UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

GUCCI AMERICA, INC., Plaintiff, v. FRONTLINE PROCESSING CORPORATION; WOODFOREST NATIONAL BANK; and DURANGO MERCHANT SERVICES, LLC d/b/a NATIONAL BANKCARD SYSTEMS OF DURANGO, Defendants.	09 CIV. 6925 (HB)

PLAINTIFF GUCCI AMERICA, INC.'S MEMORANDUM OF LAW IN SUPPORT OF AN ORDER IMPOSING SANCTIONS UPON DEFENDANT DURANGO MERCHANT SERVICES, LLC

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June 30, 2010

TABLE OF CONTENTS

TABLE OF CONTENTS
[Continued]

Page

TABLE OF AUTHORITIES

Page(s)

Cases

Rules

In connection with the evidentiary hearing scheduled for June 30, 2010, Plaintiff Gucci America, Inc. ("Gucci") submits this memorandum of law in support of an order imposing sanctions upon Defendant Durango Merchant Services, LLC ("Durango") for various discovery misconduct.

PRELIMINARY STATEMENT

For more than six months, Gucci has been working diligently to obtain discovery from Durango. Durango has consistently refused to comply with even the most basic rules of discovery, including failing to timely respond to Plaintiff's interrogatories and neglecting to institute a litigation hold. In recent weeks, Gucci learned that Durango not only failed to adequately preserve documents, but that key executives at Durango deliberately wiped their hard drives with the assistance of a file scrubbing program from Lavasoft called "File Shredder." At the recent deposition of Nathan Counley, an account manager at Durango, Mr. Counley revealed that he and Durango's co-owner purchased File Shredder only "a couple of weeks ago" and have since run the program several times, including in the two days preceding Mr. Counley's deposition. Mr. Counley testified that he ran the program on two separate computers—the Toshiba laptop that he used prior to November 2009 and the Asus laptop he has been using since then. Worse still, Durango's file scrubbing coincided directly with Gucci's statement to this Court that it might seek to have Durango's hard drives imaged as a result of continuing deficiencies in Durango's responses to Gucci's document requests. As a result of Durango's deliberate destruction of documents relevant to the claims in this litigation, Gucci now seeks an award of sanctions pursuant to this Court's inherent power and Federal Rule of Civil Procedure 37.

STATEMENT OF FACTS

A. Durango's Discovery Responses in this Litigation Have Been Consistently Deficient

On August 5, 2009, based in part on the information uncovered in connection with the Laurette litigation, Gucci filed its Complaint in this case alleging various forms of trademark infringement against Durango and others. As the Court made clear in its October 22, 2009 pre-trial scheduling order, discovery was to move forward while Defendants' motion to dismiss was pending. Accordingly, on December 4, 2009, Plaintiff served its first requests for production on Durango. *See* Declaration of Jennifer Halter, dated June 30, 2010 ("Halter Decl."), Ex. 1, (Plaintiff's First Request for the Production of Documents by Durango). Among the categories of documents requested from Durango were:

- *Request No. 3:* All documents, including any documents stored electronically, relating to Durango's review of Laurette's website, business model, or business operations, including, but not limited to, internal memoranda, e-mails, and correspondence.

- *Request No. 4:* All communications, including any communications stored electronically, between Nathan Counley and Laurette, including, but not limited to, e-mails, faxes, and other correspondence.

- *Request No. 13:* All documents, including any documents stored electronically, referring or relating to merchants whose websites sell Replica Products, including, but not limited to, any applications, account statements of such merchants, diligence materials, approval memoranda, sales data, e-mails, and other correspondence.

- *Request No. 15:* All documents, including any documents stored electronically, reflecting notifications received by Durango that any of its merchants may be infringing upon trademarks or selling counterfeit goods, including, but not limited to, any cease-and-desist letters.

Durango's response to Gucci's requests for production—which included a mere six pages of emails—were anything but forthcoming, and necessitated a series of letters and emails between counsel for Gucci and Durango. *Id.*, Exs. 2-4 (May 5-10, 2010 correspondence

between Gucci and Durango). Among the deficiencies noted by Gucci was Durango's production of only a handful of emails despite the fact that Mr. Counley used email as regular means of communicating with the replica merchants he serviced. Gucci even provided examples of such emails to Durango, which had been produced by defendants in the Laurette litigation. Gucci also raised concerns about Durango's failure to produce emails that Gucci knew to exist and that would be responsive to the categories of documents that Durango had committed to producing in this action:

> Documents produced in this litigation show that Nathan Counley was the sales agent for a number of other replica products merchants, including Stephanie Walker (PurseScene.com), Melissa Gampel (PurseBoutique.com), Rashida Ayers (Charismaticstyle.com), and Jean Pharel (Freshstyle.com). *See, e.g.,* WNB-00569, WNB-00925, WNB-00966, WNB-01078. It also appears that Mr. Counley corresponded by email with at least one of these merchants regarding a brand owner's notice to the merchant alleging trademark violations. *See* GUCCI-0048264-267. The existence of these documents and Durango's failure to produce such documents and correspondence, as well as the paucity of documents produced thus far, suggests that Durango has not conducted a diligent and thorough search of its records and electronic communications or is being deliberately obstructionist by refusing to produce such documents.

Id., Ex. 2 (May 5, 2010 letter to Durango).

