line's discovery compliance, at which time New Line's discovery
23 failures became readily apparent. These are much the same issues Judge Preska was
24 faced with in *Metropolitan Opera Ass'n, Inc. v. Local 100, Hotel Employees &*
25 *Restaurant Employees Int'l Union*, 212 F.R.D. 178 (S.D.N.Y. 2003), and this Court
26 concludes that they should be resolved in much the same way (albeit with less
27 draconian sanctions designed to facilitate a fair trial on the merits rather than
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1 establish liability as a matter of law).

2 18. New Line's continuing discovery failures fall into three basic
3 categories: (A) New Line did not conduct a reasonably diligent search for
4 numerous categories of documents that this Court ordered produced; (B) New Line
5 did not conduct a reasonably diligent search for emails and other electronic
6 documents; and (C) New Line did not suspend its document destruction policy or
7 otherwise take adequate steps to preserve documents.

8 **A. New Line Did Not Conduct A Reasonably Diligent Search For**
9 **Numerous Categories Of Documents It Was Ordered To Produce**

10 1. **New Line Has Withheld Documents Relating To Third-Party**
11 **Audits**

12
13 19. In its Second Set of Requests for Production, Wingnut requested that
14 New Line produce "[a]ll DOCUMENTS that constitute, memorialize, or refer to,
15 and all COMMUNICATIONS regarding, any other audit claims that any profit
16 participant has made against DEFENDANTS in connection with a film, television,
17 soundtrack, or videogame property." **Tab H** (Wingnut's Second Set of Requests),
18 Request No. 164.

19 20. In its initial response, New Line refused to search for and produce any
20 responsive documents. **Tab I** (New Line's Response to Wingnut's Second Set of
21 Requests), Response to Request 164. After Wingnut had incurred the time and
22 expense of drafting a motion to compel, New Line supplemented its response to
23 state that "[t]he subject matter of this request has already been addressed by the
24 Magistrate in its July 10, 2006 order on the production of documents" and that
25 "Defendants are in the process of complying with that order on a rolling basis, and
26 are working diligently to identify the likely location of documents and to produce
27 them by August 10, 2006." **Tab Z** (Defendants' Supplemental Responses to
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1 Plaintiff Wingnut Films, Ltd.'s Second Set of Requests for Production), Response
2 to Request No. 164.

3 21. Wingnut asked New Line to memorialize its agreement to produce
4 documents responsive to Request No. 164 in a stipulation to be entered by this
5 Court, so that New Line could not later claim that it somehow was not obliged to
6 produce the documents; New Line refused to enter into a stipulation, and further
7 opposed Wingnut's request that the Court enter an order requiring the documents
8 to be produced. This Court granted Wingnut's request over New Line's objection
9 and ordered that all documents responsive to Request No. 164 be produced. **Tab**
10 **J** (August 23 Order).

11 22. New Line did not produce any third-party audit documents by the
12 compliance date set by the Court. By letter dated August 18, 2006, Wingnut alerted
13 New Line to its failure to produce documents as promised: "This request [No. 164]
14 calls for documents related to other audit claims by any profit participant against
15 Defendants in connection with a film, television, soundtrack, or videogame
16 property. Defendants have clearly failed to produce all documents responsive to
17 this request." **Tab AA** (8/18/06 Letter from Kara McDonald to Christopher Frost)
18 ("8/18/06 McDonald Letter"). New Line dismissed Wingnut's concerns and
19 asserted that New Line had "conducted a diligent and good faith search for
20 responsive documents" and had produced everything they had found. **Tab BB**
21 (Letter from Bradley W. Parr to Kara McDonald dated August 21, 2006) ("8/21/06
22 Parr Letter").

23 23. At the time Wingnut filed its Motion to Compel Compliance with
24 Discovery Orders on October 12, 2006, more than two months after the discovery
25 cutoff, New Line still had not produced a single such document. Although New
26 Line had previously represented that all documents responsive to Request No. 164
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1 had already been produced, New Line now said that it *had been prepared* to
2 produce such documents: "During Defendants' search for documents, Defendants
3 looked for and were prepared to produce any documents concerning such claims
4 [described in Request No. 164] that they identified." **Tab L** (October 12 Joint
5 Stipulation) at 13. New Line did not explain why it had not actually produced the
6 documents as this Court had ordered, or why it previously represented that all
7 responsive documents had already been produced. New Line said it would "search
8 again." *Id.*

9
10 24. In late October 2006, nearly six months after Wingnut had propounded
11 Request No. 164, and more than two months after New Line had first represented
12 that all responsive documents had been produced, New Line produced one-third of
13 a box of third-party audit documents that consisted of an incomplete set of audit
14 reports and responses. New Line produced virtually nothing in the way of
15 correspondence, memoranda, emails, notes, work papers, settlement agreements, or
16 anything else relating to dozens of motion picture audits.

17 25. Following its October production, New Line claimed that its
18 production of audit documents was now complete. Wingnut questioned this
19 representation:

20 If [Defendants] can truly certify to this Court that they have now
21 produced all documents that constitute, memorialize or refer to, and all
22 communications regarding other audit claims that any profit
23 participant has brought against New Line, which is what they were
24 ordered to produce, great. I would love to have that certification.

25 I don't believe that certification could be given. And if it can,
26 I believe it will be shown whether through a custodian of records
27 deposition, or ultimately at trial, to be false or mistaken, at the very
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1 least. And there should be consequences for that.

2 **Tab M** (11/6/06 Hearing Transcript) at 18. New Line's counsel dismissed
3 Wingnut's skepticism as paranoia and certified to the Court, without any
4 equivocation, that New Line had searched for and produced all documents
5 responsive to Request No. 164:

6 The second category that Mr. Klieger raises in terms of third-
7 party 'non-Lord of the Rings' audits. He characterizes our – so, first
8 of all, he just wants to make sure we've actually completed our search
9 and produced all of the documents – and the answers – we've said
10 again and again and again, we have. We've completed the search and
11 provided the documents. So, I'm not adding any caveat or ambiguity
12 to that. I'm stating that for the record.

13
14 *Id.* at 28.

15 26. This Court in retrospect unwisely accepted the representation of New
16 Line's counsel and declined to order custodian of records depositions or to enter
17 sanctions. The Court did, however, order New Line to produce any remaining
18 third-party audit documents and to confirm by no later than November 30, 2006 that
19 all such documents had been produced. **Tab N** (November 7 Order) at 1.

