

**LJN**LAW JOURNAL  
NEWSLETTERS

LJN's

# Product Liability

*Law & Strategy*<sup>®</sup>

An incisivemedia publication

Volume 28, Number 6 • December 2008

## Punitive Damages And Discovery of a Defendant's Financial Condition

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Allegations of punitive damages can cast a heavy shadow on any litigation, and defendants in product liability cases are no strangers to tremendous punitive awards. That said, it is not difficult to understand why most defendants, at least early on, do not want to think about the potential for — or size of — a punitive damages award. Plaintiffs, on the other hand, are very tuned in to the economic side of their punitive damages allegations. Therefore, often plaintiffs serve discovery requests, seeking information regarding a defendant's wealth and financial condition concurrently, with discovery related to the underlying substantive allegations. Such early discovery of a defendant's financial condition, based upon nothing more than an allegation that punitive damages should be awarded, typically is deferred as premature. The basis for deferring discovery until after the liability phase of the case is completed is that this highly sensitive information is irrelevant and, therefore, unnecessary unless and until plaintiffs prove entitlement to the extreme remedy of punitive damages. Not all courts agree with this approach, however, leaving very much alive the question of what a defendant must do to prepare for economic pre-trial discovery.

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### THE GROSEK DECISION

At issue in *Grosek v. Panther Transp.*, \_\_\_ F.R.D. \_\_\_, 2008 WL 2853362, \*1 (M.D. Pa. Jul. 22, 2008) was an accident between plaintiffs' automobile and a truck operated by an employee of defendant Panther Transportation. Plaintiffs were granted permission to amend their complaint to add a claim for punitive damages, after which they sought discovery of the defendants' financial condition. *Id.* The defendants filed a motion for a protective order pursuant to Federal Rule of Civil Procedure (FRCP) 26(c), preventing the plaintiffs from conducting any discovery of the defendants' financial condition until a jury concluded that punitive damages were warranted. *Id.* Almost all jurisdictions allow juries to consider evidence of a defendant's wealth or financial condition in determining the amount of a punitive award; therefore, the relevance of the discovery sought by plaintiffs was not at issue. Rather, the defendants focused their argument on the premature nature of the discovery, arguing that it was unduly burdensome. The defendants argued that pre-trial discovery of a defendant's wealth is prohibited absent a bona fide claim for punitive damages — the allegations of the complaint are not enough.

Finding that “[p]unitive damages ... require a different approach to discovery,” *Id.* at \*2, the *Grosek* court denied the defendants' motion and held that “delaying discovery on [financial condition] until after the discovery of evidence supporting punitive damages would be inefficient

and delay conclusion of the case.” *Id.* at \*3. Relying on Rule 26(c), the court also found that the defendants had not established the “good cause” required for a protective order because they did not show any prejudice that would result from allowing the discovery. *Id.* at \*2.

### Federal Courts

This summary conclusion, however, overlooks the highly prejudicial invasion of the defendant's privacy rights without even a minimal showing by plaintiffs of the legitimacy of their punitive claim. Nonetheless, the rationale of the *Grosek* court seems to hold majority favor among the federal courts. District courts in the First, Fourth, Sixth, Eighth, Ninth, Tenth, D.C. — and now Third Circuits — have all permitted discovery of a defendant's financial status based on little or no showing by the plaintiff of the validity of his or her punitive claim. Plaintiffs need only file a complaint alleging facts demonstrating the possibility that punitive damages will be at issue. *See, e.g., Mid Continent Cabinetry, Inc. v. George Koch Sons, Inc.*, 130 F.R.D. 149 (D. Kan. 1990) (plaintiff need not establish a *prima facie* punitive damages case before obtaining pretrial discovery of defendant's financial statements; it is sufficient to show the claim is not spurious).