In response, Durango stated repeatedly that Gucci's inquiries "represent[ed] a continued misunderstanding of the extent of Durango's role (or lack thereof) in the relevant marketplace." *See* Halter Decl. Ex. 4 (May 10, 2010 letter from Durango). Durango offered no explanation as to why it had failed to produce these communications and, instead, continued to maintain that it had "conducted a diligent and thorough search, including a search of electronic records, and Durango does not have any additional relevant document [*sic*] within its custody or control." *Id.* In the face of Durango's stonewalling, Gucci submitted a letter to the Court requesting a conference to discuss, *inter alia*, the significant deficiencies in Durango's document production. *Id.*, Ex. 5 (May 10, 2010 Gucci letter to Judge Baer). In response to Gucci's request, the Court

held a telephonic conference with the parties on May 19, 2010. Given the lack emails produced and the corresponding lack of any explanation from Durango, Gucci expressed disbelief during the conference as to whether Durango had actually "conducted a diligent and thorough search" despite Durango representations to the Court that it had done so, *see id.* Ex. 6. Gucci also raised the possibility of moving to image and inspect Durango's hard drives, and the Court indicated that it would entertain such an application.

Following the May discovery conference, Gucci made every effort to resolve its discovery dispute with Durango without necessitating further intervention from the Court. Gucci sought additional information from Durango regarding the process by which it searched for documents in order to ascertain whether filing a motion to inspect Durango's hard drive was necessary. As before, Durango continued to represent that it had conducted a thorough and diligent search, but refused to respond to Gucci's pointed inquiries as to the specifics of how the search was conducted, including Gucci's request that Durango provide a list of the keywords it used in conducting its search. *Id.* Exs. 7-14 (May 19-June 13, 2010 correspondence between Gucci and Durango).[1] On June 1, 2010, Gucci made a third request for the search terms used by Durango in conducting its search for responsive documents and noted continuing discrepancies in Durango's document production:

> To date, Durango has produced only the residual report for TheBagAddiction.com although Durango has provided its services to a number of replica products merchants. . . . Additionally, Nathan Counley is listed as the sales agent on merchant account applications for the following [24] replica merchants, and we expect that Durango will produce residual reports for each of these merchants as well . . . . We have already brought to your attention the existence of responsive

[1] Gucci finally received a list of Durango's search terms the night before Mr. Counley's deposition.

> e-mail communications between Nathan Counley and replica merchant Stephanie Walker, which Durango has not produced. Moreover, Durango recently represented to the Court that it "does not generally keep records on merchants once they are set-up for more than three months due to privacy concerns." *See* May 17, 2010 Letter to Judge Baer. This statement is directly contradicted by Durango's production of the attached September 10, 2006 e-mail regarding Laurette, which was forwarded to Nathan Counley by Shane Kairalla. As this email was produced in response to an August 2009 subpoena, it is clear that Durango does, in fact, "keep records on merchants" for far longer than "three months."

Id., Ex. 10 (June 1, 2010 letter to Durango).

In response, Durango took the indefensible position that "the 'search terms' issue is largely irrelevant to Durango, and instead seems to be geared toward the processors, Frontline and Woodforest." *Id.* Ex. 11 (June 4, 2010 letter from Durango). In the same letter, however, Durango admitted that it had in its possession "discoverable documents" consisting of "lead sheets"—which it distinguished from the emails it still had not produced—and residual reports that Durango attempted to distinguish from "massive electronic files," even though both types of documents were, in fact, maintained electronically. Durango provided no explanation as to why it had failed to produce these documents previously or why the "diligent and thorough search" it had supposedly conducted failed to turn up these documents in the six months since Gucci served its initial document request.

On June 11, 2010, Gucci's counsel sent a letter to Durango regarding outstanding discovery items, including Durango's continuing failure to provide Gucci with its list of search terms:

> In your May 17, 2010 letter to the Court, you represented that Durango "has conducted a diligent and thorough search, including a search of electronic records, and Durango does not have any additional relevant document[s] within its custody or control." However, on numerous occasions, we have inquired regarding Durango's failure to produce electronic communications and pointed to e-mails that Nathan Counley sent and received from replica merchants Stephanie Walker and Jennifer Kirk—e-mails that were never produced by Durango. Durango has never offered an explanation for this inconsistency.

> In addition, contrary to Durango's representation to the Court that it has no additional documents responsive to Plaintiff's requests, it is clear from your recent letter that Durango does, in fact, maintain "lead sheets" that are clearly relevant, non-privileged and responsive to Plaintiff's document requests. Durango admits that these lead sheets are "discoverable documents," yet Durango has only produced lead sheets for two replica merchants out of the dozens (or more) to whom it provided its merchant broker services. Also, attached to your June 4 letter were residual reports reflecting the fees Durango earned from certain replica merchants, but Durango provided no explanation as to why these reports were not previously produced to Plaintiff. Further, Durango's evasive response to Plaintiff's repeated requests for the keywords Durango used in searching for potentially responsive documents suggests that Durango did not actually conduct a search of its electronic communications. Although you have represented that Durango conducted a diligent search for responsive documents, the facts strongly suggest otherwise.