20 27. However, New Line did not produce any third-party audit documents
21 by the November 30, 2006 compliance date. Instead, on November 30, 2006, New
22 Line gave the same assurance its counsel had made to the Court three weeks earlier
23 – *i.e.*, that all responsive documents had already been produced. **Tab BB** (11/30/06
24 Parr Letter). In opposing Wingnut's Renewed Motion to Enforce Discovery Orders
25 and for Sanctions, New Line again rejected Wingnut's contention that any
26 documents had been withheld. New Line accused Wingnut of seeking to "reopen
27 discovery simply because it—*in its paranoia*—does not trust Defendants" and of
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1 "using the discovery process to harass Defendants," and suggested that Wingnut
2 should be sanctioned "for forcing the Court and Defendants to deal with this
3 frivolous motion." **Tab A** (January 16 Joint Stipulation) at 57 & 59.

4 28. At the January 23, 2007 hearing on Wingnut's renewed motion,
5 Wingnut's counsel again expressed skepticism that New Line's certification that it
6 had produced all third-party audit claim documents could be true: "[W]e...know
7 from experience in this case and other cases that it's not going to be a third of a box.
8 It can't possibly be." **Tab CC** (1/23/07 Hearing Transcript) at 51.

9 29. On January 24, 2007, this Court ordered New Line to make its
10 custodian of records available for deposition and to provide a declaration
11 confirming, *inter alia*, that "all documents that constitute, memorialize, or refer to,
12 and all communications regarding, any audit claims that any profit participant has
13 made against defendants in connection with any film, television, soundtrack, or
14 video game property" had been produced in compliance with the Court's August 23
15 Order. **Tab P** (January 24 Order).

16 30. New Line designated Ken Horowitz, the senior member of New Line's
17 audit group, to testify as its custodian of records as to documents related to audits.
18 Mr. Horowitz testified that his group maintains a comprehensive set of audit files.
19 **Tab S** (2/8/07 Horowitz Depo.) at 20:5-20.

20 31. Mr. Horowitz testified that, for each film, the audit files include, *inter*
21 *alia*, copies of all written correspondence with the auditors engaged by participants
22 to conduct the audits (*id.* at 20:2-4); copies of New Line's frequent (often daily)
23 email communications with the auditors (*id.* at 55:11-18); copies of everything that
24 is sent to the auditors in connection with an audit, such as accounting papers, copies
25 of agreements, and the like (*id.* at 104:10-17); copies of any internal memoranda
26 (*id.* at 64:7-17); copies of all correspondence, both internal to New Line and with
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1 third parties (*id.*); and copies of documents pertaining to any litigation arising from
2 an audit (*id.* at 70:18-25). Mr. Horowitz testified that the audit files are so
3 extensive that they fill "many, many files cabinets of many drawers each." *Id.* at
4 23:6-11. On-site alone, Mr. Horowitz estimated that the audit files fill at least six
5 to ten file cabinets of three to five drawers each. *Id.* at 25:12-17.²

6 32. Mr. Horowitz identified Robin Howe and Justin Glaser as the two
7 individuals who had searched New Line's audit files in connection with this
8 litigation (*id.* at 123:12-17), but he was unable to testify with any certainty what
9 exactly Ms. Howe and Mr. Glaser had searched for and collected (*id.* at 124:4-
10 128:8). Mr. Horowitz's testimony thus provided no corroboration for New Line's
11 prior certification that it had searched for and produced all audit claim documents.

12 33. On February 9, 2007, less than 24 hours after his deposition, Mr.
13 Horowitz signed a declaration in which he declared, based on "personal
14 knowledge," that New Line had complied with the Court's discovery orders
15 regarding third-party audit documents. **Tab DD** (Declaration of Ken Horowitz)
16 ("Horowitz Declaration"). Specifically, Mr. Horowitz declared that:

17 [M]embers of my group have searched for all documents that

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19 ²New Line asserts, without any supporting citation, that "many of those documents
20 concern properties that were released before 1995" and that therefore of all outside the scope of
21 the discovery. Joint Stipulation Re Cross-Motions for Sanctions, at 46. However, no 1995
22 cutoff appears in either the discovery request nor the Court's orders. Moreover, New Line's
23 custodian specifically testified that he many audit files relating to properties released before 1995
24 have been moved to off-site storage, and therefore are not part of the "many, many file cabinets
25 of many drawers each." **Tab X** (3/28/07 Horowitz Depo.) at 237:12-238:6.
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1 constitute, memorialize, or refer to, and all communications regarding,
2 any audit claims that any profit participant has made against Katja
3 Motion Pictures Corp., New Line Cinema Crop, and New Line
4 Productions, Inc. in connection with any film, television, soundtrack,
5 or video game property. All of the documents that were found were
6 collected and sent to New Line's outside counsel, O'Melveny & Myers
7 LLP for production.

8 *Id.* at ¶¶ 1-2. New Line did not identify the source of the newfound "personal
9 knowledge" that Mr. Horowitz had lacked just one day earlier.

10 34. Mr. Horowitz appeared for his second custodian of records deposition
11 on March 28, 2007. Wingnut inquired at the outset regarding what additional
12 investigation or inquiry Mr. Horowitz had done following his February 8 deposition
13 that enabled him to certify New Line's compliance with the discovery orders the
14 very next day. Mr. Horowitz testified that he did not recall doing anything at all.
15 **Tab X** (3/28/07 Horowitz Depo.).

16 35. To prepare for the second day of his deposition, Mr. Horowitz spent
17 "five or maybe ten minutes" speaking with Mr. Glaser and "a few minutes"
18 speaking with Ms. Howe about their searches of New Line's central audit files. *Id.*
19 at 174:24-175:13 & 181:25-182:15. Mr. Horowitz testified that Ms. Howe and Mr.
20 Glaser had performed two searches of the central audit files. *Id.* at 191:18-193:20.
21 In their first search, conducted somewhere between August and October 2006, they
22 were instructed to collect only audit claims and reports, responses to audit reports,
23 and settlements. *Id.* at 192:8-22 & 194:4-11. They did not collect any other
24 documents from the drawers and drawers of audit files, including any
25 correspondence, memoranda, emails, notes, or work papers. *Id.*
26
27 In the second search, conducted in December 2006 or January 2007, Ms. Howe and
28

1 Mr. Glaser were instructed to collect only external correspondence relating to the
2 audits for which they had previously collected reports. *Id.* at 193:6-13, 199:23-
3 200:5, 201:5-23, 211:17-212:16. Again, they were not told to collect, and did not
4 collect, anything in the way of internal correspondence, memoranda, emails, notes,
5 or work papers. *Id.* There have been no further searches of the central audit files.
6 *Id.* at 202:21-204:14.³

