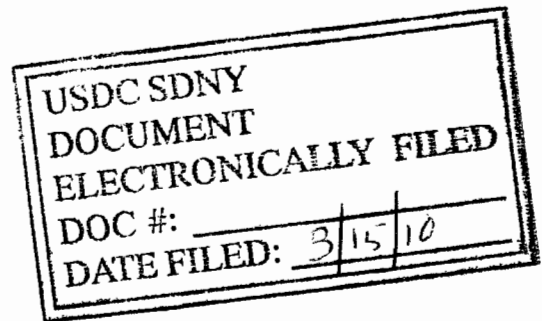


UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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BARBARA WILSON, et ano, :
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 Plaintiffs, :
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 - against - :
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 THORN ENERGY, LLC, et al., :
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 Defendants. :
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DISCOVERY ORDER

08 Civ. 9009 (FM)



FRANK MAAS, United States Magistrate Judge.

This action is brought by Barbara Wilson (individually and on behalf of a trust) and Joseph Gordon, Jr. (together, the “Plaintiffs”) against three limited liability companies (“LLCs”) and their managing member Charles Huggins (“Huggins”) (collectively, the “Defendants”). Over time, the Plaintiffs gave at least \$850,000 to the Defendants – partially as a loan and partially as an equity investment in a project purportedly intended to result in the transfer of certain “petroleum blocks” near Liberia to an oil company as part of a joint venture. Although the nine-count complaint is not a model of clarity, Mrs. Wilson apparently contends that the Defendants owe her approximately \$232,000 because they failed to honor a promissory note that they issued in her favor.¹ The Plaintiffs also seek an accounting of the Defendants’ use of their funds.

The Plaintiffs have moved for an order finding the Defendants in contempt, and awarding sanctions pursuant to Federal Rule of Civil Procedure 37(b), based on the Defendants’ failure to comply with this Court’s discovery orders. (See Docket No. 16). For the reasons set forth below, that motion is granted.

It is undisputed that during an initial pretrial conference on January 8, 2009, the Defendants’ counsel agreed to provide an accounting to the Plaintiffs. (See Aff. of Anne Baglivo Fitzpatrick, sworn to on July 23, 2009 (“Fitzpatrick Aff.”), ¶ 7). Thereafter, when the Defendants failed to comply, I directed that the “financial information previously demanded” be produced by March 30, 2009. (Id. ¶¶ 8-9). In

¹ The Defendants do not dispute that they owe plaintiff Wilson the balance due and owing under the promissory note.

response, the Defendants produced a handful of documents which plainly constituted neither an accounting nor documentation sufficient to show what had happened to the Plaintiffs' funds.² (*Id.* ¶ 10 & Ex. C). Accordingly, by letter dated May 14, 2009, counsel for both sides requested an extension of time because the "Defendants [had] agreed that a full formal accounting with supporting financial records [would be] prepared by an accountant and provided" to the Plaintiffs. (*See* letter dated May 14, 2009, from Ms. Fitzpatrick to the Court). By memorandum endorsement, I directed that this be accomplished by June 5, 2009, noting that the Court was unlikely to grant any further adjournments. (Docket No. 11).

By letter dated June 22, 2009, the Defendants' counsel acknowledged that the materials were "overdue," but sought the Court's "indulgence" because, "due to a computer failure, a significant amount of information was lost. (*See* letter dated June 22, 2009, from Bradley C. Rosen to the Court). Counsel indicated that the Defendants would have "the accounting and underlying information ready no later than July 6, 2009." (*Id.*) I therefore directed that the Defendants' production be made by that date. (Docket No. 13). When that "so-ordered" deadline also elapsed, Mr. Rosen requested a one-week extension, conceding that his clients' failure to produce the required documents had "place[d] them in contempt of Court." (*See* letter dated July 6, 2009, from Mr. Rosen to the Court). As of today, however, it appears that no further financial documentation has been produced.