Id. Ex. 12 (June 11, 2010 letter to Durango). Later that day, Durango made a belated production of residual reports "as a show of good faith" in response to Gucci's letter, although Durango admitted that "most of the material" it was providing was "irrelevant to the present litigation." *Id.* Ex. 13 (June 11, 2010 email from Durango).[2]

B. Nathan Counley's Deposition Reveals that Durango Never Instituted a Proper Litigation Hold and that Key Executives Wiped Their Hard Drives

At the June 14, 2010 deposition of Nathan Counley, who testified both in his individual capacity and as the Rule 30(b)(6) representative for Durango, Gucci sought answers regarding Durango's document retention, search and production. Mr. Counley testified that: 1) he used email as his primary means of communications internally at Durango, with credit card

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[2] On at least several occasions, Durango has provided additional information or documents only after Gucci identified specific information that Durango had failed to produce. It is clear that this is an inappropriate way to conduct discovery. *Metropolitan Opera Ass'n, Inc. v. Local 100*, 212 F.R.D. 178, 221 (S.D.N.Y. 2003) ("It was not their option to simply react to plaintiff's fortuitous discovery of the existence of relevant documents by making disjointed searches, each time coming up with a few more documents, and each time representing that that was all they had. Under the federal rules, the burden does not fall on plaintiff to learn whether, how and where defendant keeps relevant documents."), *quoting Tarlton v. Cumberland County Correctional Fac.*, 192 F.R.D. 165, 170 (D.N.J. 2000).

processors, and with replica merchants; 2) Durango failed to preserve documents and emails after it was served with Gucci's Complaint in this action (and, apparently, Durango's counsel did not instruct it to do so); 3) that he and at least one other Durango executive wiped their hard drives with File Shredder in recent weeks; and 4) that he ran File Shredder on his computer several times, including as recently as the day before his deposition. *See* Halter Decl. Ex. 15 (Transcript of Deposition of Nathan Counley, dated June 14, 2010 ("Counley Tr.") at 22:8-11; 23:12-15; 77:17-25; 190:23-191:13; 192:24-193:5; 207:3-7).

1. Nathan Counley Testified that He Frequently Used Email In Connection with His Work for Durango

Mr. Counley testified that he worked out of his home in Wisconsin and visited Durango's office in Colorado only a handful of times each year. *Id.* at 8:24-9:2; 21:20-25. As a result, he used email as his primary means of communicating internally with other Durango employees, with prospective and established merchants, and with the banks to which he referred potential merchants for processing. *Id.* at 22:8-11; 23:12-15; 77:17-25.[3] Indeed, Mr. Counley testified that he often sent and received hundreds of emails each day. *Id.* at 188:19-20.

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[3] Q: When you communicate the rest of the year when you are not in Durango, do you do that by e-mail?
A: Yes.
* * *
Q: Now when you communicate with the banks that we just listed, you do that by e-mail as well?
A: Yes.
* * *
Q: While we are back on Counley [Exhibit] Four, do you know where you this application to?
A: Like I said, I usually e-mail the applications to the merchant.
Q: You e-mailed it to the merchant and then it came back signed to you?
A: Yes.
[Footnote continued on next page]

2. Nathan Counley Testified that He Continued to Delete Emails After August 2009

Mr. Counley testified that he continued to delete emails after Durango received a subpoena for documents in connection with the Laurette case and, even more astonishingly, that he continued to delete emails after Durango was served with Gucci's Complaint in this action nearly a year ago:

> Q: Did you continue your usual practice of deleting e-mails after you received the Complaint in August of 2009?
> A: Yes. The sent e-mails I continued to delete.
>
> * * *
>
> Q: So as you sit here today, you really don't know what you deleted after August of '09, is that fair?
> A: Yes, I don't have reason to store all the emails.

Id. at 189:18-22; 190:23-191:3.

When questioned further on this issue, Mr. Counley admitted that he was not familiar with the concept of a litigation hold and, in fact, had not been advised of his obligation to retain documents relevant to this litigation. *Id.* 188:23-189:8; 192:24-193:5.

3. Nathan Counley Testified that He and Other Durango Executives Wiped Their Hard Drives in Recent Weeks

After learning that Mr. Counley had continued to delete emails after Gucci initiated this action and that Durango had not instituted a litigation hold, Gucci inquired as to what documents may or may not exist currently on Durango's hard drives. Mr. Counley testified that he and Bill

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[Footnote continued from previous page]

> Q: What did you do with it?
> A: Then I e-mailed it to the processor.

Id. at 22:8-11; 23:12-15; 77:17-25.

Demopolis, Durango's co-owner and its Vice President of Business Development, purchased a file-scrubbing program "a couple of weeks ago." *Id.* at 191:4-192:6 Counley testified that he had personally run the program "several times" on both of his laptops, and that it was last run "[y]esterday or the day before" his deposition. *Id.* at 207:3-7.

> Q: Did you ever run any file scrubbing program on your computer?
> A: Yes.
> Q: When did you last run that program?
> A: We bought them, I bought software I think Bill bought, we all bought it a couple of weeks ago. We read an article just deleting files is not really safe if your computer was stolen, someone can still recreate the files. . . .
> * * *
> Q: Do you know the date on which you ran the program?
> A: I probably ran it several times.
> Q: When did you last run it?
> A: Yesterday or the day before.

Id.

C. Durango Destroyed Emails and Documents Relevant to this Litigation

Durango does not deny that Messrs. Counley and Demopolis intentionally wiped their hard drives. In its June 23, 2010 submission to the Court, the only explanation Durango offered was that "[a]ny 'file scrubbing' . . . was ***after*** appropriate searches were made and relevant documents provided in response to Gucci's discovery requests." *See* Halter Decl. Ex. 19 (June 23, 2010 Durango letter to Judge Baer); Ex. 20 (Affidavit of Nathan Counley, dated June 23, 2010 ("Counley Aff.") at ¶ 3 (emphasis in original)). These representations, contained in a sworn affidavit and reiterated in Durango's letter to the Court, are directly contradicted by an email from Durango's counsel sent on June 11, 2010—three days before Mr. Counley's deposition and *weeks* after he purchased and ran File Shredder—in which Mr. Wengrovsky states:

> Durango is *continuing* in its search of records pursuant to your request, and is now using the information from Frontline's document production to facilitate same. Specifically, because Durango does not keep application documents (such as those produced by Frontline),it now has additional information (i.e. the names of individual principals) to use in a search. As such we expect to respond to you with further details prior to the Monday deposition.