7 36. In addition, Mr. Horowitz testified that New Line has not conducted
8 any search for audit documents outside of the central audit files. *Id.* at 227:22-
9 230:11. New Line seeks to excuse this failure based on Mr. Horowitz's testimony
10 New Line's policy is that all documents are to be placed in the central files.
11 Although Mr. Horowitz did testify that this is New Line's policy, he also testified
12 that there are no checks to monitor compliance with the policy and that he has no
13 idea how well the policy is followed. **Tab S** (2/8/07 Horowitz Depo.) at 64:7-17.
14 Moreover, the audit documents that New Line has produced from the central audit
15 files demonstrate that New Line *does* maintain work files separate and apart from
16 the central audit files. The one box of audit documents that New Line has produced
17 includes audit responses and correspondence that are copied or blind copied to
18 countless individuals within and outside of New Line's audit department (including
19 Ron Signorotti, Michael Spatt, Anna Tannenbaum, Craig Alexander, Judd Funk,
20 David Imhoff, Frank Smith, and Ted Fournier) as well as to numerous company
21

22 _____
23 ³New Line asserts, again without any supporting citation, that many of the documents in
24 the "many, many file cabinets of many drawers each" concern audits for which no audit claims
25 were ever received. Joint Stipulation Re Cross-Motions for Sanctions, at 46. However, New
26 Line's custodian, who is also the head of New Line's audit group, was unable to identify even
27 one film that has been audited but as to which no audit claims were made. **Tab X** (3/28/07
28 Horowitz Depo.) at 197:15-24.

1 files, including at least 17 files concerning just the *Austin Powers* films. Mr.
2 Horowitz was not familiar with any of these files. Tab X (3/28/07 Horowitz Depo.)
3 at 226:24-234:16. These files may contain identical or non-identical copies of
4 documents already produced, and they may also contain responsive documents that
5 have not previously been identified and produced. The fact that New Line is not
6 obligated to *produce* identical copies of the same document does not mean that it
7 need not *collect* all responsive documents so that it can determine whether
8 documents are, in fact, copies and—to the extent they are copies—whether they are
9 *identical* copies, as opposed to marked up copies with handwritten notes or the like.
10 It should go without saying that only truly identical copies may be withheld from
11 production, and New Line cannot simply assume all copies will be identical without
12 actually looking.

13
14 39. The Court finds that New Line still has not complied with the Court's
15 order that it produce all third-party audit documents. New Line has produced less
16 than one box of documents from the "many, many file cabinets of many drawers
17 each" that comprise New Line's central audit files. New Line's custodian conceded
18 that New Line has not collected or produced any internal correspondence,
19 memoranda, emails, notes, or work papers; that it has not looked anywhere outside
20 of the central audit files for any responsive documents; and that it has not
21 performed any search for electronic documents. New Line's repeated and
22 unequivocal certifications that it has fully complied with the Court's discovery
23 orders have been seriously misleading and obfuscatory.

24 **2. New Line Has Withheld Documents Relating To Other *Lord***
25 **of the Rings Audits**

26
27 40. In its First Request for Production of Documents, Wingnut requested
28 that New Line produce "[a]ll DOCUMENTS that evidence, reflect or refer to any

1 audits conducted by any PERSON pertaining to the FILM [Lord of the Rings]."
2 **Tab B** (Wingnut's First Set of Requests), Request No. 81. Besides the Wingnut
3 audit, there are two basic groups of audits that have been conducted in connection
4 with Lord of the Rings: (1) audits of New Line conducted by other profit
5 participants; and (2) audits conducted by New Line of its licensees, including a
6 number of its Warner Bros. affiliates. New Line refused to produce documents
7 from either group. **Tab C** (Defendants' Response to Plaintiff Wingnut Films, Ltd.'s
8 First Request for the Production of Documents), Request 81.

9
10 41. This Court granted Wingnut's motion to compel the production of
11 documents responsive to Request No. 81 in its July 14 Order and required New
12 Line to produce all responsive documents by no later than August 10, 2006. **Tab**
13 **E** (July 14 Order).

14 42. By the August 10 compliance date, New Line had produced just four
15 responsive documents (audit reports prepared by the Bank of New Zealand,
16 Miramax, Liv Tyler, and Saul Zaentz), totaling just 88 pages. New Line did not
17 produce any correspondence, memoranda, emails, notes, or work papers related to
18 any of these participant audits. Nor did New Line produce a single document
19 related to the audits of its Warner Bros. affiliates.

20 43. Wingnut placed New Line on notice of this deficiency in its
21 production. Specifically, by letter dated August 18, 2006, Wingnut stated with
22 respect to Request No. 81: "Defendants produced some audit reports pertaining to
23 *The Lord of the Rings*, but they have generally not produced related documents,
24 such as Defendants' responses to those reports, work papers, audit files or audit
25 correspondence." **Tab AA** (8/18/06 McDonald Letter) at 2. New Line's counsel
26 responded three days later with an assurance that "Defendants conducted a diligent
27 and good faith search for responsive documents they agreed to or were ordered to
28

1 produce, and produced the documents...they identified during that search." **Tab**
2 **BB** (8/21/06 Parr Letter) at 1.

3 44. New Line was less committal in responding to Wingnut's October 12,
4 2006 Motion to Compel Compliance with Discovery Orders. Although New Line
5 represented that it had produced all documents relating to the audit of New Line,
6 it stated that it was "still confirming" that all licensee audit documents had been
7 produced. Specifically, New Line indicated that "Defendants are confirming
8 whether additional documents exist for Warner Home Video and Warner Music
9 Group." **Tab EE** (Defendants' Supplemental Brief in Opposition to Plaintiffs'
10 Motion to Compel Compliance with Discovery Orders) at 3.

11 45. Following the hearing on Wingnut's motion, this Court ordered New
12 Line to complete its production of *Lord of the Rings* audit documents and to certify
13 the completion of that production by November 30, 2006. **Tab N** (November 7
14 Order). New Line did not thereafter produce any documents relating to the audits
15 of its Warner Bros. affiliates. Nonetheless, by letter dated November 30, 2006,
16 New Line certified that it had complied fully with the Court's orders and that all
17 responsive documents had been produced. **Tab O** (11/30/06 Parr Letter).

18 46. At the January 23, 2007 hearing on Wingnut's Renewed Motion to
19 Enforce Discovery Orders and for Sanctions, this Court inquired of New Line's
20 counsel why the Warner Bros. audit documents had not been produced. New Line's
21 counsel was unable to offer any satisfactory response. **Tab CC** (1/23/07 Hearing
22 Transcript) at 46:8-47:13.

