

## Records Retention In E-discovery And Litigation Environments

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### OVERVIEW

How should retention periods be devised for records that have a good probability of being subject to discovery and used in litigation? Perhaps the best way of introducing the importance of this topic is to cite some observations of U.S. senator Patrick Leahy. Commenting on the Arthur Andersen case, Senator Leahy wrote that “As a former prosecutor, I know that no matter how egregious the crime, you can’t prove a case without the evidence.” In organizational life today, the job of writing rules prescribing how long records—potentially legal evidence—are retained falls to records management specialists, working in close concert with lawyers. These retention rules must be designed in a manner that renders them legally sufficient should they come under scrutiny during the course of e-discovery or litigation. This article prescribes some recommended principles and practices for achieving this objective. The issue of records retention in e-discovery/litigation is perhaps of greatest concern for businesses that manufacture products that are subject to failure in performance or which may be harmful to the environment or to the health of consumers or the general public. Today, however, no organization is immune from these risks.

IT, records management, and legal personnel need to work together on process and procedures to make records retention work.

## PART 1: RECORDS RETENTION WHEN LITIGATION IS PROBABLE

Let's begin with one of the cardinal principles of records retention where litigation is concerned: Depending on how things work out, records in litigation can be a blessing or a curse. In other words, any particular record can be favorable or unfavorable to the organization's case. This being the case, as a general rule of thumb in a litigation-intensive environment, the fewer records the better. Although there are exceptions, this is true much more often than not. In litigation, it's not the records you no longer retain that cause the most problems, it's those that remain. If an organization no longer retains a certain record and that record is requested as evidence during legal proceedings, the organization must merely justify why that record no longer exists. If, on the other hand, the record still exists and is requested, it must be produced as evidence and its contents must be defended if they become at issue during the proceedings. In general, attorneys can more easily defend the absence of documents that have been properly and systematically destroyed under an established retention policy than they can defend the information content of existing records.

To reiterate, the "bottom line" is this: In discovery/litigation, it's not the records that have been routinely and properly discarded that cause the most problems, it's those that still exist. Thus, from a litigation risk avoidance perspective, the goal should be to retain only those records needed to conduct business and comply with the law. All other records should be systematically disposed of under retention policies that are as short as possible. The remainder of this article discusses some practical methods of achieving this.

### Two Golden Rules Of Retention In Litigation

Let's now turn to issues related to establishing retention periods for records that may become material in future litigation or other legal proceedings. In situations where litigation is probable, should the retention periods for records that may encounter use in litigation be longer or shorter? Is it better to retain the records for longer periods of time, in situations where it is believed that they will be favorable or "exculpatory" to the organization in such actions? Or, if it is believed that the records may be harmful or even incriminating to the organization, would a shorter retention period be in the organization's best interest? To answer these questions it is necessary to state the two Golden Rules of retention decision-making.

1. **Retention Periods Must Be Reasonable Under The Circumstances**—Assuming all retention periods are fully compliant with all applicable statutes and regulations, the next most important thing is that they be formulated such that they can be defended as reasonable from both business and legal points of view. To meet the test of reasonableness, retention periods should be not too long and not too short. This simple yet often elusive principle is the foundation for records retention policies that may come under legal scrutiny. The balance of this article is about how to do this.
2. **Retention Periods Must Avoid Any Inference Of Bad Faith**—This means that, when the retention periods were devised, the organization knew or should have known that a particular type of record had a high probability of being used in litigation. Thus, if the retention period was set too short, it could be inferred that the organization acted in bad faith as it was motivated to rid itself of evidence that may be, in future litigation, unfavorable to its defense. In other words, absent statutory/regulatory mandates to retain them, organizations may feel at liberty to rid themselves of older records, but in situations where litigation is probable, the retention periods must not be so short that they give rise to inferences of bad faith. With these key principles in mind, let's turn the discussion to some practicalities of retention decision-making when litigation is probable.