See id. Ex 13 (June 11, 2010 email from Durango) (emphasis added). Similarly, on June 13, 2010, the night prior to Mr. Counley's deposition, Durango produced documents from a "previously non-reviewed general 'customer service box'" containing "lead sheets" and "first response emails." *Id.* Ex. 14 (June 13, 2010 email from Durango). Durango stated that it was producing these documents "[i]n its *continued* efforts to search all of its records." *Id.* (emphasis added). As these communications make clear, Durango's search for records was not complete at the time its employees wiped their hard drives of relevant files and it is disingenuous for Durango to suggest otherwise.

Mr. Counley claims that he and Mr. Demopolis "ran the software only to protect old merchant credit card *applications*, not e-mails." *See* Counley Aff. ¶ 6 (emphasis in original).[4] However, Gucci's requests for production specifically requested "[a]ll documents, including any documents stored electronically, referring or relating to merchants whose websites sell Replica Products, including, but not limited to, any *applications*." *Id.* Ex. 1, (Request for Production, Request No. 13) (emphasis added). Despite this request, Durango never produced applications to Gucci, claiming that "[o]nce a merchant account is approved by a processing bank such as Frontline or Woodforest, there is no reason for Durango to keep the merchant's application

[4] Mr. Demopolis' purported reason for running File Shredder rings false. If Mr. Demopolis "does not deal with merchants," as Mr. Counley states in his affidavit, there would be no reason for him to have customer data and applications on his computer and, hence, no need to run File Shredder in order "to protect customer data on the applications." Counley Aff. ¶¶ 5-6 (emphasis in original).

package." *Id.* Ex. 11 (June 4, 2010 letter from Durango). Mr. Counley's affidavit states that his purpose in running the File Shredder was to make sure that the very merchant applications that Gucci had requested back in December could not be recovered from his hard drive. The few merchant applications produced by Woodforest contain extremely relevant information regarding the extent of Durango's support for various "replica" merchants, such as the specific websites involved, the types of products sold and the expected sales volume. Mr. Counley deliberately and intentionally destroyed the applications on his two computers in order to prevent their recovery. This makes it impossible to know the total number of counterfeit websites that Durango worked with and all of the banks to which they submitted applications on behalf of such merchants. The destruction of applications by Messrs. Counley and Demopolis also makes it impossible to know how many different types of Gucci products were sold by the unknown websites and the specific Gucci trademarks that were infringed upon—all of which is crucial information in determining statutory damages.

Further, while Mr. Counley asserts that he ran File Shredder "only to protect old merchant credit card *applications*, not e-mails," Mr. Counley does not deny that he did, in fact, delete emails. *See* Counley Aff. ¶ 6 (emphasis in original). Even assuming that Mr. Counley's practice was to delete emails on a regular basis, these deleted emails may have been recoverable from an "unshredded" hard drive. Because Messrs. Counley and Demopolis ran File Shredder, it is impossible to know what information could have been recovered had they not destroyed evidence. As documented in the correspondence between counsel for Gucci and Durango, Durango has failed to produce email communications between Mr. Counley and various replica merchants that undeniably existed at one point in time. Mr. Counley testified that he was using his Toshiba laptop at the time he sent and received various emails from Laurette and that the

Toshiba is one of the computers on which he ran the File Shredder in the past "couple of weeks." *Id.* at 187:7-15; 191:4-13; 207:3-7. Based upon the emails that Gucci has obtained from Laurette and from the Defendants in this litigation (other than Durango), it is clear that these communications—sent and received by Mr. Counley on his Toshiba laptop—would be relevant to Gucci's allegations regarding Durango's knowledge of and participation in its replica merchants' business. As just a sampling of the communications that Gucci has obtained and that Durango has failed to produce:

- March 13,2007 email from Mr. Counley to Frontline, copying Stephanie Walker, regarding "Simply Chic Purses" and attaching two spreadsheets titled "Handbag Order Tracking 03-08-07.xls" and "Handbag Order Spreadsheet 3-12-07 Tracking.xls."
- August 17, 2007 email to Mr. Counley from Laurette regarding "BagAddiction" and seeking Counley's assistance with a chargeback dispute.
- January 21, 2008 email from Mr. Counley to Frontline regarding "BagAddiction.com" and expressing the concern that Jennifer Kirk's bank may "investigate why she has wires to China (products obviously but for some reason they frown on this)."
- February 1, 2008 email from Mr. Counley to the proprietor of "ThePurseBoutique.com" providing advice as to how to protect against chargebacks.
- March 4, 2008 email from Mr. Counley to the proprietor of "ExactReplicas.com" providing advice regarding problems the merchant was having with AMEX charges.
- April 9, 2008 email from Mr. Counley to Frontline requesting an underwriting review for "BagAddiction" so that the account reserve could be capped.

Halter Decl. Exs. 21-26.