23 47. New Line has since produced a small handful of documents in
24 response to Wingnut's repeated motions to compel compliance with the Court's
25 discovery orders. However, with few exceptions, New Line has not produced any
26 correspondence, memoranda, emails, notes, work papers, or litigation or settlement
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1 documents related to the participant audits conducted by the Bank of New Zealand,
2 Miramax, Liv Tyler, or Harper Collins. New Line has not produced a single
3 document related to its audit of Warner Bros. Pictures. It has produced virtually no
4 documents related to its audit of Warner Home Video. And it has produced only
5 a small set of documents related to its audit of Warner Music Group – most of
6 which were not produced until May 2007.

7 48. At the deposition of New Line's custodians of records, Mr. Horowitz
8 testified that New Line has not made *any* effort to collect internal memoranda,
9 emails, or correspondence related to the participant audits conducted by Bank of
10 New Zealand, Harper Collins, Miramax, Liv Tyler, or Saul Zaentz. **Tab X** (3/28/07
11 Horowitz Depo.) at 211:24-212:16. Both Mr. Horowitz and New Line's other
12 custodian, Dain Landon, admitted that they have done nothing to gather information
13 with respect to the audits of Warner Bros. Pictures or Warner Home Video. *Id.* at
14 239:24-240:22; **Tab Y** (3/28/07 Landon Depo.) at 298:24-300:6. While
15 Mr. Landon testified that a search had been performed for documents related to
16 New Line's audit of Warner Music Group, he had no idea what, if any, documents
17 had been collected. **Tab Y** (3/28/07 Landon Depo.) at 301:10-304:18.

19 49. This Court finds that New Line has not reasonably complied with the
20 Court's order that it produce all documents related to any audit concerning *Lord of*
21 *the Rings*. New Line has neither searched for nor produced any its internal
22 correspondence, memoranda, emails, notes, or work papers with respect to these
23 audits. It has not produced a single document related to the Bank of New Zealand
24 claim dispute arbitration that is pending or has recently been concluded. And it has
25 produced no more than a small handful of documents related to its audits of Warner
26 Home Video, Warner Music Group, and Warner Bros. Pictures. New Line's
27 repeated and unequivocal certifications that it has fully complied with the Court's
28

1 discovery orders have been seriously misleading and obfuscatory.

2 **3. New Line Has Withheld Documents Relating To The New**
3 **Zealand Tax Subsidy**

4 50. In its Second Request for Production of Documents, Wingnut
5 requested that New Line produce "[a]ll DOCUMENTS that refer or relate to, and
6 all COMMUNICATIONS regarding, any foreign tax deductions, tax credits, or
7 other tax benefit received by DEFENDANTS in connection with THE LORD OF
8 THE RINGS." **Tab H** (Wingnut's Second Set of Requests), Request No. 49. New
9 Line refused to produce any responsive documents. **Tab I** (New Line's Response
10 Wingnut's Second Set of Requests), Response to Request 49. The Court granted
11 Wingnut's motion to compel the production of documents responsive to Request
12 No. 49 in its August 23 Order and required New Line to produce all responsive
13 documents within ten days of that order. **Tab J** (August 23 Order).

14
15 51. Discovery has shown that New Line received substantial funds in
16 connection with a structured New Zealand "tax deal." New Line was represented
17 in the tax deal by the New Zealand law firm of Simpson Grierson, which engaged
18 in countless non-privileged communications with the government of New Zealand,
19 the Bank of New Zealand, and other third parties on New Line's behalf. Documents
20 held by outside counsel that pertain to work performed for a client are within the
21 "possession, custody or control" of the client for purposes of Rule 34. *See Malletier*
22 *v. Dooney & Bourke, Inc.*, 2006 WL 3476735, at *4-5 (S.D.N.Y. Nov. 30, 2006).

23
24 52. The testimony of New Line's custodian of records proves that New
25 Line has purposefully limited its production of documents concerning the New
26 Zealand tax deal to a single set of closing binders, and that New Line has neither
27 collected nor produced other responsive documents, including documents in the
28 possession its outside counsel in New Zealand. **Tab Y** (3/28/07 Landon Depo.) at

1 307:25-309:2. New Line contends that "Defendants have never received any
2 foreign tax deduction, tax credit, or other tax benefit" and that the Court's orders
3 with respect to Request No. 49 therefore did not encompass documents pertaining
4 to the New Zealand transaction. However, as Wingnut notes, documents produced
5 by New Line for the first time on February 22, 2007 show that New Line internally
6 accounted for actual proceeds from the New Zealand tax as "Tax Deal" proceeds.
7 See Plaintiff's Submission of Newly Produced Evidence in Opposition to
8 Defendants' Motions for Summary Adjudication, Docket No. 368 (filed under seal).
9 Accordingly, New Line cannot reasonably dispute that documents relating to the
10 New Zealand tax deal are responsive to Request No. 49 and that, pursuant to this
11 Court's August 23 Order, all documents related to that deal should therefore have
12 been produced.⁴

13
14 53. Based on the foregoing, the Court finds that New Line has not
15 complied with the Court's order that it produce all non-privileged documents related
16 to the New Zealand tax deal.

17 **B. New Line Has Not Conducted A Reasonably Diligent Search For**
18 **Electronic Documents**

19 54. Wingnut's document requests specifically required the production not
20 only of paper documents, but also of all forms of electronic documents. See **Tab**

21
22 ⁴New Line notes that, based on its previous denial that proceeds from the New Zealand
23 transaction were tax benefits, Wingnut propounded a request for production directed to
24 agreements with the Bank of New Zealand with respect to *Lord of the Rings*. Although New
25 Line refused to produce all documents responsive to that request, that in no way excuses New
26 Line's obligation to comply fully with Request No. 49. This is especially so in light of the fact
27 that New Line's refusal came several weeks *before* the Court's August 23 Order. Once that
28 order issued, New Line was required to comply.

1 **B** (Wingnut's First Set of Requests), Definitions ¶ 9(d) (requesting production of
2 "all forms and manifestations of electronically stored and/or retrieved electronic
3 information, in all electronic media (hard drive, diskette, or tape), including but not
4 limited to 'e-mail.'"). This Court ordered New Line to produce all documents, not
5 simply paper documents.

6 55. This Court's January 24, 2007 Order specifically required New Line's
7 custodians of records to testify regarding "defendants' record-keeping policies and
8 procedures with respect to the categories of documents defendants have been
9 ordered to produce in this action, including both paper and electronic documents
10 and defendants' search for and collection of documents for production." **Tab P**
11 (January 24 Order) at 1.