### Government-Mandated Retention Requirements

In deciding how long any business record should be retained, the very first question to be answered is whether its retention is mandated by the government. There are three scenarios:

- The government is silent on retention. Under this scenario, no statute or regulation can be found which prescribes, directly and specifically, how long a particular type of record must be retained. In other words, where such records are concerned, the government is silent on the question of retention. This scenario is far more common than is often supposed. In fact, even for businesses that are subject to heavy regulation (for example, pharmaceutical firms) the percentage of their records for which no retention law or regulation can be found generally hovers around 50 percent. In these cases, the business may feel at liberty to establish a retention period consistent with the expiration of the

value of the records for business purposes. If, however, the records have a history or future probability of being used in litigation, this period needs to be defensible as reasonable and in good faith.

- The government imposes specific retention requirements. Under this scenario, a statute or regulation can be found that specifically and directly mandates the retention of a given type of record for a stated period of time; that is, retention rules exist and they are expressly stated. There are at least 20,000 such provisions in U.S. law alone. Where applicable, they constitute the minimum period of retention for the records to which they relate. However, as discussed below, regulated parties can (and frequently do) exceed them by establishing longer periods of retention, as required by business needs and other legal considerations.
- The government imposes non-specified requirements to maintain records. Under this scenario, a statute or regulation can be found which mandates the retention of a particular type of record, but the language is silent on how long regulated parties are obliged to retain them. This scenario is by no means uncommon. In fact, of the some 20,000 retention requirements in U.S. law, perhaps a fourth do not specify the requirement in terms of a definite period of time. This situation, of course, does nothing to resolve the uncertainty of regulated parties as to what period of retention would be advisable. While some persons consider that these “non-specified” retention requirements justify “indefinite” retention, we do not generally endorse this interpretation. Rather, in these scenarios, organizations should feel at liberty to establish a period of retention consistent with its own business needs, as long as it is believed this could be defended as reasonable and in good faith.

## Retention Periods When Statutes Of Limitation Are Relevant

In the context of any discussion concerning records retention and litigation, the relevance of statutes of limitation needs careful consideration. These laws do not impose any records retention mandates on regulated parties; rather, they specify the length of time that the parties in some type of legal relationship may institute legal proceedings against each other. Thus, they are of high—but indirect—importance to records retention, since they indicate the length of time that relevant records may possess legal value and thus may be needed in the resolution of disputes concerning the matters to which they relate. Following is a discussion of the several statutes of limitation that are of most relevance to the retention of corporate records.

### □ Contracts and agreements

These laws give parties in contractual relationships the right to sue for breach; that is, to seek relief from the courts in cases where they believe their enforceable rights under the contract have been violated. Among the U.S. states, the period of time during which such suits may be brought varies from three to 20 years, generally beginning from the date of the breach, with six years being the average. For contracts and agreements involving long-term liabilities or elevated risks, the retention is often established at the long end of the range. During these periods of time, it is advisable—but not legally required—that the parties retain whatever records they believe would be useful to either prosecute a suit against another party or defend one against themselves, keeping in mind that the presence or absence of any such records may be either helpful or harmful to the case of either party. Since it is probable that most legal actions will be instituted either during the active life of the contract or soon thereafter, most organizations have elected to go with the average, rather than the longest statute of limitation, in cases where multiple jurisdictions are involved. Finally, it should be noted that some contracts and agreements contain provisions specifying the retention obligations of one or both parties. Where such provisions exist, they should be checked and complied with as a matter of policy and practice.

### □ Personal injury

These laws give parties who have suffered injury, generally resulting from negligence, the right to sue for damages. Among the U.S. states, the period of time during which such actions may be instituted varies from one to 10 years, with three years being the average. Again, during these periods of time, it is advisable, but not legally required, that the party against which proceedings may be instituted needs to retain such records to defend itself.

### □ Improvements to real property

These laws give owners of buildings and other physical facilities the right to institute legal proceedings to recover damages resulting from structural or other failures occasioned by faulty work performed by the architects, engineers, or construction companies who designed or built them. Among the U.S. states, the period of time during which such suits may be brought varies between four and 20 years, with 10 years being the average. Once again, during these periods of time it is advisable, but not legally required, that the parties involved retain such records to either prosecute a suit or defend themselves against one.