On July 8, 2009, the Plaintiffs deposed Anne L. Thomas, a records custodian proffered by the Defendants pursuant to Rule 30(b)(6) of the Federal Rules of Civil Procedure. Ms. Thomas testified that all of the LLCs' records concerning the monies that allegedly were sent to Africa had been stored on a USB "flash drive" that she maintained. (Thomas Dep. 18, 20). In the summer of 2008, that drive allegedly failed. (*Id.* at 18, 24). As a result, Ms. Thomas no longer could access an Excel spreadsheet regarding the LLCs' banking activities. (*Id.* at 22). When she realized the file could no longer be accessed, Ms. Thomas reported this "devastating" news to Huggins, the LLCs' accountant, and the Defendants' counsel, Bradley C. Rosen. (*Id.* at 54). Additionally, because there were no backup files, Ms. Thomas asked someone who was "very good with computers," to help restore the drive. (*Id.* at 22, 33). The consultant was only able to retrieve information which was "scattered and partially" in a "different language." (*Id.* at 22). Several months later, Ms. Thomas discarded the drive. (*Id.* at 22, 27).

² One document related to a transaction in 2004, before the Plaintiffs made any investment or loan; the others, at best, accounted for \$600,000 of the Plaintiffs' funds. (*See id.* Ex. C).

During her deposition, Plaintiffs' counsel asked Ms. Thomas about the bank records allegedly reflecting the Defendants' use of the Plaintiffs' funds. In response, she claimed that she and the accountant were "going to start working on it . . . as of tomorrow. I'll find out what date he wants to come over and we'll go over the paperwork." Id. at 58 (emphasis added).

In sum, the Defendants evidently concede that they have produced neither an accounting nor any other documentation sufficient to establish what happened to the Plaintiffs' funds. Moreover, it appears that they have made no real efforts to do so despite their counsel's promises to the contrary.

The Defendants' rather terse papers set forth three responses to the Plaintiffs' motion. First, Mr. Rosen alleges that he has no recollection or notes of a conversation with Ms. Thomas during the summer of 2008 in which she reported the failure of the flash drive. (See Affirm. of Mr. Rosen, dated Aug. 7, 2009, ¶ 3). This, however, does not give rise to a factual issue in light of Ms. Thomas' sworn testimony that such a conversation occurred. See, e.g., Wesco Distrib., Inc. v. Anshelewitz, No. 06 Civ. 13444 (PKC), 2008 WL 2775005, at *7-8 (S.D.N.Y. July 16, 2008).

Second, the Defendants contend that for sanctions to be imposed, the Plaintiffs must establish that:

- (1) the party with control over the evidence had a duty to preserve it when it was lost or destroyed;
- (2) the evidence was lost or destroyed with a "culpable state of mind"; and
- (3) the evidence was relevant.

(Defs.' Mem. at 1) (citing Smith v. City of New York, 388 F. Supp. 2d 179, 189 (S.D.N.Y. 2005)).

Under Rule 37(b), the Court in fact has considerable discretion in deciding whether to sanction a party for failing to comply with its discovery orders. See Nat'l Hockey League v. Metro Hockey Club, Inc., 427 U.S. 639, 642-43 (1976). In any event, even if Smith sets forth the appropriate standard, each of the foregoing requirements has been met in this case. Thus, the duty to preserve the data on the flash drive arose when the Plaintiffs demanded payment. See Fujitsu Ltd. v. Fed. Exp. Corp., 247 F.3d 423, 436 (2d Cir. 2001) ("duty to preserve arises when . . . a party should have known that the evidence may be relevant to future litigation"). Here, this was well before the flash drive allegedly failed. (See Fitzpatrick Aff. ¶¶ 4-5 & Exs. A, B).

Additionally, at least in this Circuit, to meet the “culpable state of mind” requirement, it is not necessary for the plaintiffs to show that the Defendants intentionally destroyed evidence. Rather, negligence is sufficient to warrant the imposition of sanctions. See Residential Funding Corp. v. DeGeorge Fin. Corp., 306 F.3d 99, 108 (2d Cir. 2002). As Judge Scheindlin recently has noted, a failure to preserve evidence that results in the loss or destruction of relevant evidence is “surely negligent, and, depending on the circumstances, may be grossly negligent or willful.” Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Secs., LLC, ___ F. Supp. 2d ___, ___, 2010 WL 184312, at *3 (S.D.N.Y. Jan. 15, 2010). Similarly, the failure to collect evidence in a timely manner from a key witness, such as Ms. Thomas, constitutes “gross negligence or wilfulness.” Id. It consequently was at least grossly negligent for the Defendants not to have made a copy of the flash drive before it allegedly failed. The Plaintiffs therefore have established that the Defendants acted with the requisite state of mind.