Additionally, although Durango stopped accepting applications from replica merchants after this litigation commenced, it did continue to receive residual from certain replica merchants. *See* Counley Dep. Tr. at 117:19-118:14; 189:23-190:16; Dep. Exs. 27-28. Since Durango was still receiving residuals from replica merchants post-August 2009 and had, indeed,

continued to accept applications from replica products merchants until that time, it is likely that there were relevant communications between Mr. Counley and these merchants, which may have been recoverable until he ran the File Shredder to destroy evidence.

Durango failed to preserve documents and admittedly destroyed emails and documents: 1) prior to the close of discovery; 2) while Gucci was sending letters to Durango on nearly a weekly basis regarding Durango's deficient document production; and 3) after Gucci raised with the Court the possibility of moving to image Durango's hard drives. Based upon these continuing and irrevocable discovery abuses, Gucci requests that the Court issue an order entering a default judgment against Durango in this action.

ARGUMENT

I. DURANGO WAS UNDER A DUTY TO PRESERVE DOCUMENTS BUT FAILED TO DO SO

Durango was required to preserve relevant documents no later than August 2009, when Gucci filed its Complaint in this action. *See Arista Records LLC v. Usenet.com, Inc.*, 633 F. Supp. 2d 124, 139 (S.D.N.Y. 2009) (Baer, J.) ("There can be no dispute that the Defendants were under an obligation to preserve all documents and communications stored on their employees' computers, at least as early as the start of this litigation."); *see also Pension Comm. Of the Univ. of Montreal Pension Plan, et al., v. Banc of Am. Sec., LLC*, 685 F. Supp. 2d 456, 466 (S.D.N.Y. 2010) ("[O]nce a party reasonably anticipates litigation, it must suspend its routine document retention/destruction policy and put in place a 'litigation hold' to ensure the preservation of relevant documents.") (quotation omitted) (alteration in original); *Gutman v. Klein*, No. 03 CV 1570, 2008 WL 4682208, at *7 (E.D.N.Y. Oct. 15, 2008) (Levy, M.J.) ("From that date [when plaintiffs filed their complaint], he had an obligation to preserve the contents of the Klein laptop.").

Moreover, "it is likely that the preservation obligation arose much earlier than the initiation of this action." *See Arista Records*, 633 F. Supp. 2d at 139; *see also In re Terrorist Bombings of U.S. Embassies in E. Africa v. Odeh*, 552 F.3d 93, 148 (2d Cir. 2008) ("The obligation to preserve evidence arises when the party has notice that the evidence is relevant to litigation or when a party should have known that the evidence may be relevant to future litigation.") (citation omitted). Durango has been on notice for at least two years that the replica merchants it was servicing were the target of cease-and-desist letters and litigation instituted by the luxury brand owners whose trademarks these merchants were counterfeiting.

In May 2007, Mr. Counley received an email from Stephanie Walker, a merchant who Counley knew to be selling replicas, asking if Counley could assist her in adding a new domain name to her account – celebritystylehandbags.com. *See* Counley Tr. 207:10-210:9. As Walker stated in an email to Mr. Counley: "The reason for this is I received an email from Louis Vuitton for thepursescene.com. That is more than half of my business," *Id.* In response to Walker effectively telling him that she had received a cease-and-desist notice from a brand owner, Mr. Counley stated that "[a]dding URL's to your account isn't a big problem, since your 'DBA' is Strive Handbags." *Id.*

In 2008, Durango learned that another of its replica merchants had been sued by Gucci and Chloé SAS. On August 11, 2008, Durango was notified that a preliminary injunction had been entered against the owners and operators of TheBagAddiction.com ("Laurette") enjoining and restraining Laurette from, *inter alia*, "selling or otherwise offering for sale Counterfeit Products or any other products produced by Plaintiffs or confusingly similar to Plaintiffs' Products, or that otherwise bear, contain, display or utilize any of Plaintiffs' Marks." *Id.* Ex. 27 (Aug. 11, 2008 facsimile to S. Kairalla). On August 21, 2008, Durango was served with a

subpoena for documents in connection with Laurette litigation. *Id.* Ex. 28 (Aug. 21, 2008 letter and subpoena to S. Kairalla). Among other things, that subpoena requested "[a]ll documents concerning any and all communications between Defendants and National Bankcard Systems of Durango" and "[a]ll documents concerning whether Defendants were selling legitimate or counterfeit goods on their website." *Id.*[5] By August 2008, therefore, not only was Durango on notice that its merchant was subject to an injunction as a result of selling counterfeit goods, but it was also on notice that its communications and other documents with replica products merchants were relevant to ongoing litigation.

Accordingly, Durango should have begun preserving documents relating to its replica merchants no later than 2008. Even assuming that Durango's duty to preserve documents did not arise until Gucci filed the instant litigation, the testimony of Durango's representative, Mr. Counley, makes clear that it never instituted a proper litigation hold. [6] Although Durango now maintains that Mr. Counley was testifying in his individual capacity and not as the corporation when this testimony was elicited, this distinction is largely irrelevant—either Durango was never advised by counsel of its preservation obligation or Durango was aware of this obligation and failed to inform a key employee who was specifically referenced in Gucci's Complaint—its

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[5] In response to this subpoena, Durango claimed that it had no documents to produce in response other than the agreement for services that was attached to plaintiffs' August 11, 2008 facsimile to Mr. Kairalla.

[6] Q: Are you familiar with the concept of a litigation hold?
A: No.
* * *
Q: Did anyone ever tell you that you had an obligation to hold on to the documents that might be relevant to this lawsuit?
MR. WENGROVSKY: Objection for the record. Go ahead.
A: No.