## PART 2: COMMON RETENTION BENCHMARKS AND STANDARDS

Regardless of whether litigation/discovery is probable or not, as a practical matter, records retention is about making choices between alternatives or options. That is, an organization may elect to retain a particular record for a time period of one year or even less. Or, at the other extreme, the organization may elect to retain the record for many years or even in perpetuity. Finally, between these extremes, the alternative choices are abundant—two or three years, five to seven years, 10 to 20, etc. For many corporate people, the infinite number of choices makes for an utterly bewildering situation. Given the plethora of choices, how can some degree of logic be applied to this decision-making process? Let's answer this question by presenting some common records retention benchmarks and standards.

### When Litigation Is Probable, Retain At Least Three Years

For all business records, the average retention period falls in the three- to seven-year range. In cases where litigation is probable, organizations should seldom, if ever, retain a given set of records less than the average retention period. If they do so, they may be at risk of violating the “knew or should have known” standard discussed above, thereby exposing themselves to possible adverse inference consequences. In other words, when litigation is probable, three years should be considered the minimum retention period, notwithstanding any other legal or business consideration.

In U.S. law, there is some statutory basis for this retention posture: According to the Uniform Preservation of Private Business Records Act (“UPPBRA”), business records can be discarded after three years unless a longer time period is required by law. Moreover, under the Paperwork Reduction Act of 1980, federal agencies wishing to impose records retention burdens on regulated parties in excess of three years are obliged to justify why such burdens are in the national interest. A minimum retention of three years has also been affirmed in many specific regulatory schemes and by case law as well.

### For Records Of Transitory Value, Retain Less Than Three Years

The foregoing is not to suggest that the minimum retention period of all business records must or should be three years. For records of transitory value and when litigation is neither probable nor foreseeable, organizations should feel at liberty

to apply retention periods shorter than three years. For example, retention periods of one year are often assigned to duplicates, drafts, and working papers. Frequently, retention policies authorize disposal of such records immediately upon having been superseded by newer versions of documents, or upon completion of the projects to which they relate. Under no circumstances should such records be retained longer than the period of retention assigned to the official copies.

### Financial Records And Tax Documentation

Let's now turn the discussion to a key aspect of corporate records retention—financial records and tax documentation. In one sense, these types of records are no more likely to be subject to litigation/discovery than any other records. The legal issues surrounding them are, however, of high importance as common retention benchmarks and standards for corporate records, and thus they are pertinent for purposes of this article.

### The SOX Seven-Year Retention Standard

The Sarbanes-Oxley Act of 2002 (“SOX”) does not address the requirements of a records retention program that can be demonstrated to be in compliance with its provisions. The Act does, however, contain several provisions pertaining to records retention and document destruction. The most important one is of very narrow applicability—the retention of audit records of public accounting firms. The Act requires registered public accounting firms to “prepare, and maintain for a period of not less than seven years, audit workpapers, and other information related to any audit report, in sufficient detail to support the conclusions reached in [the audit report].”

It is important to note that this seven-year retention requirement in SOX does not apply to records maintained by the audited companies themselves. Rather, it is limited to records maintained by public accounting firms. Rules promulgated by the U.S. Securities and Exchange Commission state that audited companies are not required to retain copies of records that public accountants have examined during their audits and reviews; but of course they may do so at their discretion. However, some analysts have asserted that SOX creates an “implied” though not expressed requirement for seven-year retention of most if not all financial, accounting or other records that would be needed to demonstrate compliance with the Act. Thus, a minimum “default retention” of seven years is often recommended for records needed to demonstrate compliance with SOX,

unless other laws, regulations, or business requirements necessitate a longer period. We should also mention that the SEC has issued rules under SOX that specify a seven-year retention requirement (17 C.F.R. §210.2-06).

### **Tax Documentation: The Traditional Seven-Year Retention**

Even before the enactment of SOX in 2002, seven years has been common practice in the United States for the retention of supporting tax documentation by corporate taxpayers for many years. It should be noted, however, that financial statements, books of account and other summary financial records are often retained considerably longer, sometimes permanently.

To arrive at a better understanding of the situation concerning the retention of supporting tax documentation, a little background is necessary. Contrary to popular belief, there is nothing in the Internal Revenue Code, or any of its implementing regulations, prescribing a seven-year period of retention for any tax documentation subject to audit scrutiny. For that matter, there is nothing in the Code limiting taxpayer liability to seven years.