12 56. The testimony of New Line's custodians demonstrates that New Line's
13 efforts to locate and collect electronic documents has been less than diligent. Ken
14 Horowitz, who was the designated custodian with respect to documents relating to
15 participant audits of *Lord of the Rings* and other films, testified at his first
16 deposition that he was not aware of any search for electronic documents on New
17 Line's servers, on any individual's desktop or laptop computer, or otherwise. **Tab**
18 **S** (2/8/07 Horowitz Depo.) at 130:20-131:7 & 134:10-25. At the second day of his
19 deposition, Mr. Horowitz confirmed that no electronic search had been conducted.
20 **Tab X** (3/28/07 Horowitz Depo.) at 229:25-230:11.

21 57. New Line's other custodian, Dain Landon, testified that he had
22 undertaken a search of New Line's servers for documents relating specifically to
23 merchandising agreements. Mr. Landon's "search" consisted of little more than
24 clicking through various folders on the only two server drives he personally could
25 access. **Tab T** (2/8/07 Landon Depo.) at 72:25-73:25. Mr. Landon acknowledged
26 that he did not conduct or arrange for a server-wide search for documents
27
28

1 containing the phrase "Lord of the Rings" or any other keywords; indeed, he did not
2 even search for documents with "Lord of the Rings" in the title. *Id.* at 74:2-13 &
3 76:21-23.

4 58. New Line likewise failed to conduct any search of the company's email
5 servers for email correspondence containing the phrase "Lord of the Rings" or any
6 other keywords. While some individual employees were asked to collect their
7 emails, others were not; and even those employees who did collect emails were
8 given little or no guidance on where to search (*e.g.*, inbox, sent items, deleted items,
9 archived folders) or how to conduct their search (*e.g.*, keyword searching). Indeed,
10 of the eleven individuals Mr. Landon spoke to in preparation for the second day of
11 his deposition, only three told him that they had even looked for emails, and Mr.
12 Landon had no information regarding how those searches were performed. **Tab Y**
13 (3/28/07 Landon Depo.) at 273:3-279:17.
14

15 59. This Court finds that New Line has still not performed any meaningful
16 search for emails and other electronic documents. No emails or other electronic
17 documents have been collected from the audit group. Mr. Landon has performed
18 no more than a haphazard search for electronic documents, and even then only with
19 respect to merchandising agreements and only on the servers to which he happened
20 to have access. And no witness can say with any degree of certainty what
21 individuals searched their own email files or how any of those searches were
22 conducted. The most New Line's custodians can say is that any emails or electronic
23 documents that happened to have been printed in the ordinary course of business
24 and placed in the paper files would have been captured in the document collection
25 (at least to the extent those paper files were ever searched). However, a search for
26 printouts is not a search for electronic documents; it is a search for paper
27 documents.
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1 60. At the very least, New Line should have charged its in-house
2 information technology professionals with responsibility to ensure that all of the
3 company's servers and individual computers were searched, and that they were
4 searched in a manner that was reasonably calculated to capture all responsive
5 documents (e.g., keyword searches of electronic documents and emails). To the
6 extent this could not be accomplished in-house, New Line should have retained an
7 outside vendor. *See Malletier*, 2006 WL 3476735, at *8-9. Instead, New Line
8 practically disregarded its obligation to produce electronic documents at all.

9
10 **C. New Line Did Not Suspend Its Document Destruction Policy Or**
11 **Otherwise Take Adequate Steps To Preserve Documents**

12 61. Equally concerning as New Line's scant search for emails and other
13 electronic documents is its failure to suspend the automatic deletion of electronic
14 documents after this dispute arose.

15 62. Mr. Landon testified that every employee's email in-box is purged
16 every 30 days, and that the backup tapes are wiped clean on a weekly basis. **Tab**
17 **T** (2/8/07 Landon Depo.) at 45:9-46:7. Mr. Landon testified that the backup tapes
18 for other electronic documents, such as word processing files, are recycled after one
19 year. *Id.* at 46:8-14. However, New Line did not suspend the automatic deletion
20 of emails and other electronic documents as part of a litigation hold; instead, to this
21 day, emails continue to be purged from every employee's email in-box every thirty
22 days, and backup tapes continue to be recycled every week (for emails) or year (for
23 other electronic documents). **Tab Y** (3/28/07 Landon Depo.) at 293:16-294:1.

24 63. As a result of New Line's failure to suspend its automatic document
25 destruction procedures, the only email correspondence that has possibly been
26 preserved is that which an individual employee moved from his or her in-box into
27 a saved folder. And there is no assurance that even those emails are still accessible.
28

1 A number of employees involved in the facts of this case no longer work at New
2 Line, including the individual who negotiated the profit participant agreement at the
3 heart of this case (Suzanne Rosencrans) and the former head of New Line's audit
4 group (Anna Tannenbaum). Mr. Landon testified at the first day of his deposition
5 that "once a person leaves the company, I was told by our IT department after about
6 a month, any archived or stored e-mail is also deleted." **Tab T** (2/8/07 Landon
7 Depo.) at 55:19-56:2. Mr. Landon confirmed this at the second day of his
8 deposition. **Tab Y** (3/28/07 Landon Depo.) at 246:10-21. Consequently, all of the
9 emails that Ms. Rosencrans, Ms. Tannenbaum, or any other departing employee had
10 saved on the company's servers have since been destroyed.

11
12 64. New Line attempts to defend its conduct by arguing that relevant
13 documents were destroyed "long before this lawsuit was filed." In particular, New
14 Line makes much of the fact that Suzanne Rosencrans, the New Line executive who
15 negotiated the Wingnut agreement, left the company in 2003. There are two
16 fundamental problems with this argument. First, New Line was on notice of
17 potential litigation years before the lawsuit was actually filed. Wingnut commenced
18 its audit in February 2003 – *before* Ms. Rosencrans left the company and her files
19 were purged. There can be no doubt that New Line anticipated litigation long
20 before the lawsuit was filed; indeed, every document authored by Mr. Rosencrans
21 that somehow avoided deletion has been logged on New Line's privilege log as
22 "work product," *i.e.*, as having been created in anticipation of litigation. Second,
23 this litigation concerns the manner in which New Line has accounted to Wingnut
24 from the film's release *through to the present*. New Line's continued purging of
25 emails during the pendency of this litigation therefore cannot be excused.