Id. at 188:23-25; 192:24-193:5.

designated Rule 30(b)(6) witness—of his duty to preserve documents. It is clear that, under either scenario, Durango failed to institute a proper litigation hold. Further, Durango states plainly in its recent letter to the Court that Mr. Demopolis—who Durango claims *was* advised of his obligation to preserve documents—nonetheless ran a file scrubbing program on his hard drive. *See* Halter Decl. Ex. 19 ("[M]ost of counsel's communications with Durango were with its owners, Shane Kairalla and Bill Demopolis.").

As previously discussed, Durango has failed to produce emails and documents that undoubtedly existed at one point in time. The volume and content of the emails that Mr. Counley wiped from his hard drive cannot be estimated, but there is no question that relevant and responsive communications were among the documents deleted. *See Arista Records*, 633 F. Supp. 2d at 140 ("[T]he data alleged to have been despoiled here was not transitory in nature; rather, it was the sort of data—internal reports, email communication, and the like—that are clearly subject to a preservation obligation."). The result of Durango's actions—in failing to institute a litigation hold and allowing key executives to wipe files from their hard drives—is that Gucci now has no way to obtain internal Durango communications and can only obtain communications with third parties if it can identify, locate and then compel those third parties to produce them. That is not how discovery is supposed to work.

Although Durango made a belated production of emails on the eve of Counley's deposition, these emails are comprised of so-called "lead sheets." Durango does not dispute that these documents do not contain Mr. Counley's regular correspondence with his merchants, or that it has failed to produce such communications. Indeed, although much of the parties' correspondence has addressed Durango's failure to produce Mr. Counley's emails, Durango has never come forth with an explanation as to why it has not produced the emails of its other agents

who also serviced replica merchants.[7] Mr. Counley's communications with admitted counterfeiters and other replica merchants are clearly relevant to this litigation.

II. DURANGO'S SPOLIATION OF EVIDENCE WARRANTS ENTRY OF A DEFAULT JUDGMENT

"Spoliation refers to the destruction or material alteration of evidence or to the failure to preserve property for another's use as evidence in pending or reasonably foreseeable litigation." *Pension Comm.*, 685 F. Supp. 2d at 466 (noting the court's "inherent power" to "impose sanctions for spoliation"). The Second Circuit has stated that "[e]ven in the absence of a discovery order, a court may impose sanctions on a party for misconduct in discovery under its inherent power to manage its own affairs" and emphasized that a court has "broad discretion in fashioning an appropriate sanction." *Residential Funding Corp. v. De-George Financial Corp.*, 306 F.3d 99, 106-07 (2d Cir. 2002). As Judge Scheindlin recently noted in *Pension Comm.*, "a terminating sanction is justified in only the most egregious cases, such as . . . intentionally destroying evidence by burning, shredding, or wiping out computer hard drives." 685 F. Supp. 2d. at 469; *see also Arista Records*, 633 F. Supp. 2d at 140 ("Severe sanctions for discovery violations, including dismissal, may be imposed for intentional conduct, such as bad faith or gross negligence.") (quotations omitted); *Southern New England Tel. Co. v. Global NAPs, Inc.*, 251 F.R.D. 82, 90 (D. Conn. 2008) (the sanction of dismissal "is appropriate if there is a showing of willfulness, bad faith, or fault on the part of the sanctioned party," including gross negligence) (quotation omitted); *Global NAPs, Inc. v. Verizon New England, Inc.*, 603 F.3d 71

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[7] For example, Defendant Frontline produced an email regarding the replica website "MyFauxDesigner.com" which was authored by Shane Kairalla, Durango's President, and copied to Durango agents Nathan Counley and Brad Jess. *See* Halter Decl., Ex. 29 (Feb. 27, 2008 email from S. Kairalla).

(1st Cir. 2010) (affirming the district court's grant of default judgment as a sanction for willful discovery misconduct). Plaintiff respectfully submits that Durango's spoliation of evidence is so severe as to warrant the entry of a default judgment.

A. Durango's Failure to Institute a Litigation Hold was Grossly Negligent

Courts in this Circuit have found that "the failure to issue a *written* litigation hold constitutes gross negligence because that failure is likely to result in the destruction of relevant information." *Pension Comm.*, 685 F. Supp. 2d at 465 (emphasis in original); *see also Gutman v. Klein*, No. 03 Civ. 1570, 2008 WL 5084182, at **1-2 (E.D.N.Y. Dec. 2, 2008) (adopting finding of the magistrate judge that the spoliator acted in bad faith by deleting computer files); *Doe v. Norwalk Cmty. College*, 248 F.R.D. 372, 380 (D. Conn. 2007) (finding gross negligence where there was "no evidence that the defendants did anything to stop the routine destruction of backup tapes after [their] obligation to preserve arose").

In *Pension Comm.*, Judge Scheindlin set forth examples of "failures [that] support a finding of gross negligence" against a party who was under an obligation to preserve documents: 1) the failure "to issue a written litigation hold;" 2) the failure "to identify all of the key players and to ensure that their electronic and paper records are preserved;" 3) the failure "to cease the deletion of email or to preserve the records of former employees that are in a party's possession, custody or control;" and 4) the failure "to preserve backup tapes when they are the sole source of relevant information or when they relate to key players, if the relevant information maintained by those players is not obtainable from readily accessible sources." 685 F. Supp. 2d at 471. A review of Durango's conduct in this litigation shows that a finding of gross negligence is entirely appropriate.