Briefly, the situation is this: In matters of federal corporate taxation, the IRS has three years to conduct audits of taxpayers' accounts (a period of time referred to as a "limitation on assessment"), after which it forfeits its right to do so. However, extensions for an additional three years are often sought and granted, which makes six years. Further, an additional year must be added because the period of the limitation on assessment does not start running until the year after filing; thus, six plus one additional year equals the "standard" retention of seven years.

Finally, one additional caveat must be applied to the seven-year standard for tax documentation: For a given tax year, the tax documentation of corporate taxpayers can remain open to scrutiny by revenue authorities for still longer periods of time; sometimes 10 years or longer. "Open" tax years do not become "closed" until all audit exceptions—disputes between the IRS and taxpayers as to the legitimacy of deductions or other issues in dispute—have been resolved. Sometimes these disputes cannot be resolved administratively and evolve into litigation, which must be adjudicated by the tax courts. Resolution of these matters can take many years. Thus, supporting tax documentation for a given tax year is not subject to disposal until audit closeout has occurred.

### **Retention Longer Than The Norm: 10 Years To Permanent**

We have said that the issue of records retention where discovery/litigation is probable is of greatest concern for businesses that manufacture products that are subject to failure in performance and/or which may be harmful to the environment or to the health of consumers or the general public. For the records documenting these matters, let's conclude this article by noting some retention requirements that are longer than the norm of three to seven years. It should be noted that this list of long-term records is illustrative rather than exhaustive; organizations typically retain many types of records for extended-term retention periods; these are just a few for which discovery/litigation is probable.

#### **Product design and development records**

For many engineered/industrial products, as well as drugs and drug devices manufactured by pharmaceuticals firms, companies generally retain many types of product design and development records for the commercial life of the product plus a period of years thereafter (generally ranging between five and 15 years), during which time litigation may occur in cases where the products fail in performance and/or result in harm to the health of consumers/users. In cases where such products enjoy a long life in the commercial marketplace, such retention can be tantamount to permanent. However, records documenting the quality of products during the manufacturing process before their introduction into the stream of commerce (for example, product testing and inspection records) are typically retained for shorter periods of time. Retention periods ranging from three to seven years are common. Finally, if the products are subject to warranty, records needed in the administration of warranty claims are generally retained for the life of the warranty, plus some period of time thereafter (frequently three years).

#### **Environmental records**

As a general principle, companies owning environmentally sensitive properties and facilities are obliged to retain in perpetuity records showing the environmental status of the property, including records documenting the remediation of pollution or other environmental damage. This is because, even though a property owner may divest itself of such land or facilities, the liabilities associated with ownership never fully extinguish. In other words, companies owning environmentally sensitive properties are obliged, indefinitely, to defend their stewardship of them. Other environmental records, however, can be disposed of after relatively short retention periods. These include monitoring and reporting records, records documenting the disposal of non-hazardous wastes, etc. Retention periods of three to 10 years are common for these types of records.

### Employee health and safety records

Under regulations of the U.S. Occupational Safety and Health Administration, for employees who are exposed to hazardous substances in the workplace, or in cases where long-term health effects may result from conditions of employment, companies must retain records of such exposure, as well as employee medical records, material safety data sheets and related records, for a minimum of 30 years. Records documenting exposure to certain specific hazardous substances must be retained even longer—40 years or duration of employment plus 20 years, whichever is longer. (See 29 C.F.R. §§1910.1018(q), and 1910.1044(p).) Such retention requirements are, of course, tantamount to permanent. For companies having no involvement with hazardous substances in the workplace, records documenting the safety of the workplace, including accident and injury records, are typically retained for a minimum of five years. This period of retention is compliant with government regulations, and is generally sufficient to address the statutes of limitation for personal injury discussed earlier.

### CONCLUSION

The retention guidance discussed above has always been an important matter for businesses. From an operational standpoint, records retention is the heart of the institutional memory that keeps a business running. From a legal standpoint, records retention is both a sword and a shield. But it is a difficult weapon to wield properly. The retention guidance discussed above consists of general principles associated with the retention of common corporate records. It must not be construed to constitute legal advice. Organizations are obliged to arrive at their own judgments concerning the retention of any and all records they own, based on a careful assessment of laws and regulations, business requirements, and other factors.

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