### State Courts

Many state courts, however, disagree with such an approach. In fact, many require some showing of liability by the plaintiff before a defendant's financial privacy is invaded; Generally, it is a matter of

degree. New York, for example, has gone so far as to deny discovery of a defendant's wealth until after the jury has determined the defendant's liability for punitive damages, thereby bifurcating the determination of the amount of such damages. *Chilvers v. N.Y. Magazine Co., Inc.*, 453 N.Y.S.2d 153 (Sup. Ct. 1982). Stopping short of mandatory bifurcation, a number of courts have held *prima facie* proof of a plaintiff's right to recover punitive damages is a prerequisite to discovery of a defendant's financial condition. *Gierman v. Toman*, 185 A.2d 241, 244 (N.J. Super. Ct. Law Div. 1962); *Liedholt v. District Court of Denver*, 619 P.2d 768 (Colo. 1980); *Campen v. Stone*, 635 P.2d 1121 (Wyo. 1981). Still others have held that there must be some evidence of a defendant's liability for punitive damages before its financial condition may be discovered. *Breault v. Friedli*, 610 S.W.2d 134 (Tenn. Ct. App. 1980) (allowing discovery of defendant's financial condition only after showing some factual basis for punitive recovery); *Holman v. Burgess*, 404 S.E.2d 144 (Ga. Ct. App. 1991) (same).

### DISCLOSURE V. PRIVACY

What these courts seem to recognize is that finances are typically closely guarded, and the need for disclosure must be weighed against the strong privacy interests of the defendants. Weighing a defendant's right to privacy against the relative ease with which a plaintiff can state a plausible claim for punitive damages, it is readily apparent that permitting unlimited pre-trial discovery of a defendant's wealth could lead to unfortunate results, including excessive pressure on defendants to settle unwarranted claims. If disclosure of private financial information is compelled before any showing that the punitive allegations have a basis in fact, plaintiffs may be tempted to include punitive damages claims with the sole purpose of discovering a defendant's financial condition, information which could be very useful in settlement discussions.

By foregoing a balancing test, the

*Grosek* court, and others like it, may give too much favor to a perceived efficiency in allowing the discovery early in the proceeding. Not only does this not afford the proper deference to a defendant's privacy interests, it also overlooks the trial court's power to regulate the timing of discovery. Courts have authority to defer discovery on certain issues until a potentially dispositive issue is decided. One purpose behind FRCP 42(b) is the deferral of costly and potentially unnecessary discovery and trial preparation on other phases of the case pending resolution of preliminary dispositive issues. *Martin v. Bell Helicopter Co.*, 85 F.R.D. 654, 658 (D. Colo. 1980). Since most jurisdictions require a determination of liability for compensatory damages as a prerequisite to an award for punitive damages, it follows that discovery of a defendant's wealth, relevant only to punitive damages, reasonably can be deferred until after a verdict on compensatory damages. If the defendant prevails on compensatory damages, having deferred discovery of its financial condition not only would avoid the undue burden and expense of discovery on irrelevant issues, but also spare the defendant from having to divulge private financial information.

In response to such an argument, the *Grosek* court likely would contend that any savings in time and burden to the defendant in the case of a defense verdict is outweighed by the potential for delay if a compensatory verdict is returned in favor of the plaintiff. This is easily remedied. Postponing disclosure of a defendant's finances does not mean that the scope of the production cannot otherwise be litigated in advance of a verdict. Determinations can be made, for example, regarding the type of data that will be produced, the relevant time period, whether production of net worth or sales/profits is required. If the scope is well defined, then there is no reason the actual disclosure will result in any prejudicial delay.

### PREPARING FOR DISCOVERY OF FINANCIAL CONDITION

As discussed above, the timing of discovery of a defendant's financial condition is varied, and the first thing a defendant faced with such discovery can do is seek to postpone the discovery until after the plaintiff has proffered *prima facie* evidence of an entitlement to punitive damages. Ideally, this will be after the plaintiff proves a claim for compensatory damages, and a defendant must decide whether to seek bifurcation of the punitive phase of trial. Bifurcating the decision on the amount of any punitive award not only postpones discovery on financial status, but can also prevent evidence of a defendant's wealth from coloring the jury's decision on liability.