Finally, with respect to the third showing required to impose sanctions, it is hard to think of evidence that would be more relevant in this action for an accounting and to recover money than the Defendants’ financial records.

The Defendants’ final contention with respect to the Plaintiffs’ motion is that they are protected by the “safe harbor” provisions of Rule 37(e) of the Federal Rules of Civil Procedure. (See Defs.’ Mem. at 2). Even if one assumes that the data on the flash drive was lost in the innocent manner that Ms. Thomas described, Rule 37(e) is inapplicable. That rule provides that a court may not sanction a party “for failing to provide electronically stored information lost as a result of the routine, good-faith operation of an electronic information system.” Fed. R. Civ. P. 37(e). As the Advisory Committee notes explain, the term “routine operation” relates to the “ways in which such systems are designed, programmed, and implemented to meet the party’s technical and business needs.” Id., advisory committee’s notes (2006). Here, however, the data on the flash drive was not overridden or erased as part of a standard protocol; rather, it was lost because the Defendants failed to make a copy. Moreover, even if the loss of the data could be described as “routine,” by the summer of 2008, the Defendants were fully aware that the Plaintiffs contemplated litigation to recover the funds that they were owed. Accordingly, the Defendants had a duty to preserve their data. Fujitsu Ltd., 247 F.3d at 436. At a minimum, that duty required that they make a copy of the files on the flash drive. Zubulake v. UBS Warburg LLC, 220 F.R.D. 212, 217 (S.D.N.Y. 2003) (“While a litigant is under no duty to keep or retain every document in its possession . . . it is under a duty to preserve what it knows, or reasonably should know, is relevant in the action, is reasonably calculated to lead to the discovery of admissible evidence, is reasonably likely to be requested during discovery and/or is the subject of a pending discovery request.”) (quoting Turner v. Hudson Transit Lins, Inc., 142 F.R.D. 68, 72 (S.D.N.Y. 1991);

William T. Thompson Co. v. General Nutrition Corp., 593 F. Supp. 1443, 1455 (C.D. Cal. 1984)). The Defendants' failure to do so means that they failed to act in good faith. Rule 37(e) consequently does not preclude an award of sanctions.

It also bears mention that the Plaintiffs did not specifically request, nor did this Court ever require production of the data on the flash drive. Instead, what the Plaintiffs sought, and the Defendants agreed to provide, was an accounting of the LLCs' use of the Plaintiffs' funds and the documentation that supported that accounting. Since Ms. Thomas testified that she and the accountant intended to begin that process the day after her deposition, it is apparent that at least some underlying documentation must have been available. (See Tr. at 39 (indicating that the accountant "has the bank statements")). Significantly, during her deposition, Ms. Thomas did not attribute the failure to provide such documents to the failure of her flash drive, but to other inexcusable reasons for delay. (See, e.g., id. at 49 (noting that the accountant "has a lot of other clients," that "the whole month[] from January through April is tax time," that his "wife hasn't been feeling well," and that "[i]t's one thing after the next.")).

It consequently is clear that the Defendants have violated this Court's orders by failing to preserve and produce in a timely manner relevant financial records in their custody or control. Moreover, their failure to do so is, at a minimum, attributable to their negligence.

In these circumstances, the Court will grant the Plaintiffs sanctions motion, (Docket No. 16), and direct that the Defendants be precluded from offering any evidence at trial concerning their financial records or the data allegedly contained on the flash drive discarded by Ms. Thomas. Additionally, the Court will hold a further conference on April 1, 2010, at 9:30 a.m., in Courtroom 20A, to discuss the completion of pretrial procedures in this case and the scheduling of a trial.

SO ORDERED.

Dated: New York, New York
March 15, 2010



FRANK MAAS
United States Magistrate Judge

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