26
27 65. Although there is no automatic purging of paper documents akin to
28 that for electronic documents, it is apparent that New Line has not taken adequate

1 steps to ensure that even paper documents are preserved. Mr. Landon testified that
2 New Line has not implemented any document retention policy. *Id.* at 41:22-42:3.
3 Mr. Landon also testified that New Line has no policy or guidelines, written or oral,
4 regarding how long paper documents should be kept or maintained. *Id.* at 42:15-24.

5 66. At the first day of his deposition, Mr. Landon further testified that New
6 Line had not taken any steps to preserve documents even after the filing of this
7 litigation. *Id.* at 68:9-69:13. Mr. Landon's testimony had changed by the second
8 day of his deposition, such that he not only knew that a document retention notice
9 had been circulated, but he now recalled that he was the one who drafted it. **Tab**
10 **X** (3/28/07 Landon Depo.) at 282:15-284:2. Mr. Landon's changed testimony is
11 difficult to credit, however, given that Mr. Landon, New Line's general counsel, and
12 numerous New Line employees have been unable to locate even a single copy of the
13 notice, and New Line's other custodian of records, who is also the head of New
14 Line's audit group, has no recollection of having ever received such a notice. *Id.*
15 at 289:18-290:7; **Tab S** (2/8/07 Horowitz Depo.) at 61:5-22; **Tab X** (3/28/07
16 Horowitz Depo.) at 207:13-16.

17 67. In light of the foregoing, the Court finds it doubtful that any litigation
18 hold notice was issued in this litigation. Moreover, even if such a notice had been
19 issued, it was not heeded, as the automatic deletion of emails and other electronic
20 documents has never been suspended. New Line's document retention efforts fall
21 far short of what the law requires.

22 **III. SANCTIONS**

23 68. The obvious and overall purpose of discovery under the Federal Rules
24 is to require disclosure of all relevant information, so that the ultimate resolution
25 of disputed issues is based on a full and accurate understanding of the facts and
26 therefore embodies a fair and just result. *See United States v. Procter & Gamble*
27
28

1 Co., 356 U.S. 677, 682 (1958). The rules are intended to operate with minimal
2 judicial involvement and to rely on the honesty and good faith of counsel in dealing
3 with adversaries. See *Rozier v. Ford Motor Co.*, 573 F.2d 1332, 1345 (5th Cir.
4 1978) ("Our system of civil litigation cannot function if parties . . . suppress
5 information called for upon discovery.").

6 69. For the discovery system to function properly, the costs of resisting
7 discovery must be sufficiently great so that the benefits to be gained from sharp or
8 evasive discovery practices are outweighed by the sanctions imposed when those
9 practices are discovered. It is not enough that an offender belatedly comply with
10 its discovery obligations; "[i]f the only sanction for failing to comply with the
11 discovery rules is having to comply with the discovery rules if you are caught, the
12 diligent are punished and the less than diligent, rewarded." *Poole v. Textron, Inc.*,
13 192 F.R.D. 494, 506 (D. Md. 2000).

14 70. Wingnut has suffered three distinct forms of prejudice as a result of
15 New Line's persistent disregard of the Court's discovery orders. First, Wingnut has
16 been and continues to be denied access to documents that the Court has already
17 determined are relevant to the claims and defenses in this action. Without access
18 to the true facts, there can be no just result. *Valley Eng'rs Inc. v. Electrical Eng'g*
19 *Co.*, 158 F.3d 1051, 1058 (9th Cir. 1998) ("There is no point to a lawsuit, if it
20 merely applies law to lies. True facts must be the foundation for any just result.").
21 Second, New Line's failure to timely produce documents in response to Wingnut's
22 requests and this Court's orders resulted in Wingnut being forced to complete its
23 fact depositions of New Line's witnesses before New Line produced the lion's share
24 of its documents; indeed, less than forty percent of New Line's entire production to
25 date was produced prior to the August 10, 2006 discovery cutoff. Finally, Wingnut
26 has been forced to incur substantial attorneys' fees and costs as a result of New
27
28

1 Line's failure to comply with its discovery obligations and the discovery orders.

2 **A. Potential for Plaintiff's On-Site Access To Audit Files**

3 71. New Line has not fulfilled its obligation to produce responsive
4 documents from its audit files. With respect to both *Lord of the Rings* and other
5 films, New Line has been ordered to produce documents related to and
6 communications regarding participant audit claims. The orders do not distinguish
7 between internal and external correspondence and do not exclude memoranda,
8 notes, emails, work papers, or documents related to legal proceedings arising from
9 participant audit claims. Yet, the head of New Line's audit group conceded that
10 New Line has deliberately limited its searches – in the first instance to audit reports,
11 responses, and settlement agreements, and in a subsequent search to external
12 correspondence.
13

14 72. New Line has had no fewer than five opportunities to comply with its
15 obligation to collect and produce all responsive third-party audit documents – *first*,
16 by the compliance date set forth in the Court's August 23 Order; *second*, by the
17 November 30 certification date set forth in the Court's November 7 Order; *third*, in
18 advance of the custodian of records depositions ordered in the Court's January 24
19 Order; *fourth*, following Wingnut's filing of its Report on Custodian of Records
20 Depositions and the Court's order that the custodians reappear for deposition; and
21 *fifth*, in advance of this filing. Yet, New Line still has not complied. It will be
22 afforded one final and brief opportunity.

23 73. In light of New Line's studied non-compliance with this Court's prior
24 discovery orders, the Court has determined that Wingnut's counsel would be
25 permitted to directly inspect and arrange for the copying of New Line's audit files
26 on site, but only if all responsive third party documents are not produced within 21
27 days of the date of this Order. New Line will, of course, retain the right to
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1 withhold from inspection and copying the audit file documents—if any—that have
2 been logged on New Line's privilege log. In the event that any individual members
3 of the audit group, or of the broader participations and contract accounting
4 department, have their own audit work papers, those shall also be made available
5 for inspection and copying within 21 days. New Line shall within 21 days also
6 provide a sworn declaration from the head of its participations and contract
7 accounting group confirming that all such audit files have been made available for
8 Wingnut for inspection and copying.

9
10 74. At the same time New Line produces participant audit files for
11 inspection and copying, New Line shall also make available all files from its
12 international distribution, home video, and music divisions relating to any ongoing
13 or completed audits concerning *Lord of the Rings*. As with the participant audit
14 files, these are files that New Line has repeatedly been ordered to produce, but from
15 which only a small handful of documents has actually been produced. The Warner
16 Bros. audit files made available to Wingnut for inspection and copying shall include
17 not only department files but also any individual employee's separate work files.
18 The files shall be made available on the same terms set forth above, and New Line
19 shall file a sworn declaration from the president of each of the foregoing divisions
20 within 21 days confirming that all such files have been made available to Wingnut
21 for inspection and copying. Failing total compliance with the above orders, the
22 court will grant plaintiff's counsel direct access to the subject files on shortened
23 notice.