1. Durango Failed to Issue a Proper Litigation Hold and Failed to Ensure that the Emails of Key Employees were Preserved

In *Metropolitan Opera*, the Court found that the defendant "fail[ed] to set up an adequate system for document production," "made less than a good faith effort to produce documents that were responsive," and its employees conducted a "grossly inadequate" search for documents. 212 F.R.D. at 227-28. The Court found that these "document production efforts were purposely scattershot, intended only to go through the motions," and that "[s]uch a haphazard effort at collecting documents is insufficient." *Id.* at 228. Durango's execution of its discovery obligations in this case are similarly inadequate and "suggest[] a callous disregard for its obligations as a litigant." *Id.*

Mr. Counley testified that he was neither familiar with the concept of a litigation hold, nor was he ever advised of his duty to preserve relevant documents. . Counley's name appears more than a dozen times in the Complaint filed in this action. That Durango failed to inform a key custodian of his duty to preserve documents is inexplicable. *See Metropolitan Opera*, 212 F.R.D. at 228 ("Perhaps most indicative of [defendant's] lack of good faith effort is that he never checked back with the few employees he did speak with to be sure they were complying with his instructions."); *see also Turner v. Hudson Transit Lines, Inc.*, 142 F.R.D. 68, 73 (S.D.N.Y. 1991) ("It is no defense to suggest, as the defendant attempts, that particular employees were not on notice. To hold otherwise would permit an agency, corporate officer, or legal department to shield itself from discovery obligations by keeping its employees ignorant.").

Further, Mr. Counley confirmed that he continued his "usual practice of deleting emails after [he] received [Gucci's] complaint in August of 2009." Counley Tr. at 189:18-22. Similarly, Durango admits that Mr. Demopolis, Durango's co-owner and Mr. Counley's boss, was informed of his duty to preserve documents, but nevertheless ran the File Shredder on his

hard drive. *See* Halter Decl. Ex. 19 (June 23, 2010 letter from Durango to Judge Baer); Counley Tr. 191:7-21.

2. Durango Failed to Cease the Deletion of Email and Preserve Backup Tapes

Since Durango never instituted a proper litigation hold, it is axiomatic that at least certain of its employees—including Mr. Counley—continued to delete emails on a regular basis. *Id.* at 189:18-22. As Mr. Counley testified, Durango's computers are not on a network, *id.* at 22:12-16, and the destroyed data is not backed up to a network server. Durango uses a company called Intermedia to store Durango's Outlook folders, which deletes the items stored in Durango's Outlook folders on a weekly basis. *Id.* at 186:8-187:24. Durango could have taken advantage of an archiving service offered by Intermedia to suspend the deletion policy but, apparently, chose not to do so. *Id.* It does not appear that Durango ever contacted Intermedia to request that they place a hold on Durango's emails. As a result, Intermedia continued to delete Durango's emails from its server every seven days. Moreover, Mr. Counley testified that Intermedia did not maintain backup tapes of the deleted emails. *Id.*

B. Durango's Wiping of Hard Drives was Intentional, Willful, and Egregious

Durango does not deny that, at a minimum, Mr. Counley—a key figure in this litigation—and Mr. Demopolis used File Shredder to wipe their hard drives. However, Mr. Counley's testimony leaves open the possibility that the File Shredder was used by additional employees. Counley Tr. at 191:4-192:6 ("we all bought it a couple of weeks ago."). It beyond dispute that these hard drives were wiped intentionally and, indeed, this conclusion is "inescapable." *See Global NAPs*, 251 F.R.D. at 93 ("Because the computer was in the possession and control of the defendants at all times, the conclusion that this [file scrubbing]

program was used intentionally to destroy files that should have been preserved is inescapable."). Mr. Counley's testimony makes clear that these files were purposefully deleted after "we all read an article" that "just deleting files is not really safe" because "someone can still recreate the files." *Id.* at 181:21-24. Further, the Lavasoft website explains quite clearly what its product does and what purpose Messrs. Counley and Demopolis had in mind when running the File Shredder on their computers. Lavasoft's website states that the File Shredder program "permanently removes information from your computer by shredding selected files." The website goes on: "Lavasoft File Shredder helps you take control of the information you don't want anyone else to get their hands on, by permanently removing the files." Put simply, they did not "want anyone else to get their hands on" the applications and their emails, so they destroyed them.

Despite Durango's assertions to the contrary, the fact that Durango's employees happened to "read an article" about file scrubbing and wipe their hard drives at around the time Gucci had suggested that it might seek to image Durango's hard drives is more than mere coincidence. *See Verizon New England*, 603 F.3d at 94 (affirming default judgment as discovery sanction and noting that the "computer mishaps" at issue "were suspiciously timed"). However, even if one could accept Durango's contention that the file scrubbing was unrelated to the possibility that Gucci might image its hard drives, these actions took place while discovery in this action was ongoing and while there was a dispute regarding the sufficiency of Durango's discovery responses. For Durango to allow the hard drives of key employees to be wiped evidences a "willful disregard of their discovery obligations." *Metropolitan Opera*, 212 F.R.D. at 210 (noting that defendant's decision to replace three computers two weeks after a teleconference in which the plaintiff "asked permission to have a forensic computer expert

examine defendants' computers" was evidence of "willful disregard" even if it was purely coincidental).