Unless the trial is bifurcated, it is more likely than not that a defendant will have to respond to discovery requests regarding its wealth and financial condition, prior to a liability verdict. The focus then shifts from when discovery will be answered to what and how it will be answered. While the courts have been less than uniform in their decisions regarding what constitutes evidence of a defendant's wealth, they are much closer aligned when it comes to protecting that information. Starting with how the information is discovered, appropriate protective orders should be in place to protect the confidentiality of any financial information disclosed. Orders restricting the use of financial information to the purposes of the pending litigation are not uncommon. Further, and especially if the discovery is allowed early in the litigation, courts have been known to limit access to the information to the plaintiff's attorney or to seal the information until an appropriate point in the litigation. Any of these measures can help balance the invasion of defendants' privacy with plaintiffs' right to discovery and protect defendants from embarrassment or harassment. Orders should also address the return of all financial information to defendants at

the close of all proceedings.

What defendants are required to disclose is much more wide-ranging and presents challenges such as limiting overly broad inquiries while developing evidence necessary to counter plaintiffs' invariably inflated financial assertions. The reason evidence of a defendant's financial condition is generally admissible when a plaintiff claims punitive damages is that the purpose of punitive damages is to punish or deter. Therefore, courts have ruled that the award should "sting," but should stop short of financial annihilation. The jury, therefore, should have evidence of the defendant's wealth. Defendants should seek to limit discovery to information needed to determine present net worth. Public corporations may attempt to limit discovery to published annual reports and proxy statements, but a number of courts have found that such publicly available information does not sufficiently represent true net worth. In fact, some courts have determined that evidence of income or earnings is a more accurate reflection of a defendant's ability to pay. While few courts allow unfettered access to all of the details of a defendant's financial affairs, production of authenticated financial statements is typically permitted. In the more liberal jurisdictions, courts have allowed financial discovery to include a defendant's income, cash flow and expenses; bank accounts; and tax returns.

With the scope of discovery so varied, defendants need to consider what evidence they want to proffer on their own behalf regarding profitability to counter any submissions by plaintiffs spotlighting the overall net worth of the company. In product liability cases, some courts have found that the profitability associated with sales of an allegedly defective product is relevant and this may be the area in which defendants in product liability cases will want to focus. The profits or earnings associated with the sale of a

particular product will be less than the net worth of the entire company, and being able to present the jury with this more realistic dollar figure should be one of the defendant's goals. Indeed, a defendant may appropriately introduce evidence of unprofitability or insignificant returns. Relying on the Supreme Court's ruling in *State Farm Mutual Automobile Insurance Company v. Campbell*, 538 U.S. 408, 421 (2003), that "as a general rule, a State [does not] have a legitimate concern in imposing punitive damages to punish a defendant for unlawful acts committed outside of the State's jurisdiction, a products defendant may seek to limit the financial information to be considered by the jury to profits earned by the defendant on the sale of the product at issue in a plaintiff state of residence."

One of the biggest obstacles a defendant faces in presenting evidence of financial condition is overcoming the strong desire to guard this type of information from public disclosure. To show profitability, a defendant has to be willing to disclose sales, expenses, costs and other details typically held in strict confidence. A defendant also has to be wary that opening the door a crack may lead to its swinging wide for plaintiffs to probe financial details. Therefore, defendants need to weigh protecting the privacy of their financial information against presenting a more defense-friendly financial picture to the jury. If a defendant opts to disclose information regarding product-profitability, it should remember to include a percentage of overhead costs, and research and development costs, incurred before the product entered the market.

Finally, defendants need to consider whether to retain an expert on economics and punitive damages. An accounting or economics expert can be useful in ascertaining the appropriate methodology for determining profitability and in presenting it to the jury. (See article by Chad L. Staller on page 1.) Not surprisingly, a

company's financial records are kept for business purposes, not litigation purposes. Often, an outside expert's advice and guidance can help organize the data efficiently and effectively. An experienced litigation expert also might make a more effective witness than a corporate financial officer.

While there is little or no way for defendants to avoid at least some discovery of their financial condition, when plaintiffs state a claim for punitive damages, defendants should be prepared to argue for postponement of that discovery until plaintiffs have established a factual basis for their punitive claim, to secure a protective order restricting the access and use of any financial information disclosed, and to examine thoroughly their finances in order to present evidence regarding true assets and profitability.