24 **B. Outside Vendor To Collect Emails And Other Electronic**
25 **Documents**

26 75. New Line's failure to perform any structured search for emails and
27 other electronic documents from the company's servers and from individual
28

1 employees' desktop or laptop computers requires a different solution. Nor does the
2 Court have any confidence that once again ordering New Line to conduct a good
3 faith search for electronic documents will be any more effective than it has in the
4 past. The Court has determined that, under the circumstances here presented, New
5 Line should be required to retain an outside vendor experienced in electronic
6 document retrieval to collect responsive documents.

7 76. The Court finds the decision in *Tulip Computers Int'l B.V. v. Dell*
8 *Computer Corp.*, 2002 WL 818061 (D. Del. Apr. 30, 2002), instructive. The
9 plaintiff in *Tulip*, like Wingnut here, expressed concerns over a period of months
10 "about what it perceived to be gaps in [defendant] Dell's document production"
11 related to the issues in dispute. *Id.* at *2. In response, Dell "repeatedly denied that
12 such documents existed" and "maintained that they had produced all responsive
13 documents that they had." *Id.* Then, more than nine months after plaintiff had
14 served its requests for production, Dell disclosed for the first time the existence of
15 an off-site warehouse containing a large number of documents that had not
16 previously been disclosed. *Id.* Dell maintained that it had disclosed the existence
17 of these documents as soon as it discovered them, and Dell ultimately provided
18 Tulip access to the documents. *Id.* at *3-4. However, Tulip argued that the Court
19 could no longer trust Dell's representations regarding its collection of other
20 documents, including email correspondence from its employees' computers. *Id.* at
21 *4. Tulip therefore sought an order requiring Dell to allow an outside vendor to
22 conduct a search of emails from the hard drives of specified Dell executives. *Id.*

23
24 77. In granting Tulip's request for relief, the Court spoke directly to the
25 issues we are confronted with here:

26 Tulip seeks this [email] discovery, and contends that Dell's prior
27 pattern of behavior in blocking discovery and inaccurately stating that
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1 no responsive documents could exist in certain places that were
2 subsequently found to have responsive documents, causes it to doubt
3 Dell's representation that all relevant documents have been
4 produced....

5 ...

6 ...[I]t is apparent that Dell has not fulfilled many of its basic
7 discovery obligations in this case. Dell's failure to identify an off-site
8 warehouse which contained responsive information, its failure to take
9 steps to prevent the destruction of potentially responsive documents,
10 and its inaccurate representations about the scope of discoverable
11 information accessible in its own data warehouse indicates either a
12 failure to take its discovery obligations with the required degree of
13 seriousness and diligence or an extreme lack of knowledge and control
14 over its own files and procedures. The latter seems unlikely for a
15 party as large and sophisticated as Dell.
16

17 ...

18 The court will next turn to the e-mail based discovery that Tulip
19 seeks. Counsel for Dell has repeatedly argued that because Tulip has
20 not shown that Dell breached its discovery obligations with regard to
21 e-mail, the court should not accede to Tulip's request. Dell's argument
22 misses the mark. The history of Dell's failures to cooperate in the
23 discovery process—and its sweeping but inaccurate positions that
24 Tulip would never find certain documents that Tulip, through
25 persistence and diligence, later uncovered—counsel in favor of
26 awarding Tulip some relief that allows them to ascertain for
27 themselves whether Dell's representations that all responsive
28

1 documents have been produced are accurate. Moreover, counsel for
2 Dell could not represent to the court that it has thoroughly searched
3 these e-mail records for responsive information.

4 The procedure that Tulip has suggested for the discovery of e-
5 mail documents seems fair, efficient, and reasonable. Dell shall
6 provide the e-mails from the hard disks of the identified executives in
7 electronic form to [the outside vendor]. [That vendor] will search the
8 e-mails based on an agreed upon list of search terms. Tulip will give
9 Dell a list of the e-mails that contain those search terms. Dell will then
10 produce the e-mails to Tulip, subject to its own review for privilege
11 and confidentiality designations.
12

13 *Id.* at *4-7.

14 78. New Line's discovery order non-compliance is more serious than the
15 defendant in *Tulip*. In *Tulip*, there had been no prior discovery orders requiring the
16 production of the subject documents; only compliance with the documents requests
17 themselves was at issue. Here, by contrast, New Line has repeatedly been ordered
18 to produce the documents. In *Tulip*, Dell had not certified to the court that it had
19 conducted a diligent search for all responsive documents and that all such
20 documents had been produced. Here, by contrast, New Line and its counsel have
21 repeatedly certified their purported compliance with the discovery orders. In *Tulip*,
22 Dell had voluntarily disclosed its discovery of an off-site warehouse containing
23 documents that had been overlooked in its initial search. Here, by contrast, New
24 Line has never admitted to any discovery failures, such that Wingnut has been
25 forced to incur the time and expense of multiple motions to compel, multiple
26 motions to enforce the discovery orders, and multiple custodian of records
27 depositions simply to bring those failures to light. And in *Tulip*, there was no
28

DEMANDED

1 reason to doubt Dell's representations regarding its search for email correspondence
2 other than the fact that Dell's representations regarding its production of other
3 documents had proven to be inaccurate. Here, by contrast, the Court is presented
4 not only with a record of New Line's repeated breach of its discovery obligations,
5 but also with specific proof—in the form of custodian of records testimony—that
6 New Line's search for electronic documents has been anything but diligent.

7 79. New Line shall be required to retain an outside vendor, to be jointly
8 selected by the parties, within 21 days of this date, to collect electronic documents
9 and email correspondence that are within the scope of the Court's discovery orders.
10 The vendor shall be granted access to New Line's servers, including without
11 limitation its email server(s), for the purpose of conducting keyword searches for
12 responsive documents and emails. The vendor shall also be granted access to the
13 hard drives from the desktop and laptop computers of specified employees who are
14 connected with this dispute for the purpose of conducting keyword searches. All
15 documents and emails collected by the outside vendor may be reviewed by New
16 Line for privilege and confidentiality designations; however, no documents
17 identified by the vendor may be withheld on relevance grounds.