C. Gucci Has Been Prejudiced by Durango's Spoliation of Relevant Documents

The party seeking sanctions must show "that the spoliating party (1) had control over the evidence and an obligation to preserve it at the time of destruction or loss; (2) acted with a culpable state of mind upon destroying or losing the evidence; and that (3) the missing evidence is relevant to the innocent party's claim or defense." *Pension Comm.*, 685 F. Supp. 2d at 467. At least by August 2009, Durango was under an obligation to preserve documents of its employees and principals. Further, the documents were destroyed in a grossly negligent manner (for those documents destroyed as a result of Durango's failure to institute a litigation hold) or in bad faith (for those documents intentionally destroyed by the File Shredder program). While "[r]elevance and prejudice may be presumed when the spoliating party acted in bad faith or in a grossly negligent manner," *id.*, here there is no question that the destroyed documents were directly relevant to Gucci's claims and that Gucci has been prejudiced as a result of Durango's misconduct.[8]

Although the relevance of the deleted documents can be presumed, Mr. Counley admits that his purpose in running File Shredder was to destroy files containing merchant applications, unproduced documents that are undeniably relevant to this litigation. In addition, Mr. Counley communicated regularly with his replica merchants via email, Counley Tr. at 77:17-25, and these

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[8] A showing of prejudice is not required prior the Court imposing sanctions under Rule 37. *See Metropolitan Opera*, 212 F.R.D. at 229 ("[Defendant's] assertion that [plaintiff] must show prejudice before a sanction may be ordered under Rule 37 is without merit. . . . [and] is wrong on the law.").

communications have also not been produced to Gucci. *See Pension Comm.*, 685 F. Supp. 2d at 478 ("The documents that no longer exist were created during the critical time period. Key players must have engaged in correspondence regarding the relevant transactions. There can be no serious questions that the missing material would have been relevant."); *see also Global NAPs*, 251 F.R.D. at 92 ("plaintiff need not prove that the deleted files were material; 'the intentional or grossly negligent *destruction* of evidence in bad faith can support an inference that the destroyed evidence was harmful to the destroying party.'") (*quoting Residential Funding*, 306 F.3d at 110).

Despite Gucci's repeated requests, Durango never came forth with any explanation as to why it has not produced email communications that Mr. Counley clearly sent and received from replica merchants, and there is no way to tell how many such communications were deleted from Mr. Counley's hard drive. Mr. Counley has admitted to destroying application files and emails and that he ran the File Shredder program on his computers "a couple of weeks ago" in order to permanently delete these applications and emails from his hard drive. As the Court noted in *Pension Comm.*, "it is impossible to know the extent of the prejudice suffered . . . as a result of those emails and documents that have been permanently lost . . . . The volume of missing emails and documents can never be learned, nor their substance be known." 685 F. Supp. 2d at 478; *see also Metropolitan Opera*, 212 F.R.D. at 229 ("it is beyond peradventure that many documents have been destroyed that relate directly to events taking place during the most critical time period in this action").

The result of Durango's actions is that Gucci has had to move its case forward working with only the limited documents that Durango produced. Gucci has been forced to prepare for depositions without complete information. Indeed, for a Monday deposition of Mr. Counley,

Durango was producing supposedly responsive documents on Friday evening, Sunday evening, and even during the deposition. No explanation was provided as to why these documents had only just been discovered six months after Gucci first served its discovery requests. Durango's eleventh-hour production of "480 relatively recent merchant-related emails" does not negate the fact that it routinely deleted emails after the commencement of this litigation and ran a file scrubbing program on multiple, unlinked computers for the express purpose of making relevant merchant applications unrecoverable.

D. Lesser Sanctions Are Not An Effective Remedy for Durango's Misconduct

An appropriate sanctions remedy should: "(1) deter the parties from engaging in spoliation; (2) place the risk of an erroneous judgment on the party who wrongfully created the risk; and (3) restore the prejudiced party to the same position [it] would have been in absent the wrongful destruction of evidence by the opposing party." *Pension Comm.*, 685 F. Supp. 2d at 469 (quotations omitted) (alteration in original); *see also Global NAPs, Inc.*, 251 F.R.D. at 90 (sanctions imposed under Rule 37 "serve two purposes: to penalize those whose conduct may be deemed to warrant such a sanction and to deter those who might be tempted to such conduct in the absence of such a deterrent"). Although lesser sanctions, such as an adverse inference, are available even for discovery misconduct that rises to the level of gross misconduct, such as Durango's failure to institute a proper litigation hold, Durango's actions are akin to the types of egregious behavior for which terminating sanctions are the most appropriate remedy. *See Pension Comm.*, 685 F. Supp. 2d at 469-70 ("[A] terminating sanction is justified in only the most egregious cases, such as . . . intentionally destroying evidence by burning, shredding, or wiping out computer hard drives."); *Global NAPs*, 251 F.R.D. at 90 (the sanction of dismissal "is

appropriate if there is a showing of willfulness, bad faith, or fault on the part of the sanctioned party," including gross negligence) (quotations omitted).

Courts in this Circuit have entered default judgments where emails and documents have been similarly destroyed, finding that a sanction other than a default judgment "would serve as a license, encouraging similar behavior." *See e.g., Metropolitan Opera*, 212 F.R.D. at 231. There, the Court found that entry of a default judgment was the only appropriate remedy where "untold numbers of documents from the time period most critical to the case are irretrievable." *Id.* at 230; *see also Gutman*, 2008 WL 4682208, at *12 (recommending that district court grant default judgment where "lesser sanctions such as adverse inferences are ill-suited to a case like this, where the spoliator has, in bad faith, irretrievably deleted computer files that likely contained important discovery information.").

CONCLUSION

For the foregoing reasons, Plaintiff respectfully requests that the Court enter an order sanctioning Durango for its misconduct.

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