Dynamo Holdings Limited Partnership v. Commissioner of Internal Revenue, 143 T. C. 183 (2014)

In Dynamo Holdings L. P. v. Commissioner, the U. S. Tax Court endorsed the use of predictive coding for electronic discovery, allowing petitioners to use this technology to identify and produce relevant electronically stored information (ESI) in response to the Commissioner's discovery request. This ruling marked a significant acceptance of predictive coding, recognizing it as an efficient and cost-effective method for managing large volumes of ESI, thereby impacting how future discovery requests involving digital data might be handled in legal proceedings.

Parties

Dynamo Holdings Limited Partnership and Beekman Vista, Inc. , as petitioners, challenged the Commissioner of Internal Revenue, as respondent, in the United States Tax Court. Dynamo Holdings Limited Partnership's tax matters partner, Dynamo, GP, Inc. , was also involved in the litigation.

Facts

Dynamo Holdings Limited Partnership (Dynamo) and Beekman Vista, Inc. (Beekman) were involved in litigation concerning alleged disguised gifts from Beekman to Dynamo's owners. The Commissioner sought access to electronically stored information (ESI) contained on two of Dynamo's backup storage tapes, claiming the need to review the ESI's metadata and verify document creation dates to ascertain all relevant transfers. Dynamo resisted this request, citing the high cost and time required for manual review, as well as the presence of privileged and confidential information on the tapes. Dynamo proposed using predictive coding to efficiently and economically identify nonprivileged, responsive ESI. The Commissioner opposed this method, considering predictive coding an unproven technology, and suggested a 'clawback agreement' to allow review of all data with subsequent claims of privilege.

Procedural History

The case was before the United States Tax Court on the Commissioner's motion to compel production of documents from the backup tapes. Petitioners opposed the motion and proposed using predictive coding to respond to the discovery request. The Court held an evidentiary hearing to address this issue and subsequently ruled on the permissibility of predictive coding in discovery responses.

Issue(s)

Whether petitioners may use predictive coding to respond to the Commissioner's discovery request for electronically stored information?

Rule(s) of Law

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The Tax Court Rules of Practice and Procedure allow parties to obtain discovery of documents and ESI relevant to the subject matter of the case, provided the information is not privileged. Rule 70(a)(1) and (b) govern the general scope of discovery, while Rule 72(a) specifically addresses the production of ESI. These rules are designed to secure the just, speedy, and inexpensive determination of cases, as per Rule 1(d).

Holding

The Court held that petitioners may use predictive coding in responding to the Commissioner's discovery request for electronically stored information.

Reasoning

The Court found predictive coding to be a reasonable and efficient method for managing the discovery of ESI. It noted that predictive coding, a form of computer-assisted review, could significantly reduce the time and cost associated with manual review of large volumes of documents. The Court cited expert testimony, including that of James R. Scarazzo, who compared predictive coding favorably to keyword searches, emphasizing its ability to minimize human error and expedite review. The Court also referenced the growing acceptance of predictive coding in the technology industry and federal litigation, as discussed in judicial opinions and legal literature. The Court rejected the Commissioner's argument that predictive coding was an unproven technology, finding it to be a widely accepted method for limiting e-discovery to relevant documents. The Court emphasized the need for cooperation between the parties in implementing predictive coding, allowing the Commissioner to challenge the completeness of the discovery response at a later stage if necessary.

Disposition

The Court granted the Commissioner's motion to compel production of documents to the extent that petitioners may use predictive coding in responding to the discovery request.

Significance/Impact

This case is doctrinally significant as it represents the first time the U. S. Tax Court formally sanctioned the use of predictive coding in the discovery process. The ruling has practical implications for legal practice, as it provides a precedent for using advanced technology to manage the challenges of electronic discovery in tax litigation and potentially in other areas of law. It signals a shift towards more efficient and cost-effective methods of discovery, particularly in cases involving large volumes of ESI, and underscores the importance of cooperation between parties in the implementation of such technologies.

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