18 80. The vendor shall prepare a log of all collected documents so that
19 Wingnut can confirm that all such documents are either produced or logged. In the
20 event that the parties are unable to agree upon the identity of the outside vendor, the
21 search protocol, or the individual employees whose desktop and laptop computers
22 will be provided for inspection, those disputes should be promptly submitted to the
23 Court for resolution. New Line shall bear all costs and expenses of the outside
24 vendor.
25

26 ///

27 ///

SCANNED

1 **C. Production Of Documents By New Line's Outside Counsel In New**
2 **Zealand**

3 81. As discussed above, the testimony of New Line's custodian shows that
4 New Line did not collect all documents related to the New Zealand tax deal, as the
5 Court has ordered, but instead directed its outside counsel in that transaction,
6 Simpson Grierson, to produce only the closing binders from the transaction. This
7 is easily remedied. New Line shall produce, and shall direct Simpson Grierson to,
8 produce all responsive documents, withholding only those documents that have
9 been logged on New Line's privilege log. Wingnut will treat all produced
10 documents as "Attorneys' Eyes Only" unless the parties agree upon or the Court
11 orders that a different confidentiality designation shall apply.
12

13 **D. Poential Depositions Regarding Late-Produced And Destroyed**
14 **Documents**

15 82. Wingnut has requested that New Line be ordered make its previously-
16 deposited fact witnesses available for questioning in light of New Line's late-
17 produced documents and failure to implement an effective litigation hold and to
18 suspend its automatic email destruction practices during the pendency of this
19 litigation.

20 83. Although the court reserves ruling on this request, the Court
21 concludes that targeted additional depositions likely will be warranted and that,
22 following compliance with the other portions of this Order, the court will likely will
23 order that New Line shall make its previously-deposed fact witnesses available, at
24 its sole expense, for examination regarding (1) documents produced on or after the
25 discovery cutoff and the matters identified therein; and (2) any documents that have
26 been destroyed as a result of New Line's failure to implement an effective litigation
27 hold or to suspend its automatic email destruction practices during the pendency of
28

1 this litigation.

2 **E. Monetary Sanctions**

3 84. Wingnut is entitled to reimbursement of much of the substantial costs
4 it has incurred as a result of New Line's failure to timely comply with this court's
5 discovery orders. Rule 37(b)(2) provides that, in addition to the other sanctions the
6 court may in its discretion impose, "the court shall require the party failing to obey
7 [an] order or the attorney advising that party or both to pay the reasonable expenses,
8 including attorney's fees, caused by the failure." Fed. R. Civ. P. 37(b)(2). Except
9 where the offender's conduct was "substantially justified" or an award of expenses
10 is otherwise "unjust" – neither of which describes the present case – Rule 37
11 sanctions are mandatory and "must be applied diligently both 'to penalize those
12 whose conduct may be deemed to warrant such a sanction, [and] to deter those who
13 might be tempted to such conduct in the absence of such a deterrent.'" *National*
14 *Hockey League v. Metropolitan Hockey Club, Inc.*, 427 U.S. 639, 43 (1976) (*per*
15 *curiam*).

16
17 85. Sanctions are likewise mandatory under Rule 26(g), which requires
18 that counsel make a reasonable investigation and effort to certify that the client has
19 provided all information and documents available to it which are responsive to a
20 discovery request – something that New Line's counsel has plainly failed to do here.
21 Fed. R. Civ. P. 26(g)(3) (When Rule 26(g) is violated without substantial
22 justification, "the court . . . shall impose upon the person who made the
23 certification, the party on whose behalf the disclosure, request, response, or
24 objection is made, or both, an appropriate sanction, which may include an order to
25 pay the amount the reasonable expenses incurred because of the violation, including
26 a reasonable attorney's fee." Fed. R. Civ. P. 26(g)(3) (emphasis added). The court
27 finds without equivocation that defendants' actions have been without substantial
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SCANNED

1 justification.

2 86. This Court has considered the sobering, though plausible, award of
3 attorneys' fees and costs sought by Wingnut in connection, specifically, in regard
4 to the 1) Renewed Motion to Enforce Discovery Orders, 2) the Custodian of
5 Records Depositions, 3) and the current Motion, as set forth in Mr. Klieger's
6 August 21, 2007 Declaration, and finds them to be substantially reasonable.
7 Despite this court's prior reticence to impose sanctions, at a minimum there was no
8 substantial justification for requiring Wingnut to go through the exercise of 1) the
9 Renewed Motion, 2) the Custodian of Record Depositions, or 3) filing of the
10 current Motion (and the Opposition to Defendants' Motion). However, the court
11 affords defendant the opportunity to challenge the reasonableness of plaintiff's
12 billings as to the three items listed above.
13

14 87. Based on the foregoing, this Court GRANTS Wingnut's Motion for
15 Sanctions and orders as follows:

16 A. Within twenty-one (21) days of the date of this Order, New Line shall
17 produce all audit files on the terms set forth in paragraphs 73 and 74 of this Order;

18 B. Within twenty-one (21) days of the date of this Order, New Line shall
19 retain, at its expense, an outside vendor, to be jointly selected by the parties, to
20 collect electronic documents and email correspondence that are within the scope of
21 the Court's discovery orders in accordance with paragraphs 79 and 80 of this Order;

22 C. New Line shall produce, and shall direct Simpson Grierson to
23 produce, all responsive documents within twenty-one (21) days of the date of this
24 Order, withholding only those documents that have been logged on New Line's
25 privilege log. Wingnut shall treat all such documents as "Attorneys' Eyes Only"
26 unless the parties agree upon or the Court orders that a different confidentiality
27 designation shall apply;
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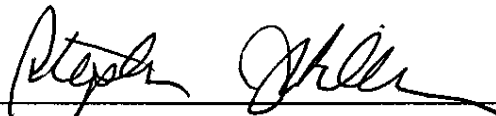
1 D. Following the completion of the electronic document collection and
2 production, Wingnut may move on shortened notice to make New Line's
3 previously-deposed fact witnesses available for examination regarding (1)
4 documents produced on or after the discovery cutoff and the matters identified
5 therein; and (2) any documents that have been destroyed as a result of New Line's
6 failure to implement an effective litigation hold or to suspend its automatic email
7 destruction practices during the pendency of this litigation; and

8 E. Within ten (10) days of the date of this Order, defendants shall file any
9 additional Opposition as to why a reasonable, substantial portion of Wingnut
10 attorneys' fees and costs in the appropriate amount of \$125,000 should not be
11 imposed as sanctions on defendants. The Opposition shall be limited to addressing
12 Mr. Klieger's Declaration, and the related billing records.
13

14 F. Defendants' Cross-Motion is DENIED.

15 IT IS SO ORDERED.

16 DATED: 9/18/07

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20 STEPHEN J. HILLMAN
21 UNITED STATES MAGISTRATE JUDGE
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