The U.S. Supreme Court and Punitive Damages: On the Road to Reform

After years of developing its jurisprudence, the Supreme Court in State Farm signals that the days of runaway, irrational punitive damages may be ending

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LAST APRIL, the U.S. Supreme Court issued what may be the most important punitive damage ruling ever to come from that Court—*State Farm Mutual Automobile Insurance Co. v. Campbell*.[1] First, the Court set a single-digit multiplier as the ordinary constitutional limit for the permissible ratio between compensatory damages and punitive damages. Second, it also dealt a body blow to the pattern-and-practice cases by imposing a "similarity to the conduct that caused the harm" test on the admissibility of evidence that can be used to prove malice or reprehensibility. It stated: "A defendant's dissimilar acts, independent from the acts upon which liability was premised, may *not* serve as a basis for punitive damages." (Emphasis supplied.)

The Court set the foundation for both these rules in the procedural and substantive constitutional limitations imposed by the due process clause of the 14th Amendment. That clause, the Court stated, "prohibits the imposition of grossly excessive or arbitrary punishments on a tortfeasor."

In addition, the court made a number of other important comments:

- The wealth of the defendant cannot justify an otherwise unconstitutional punitive damage award.
- The disparity between permissible civil fines and penalties for the same conduct and punitive damages award based on that conduct are indicative of an improper measure of punitive damages.
- When the compensatory damages are substantial, then a lesser ratio—perhaps only equal to compensatory damages—can reach the outermost limits of the due process guarantee.

THREE-PART DECISION

The decision contains three major parts, each of which creates a different constitutional test for punitive damage awards. First, the Court examined and rejected as not sufficiently similar the evidence used in the Utah courts to prove "reprehensible" conduct. Second, it limited the constitutionally permissible ratio between compensatory damages and punitive damages to a single-digit multiplier (nine times or less). Third, it focused on the civil penalties available for the conduct and used those penalties as a measure to determine the propriety of the punitive damage award.

All three tests, denominated as "guideposts" by the Court, should be considered in any given case.

The facts giving rise to the massive verdict in the Utah state courts and then to this landmark decision involved an excess verdict case arising from an automobile accident in which one driver was killed and another permanently disabled. Curtis Campbell, the State Farm insured, asserted that he was not at fault for the accident, but the facts indicated otherwise. Campbell's policy limits were $50,000, and State Farm declined the claimants' offers to settle for

1. 123 S.Ct. 1513 (2003), *rev'g and remanding* 65 P.3d 1134 (Utah 2001).

that amount—$25,00 per claimant. State Farm ignored the advice of its own investigator and took the case to trial. At trial, the jury returned a verdict against Campbell for $185,000. State Farm refused to pay the excess judgment, and its counsel made the bonehead statement to the insured: "You may want to put 'for sale' signs on your property."

Campbell then obtained his own counsel and gave an assignment of his rights to the claimants in exchange for a covenant not to execute. Campbell and the underlying claimants then pursued a bad faith action, using the claimants' counsel.

In reviewing the punitive damages award, the U.S. Supreme Court focused on State Farm's egregious conduct. It concluded that the handling of the claim "merits no praise" and that by disregarding the overwhelming likelihood of liability, State Farm caused the Campbells harm. The harm was amplified by State Farm's refusal to pay the excess verdict and by what was claimed to be a "national scheme to meet corporate fiscal goals by capping payouts on claims company-wide." This was asserted to be a consistent nationwide feature of the business operations orchestrated from the highest levels of corporate management.[2]

During the course of the bad faith action in the Utah courts, evidence of all manner of allegedly improper conduct by State Farm across the United States over a 20-year period was admitted. Issues of original equipment manufacturer parts, corporate financial goals, compensation of claims representatives, and disposition of claims manuals were admitted in an attempt to prove wrongful conduct. Much of the proof was remote in time, nature and geography from Utah and the instant bad faith claim.

The jury in the bad faith action returned a verdict of $2.6 million in compensatory damages and $145 million in punitive damages. The trial court reduced the compensatory damages to $1 million and the punitive damages to $25 million. The Utah Supreme Court reinstated the $145 million punitive damage award.

U.S. SUPREME COURT RULING

Justice Anthony Kennedy wrote the opinion for the U.S. Supreme Court's 6-3 majority. He was plainly appalled by the punitive award, to which he referred as "punishment," "grossly excessive," "arbitrary," "massive," "irrational" and "neither reasonable nor proportionate to the wrong committed."

The opinion begins with the assumption that the Campbells were made whole by the compensatory award. Punitive damages, Justice Kennedy wrote, are intended to punish, rather than redress, loss. Punitive damage awards, themselves, create a danger of "arbitrary coercion" and carry "devastating potential for harm." The states cannot allow their courts to "classify arbitrariness as a virtue." There are procedural and substantive constitutional limitations to prohibit this. Wealth cannot justify an otherwise excessive punitive damages award. The Court showed little faith in the jurors in this area, asserting that the vague instructions to avoid passion or prejudice "do little to aid the decision maker."

The Court approached its resolution of the case under the guideposts it established in *BMW of North America Inc. v. Gore*,[3] which are (1) the reprehensibility of the defendant's conduct, (2) ratio limits between compensatory and punitive damages, and (3) disparity between civil penalties and punitive damages.

A. Admissible Evidence of Reprehensible Conduct

The evidence admitted to prove reprehensible conduct must be carefully monitored to avoid unconstitutionally arbitrary results, the Court stated, because this evi-

2. Although these assertions are not correct, by making the conduct appear more egregious, they serve to add weight to the restrictions on punitive damages. In fact, less than 60 days after the verdict was returned, State Farm had filed a notice of appeal on the Campbells' behalf and posted a bond. The appeal failed, Slusher v. Ospital, 777 P.2d 437 (Utah 1989). State Farm ultimately told the Campbells it would pay the entire judgment and did, in fact, pay the judgment after the unsuccessful appeal.

3. 517 U.S. 559 (1996), *rev'g and remanding* 646 So.2d 619 (Ala. 1994).

dence has a significant impact on the punitive damage award. The conduct used to prove the reprehensible conduct must be similar to the conduct that actually caused the damage. It need not be identical, but it "must have a nexus to the specific harm suffered by the plaintiff." The Court declared:

> A defendant's dissimilar acts, independent from the acts upon which liability was premised, may not serve as a basis for punitive damages. . . . Due process does not permit courts, in the calculation of punitive damages, to adjudicate the merits of other parties' hypothetical claims against a defendant under the guise of the reprehensibility analysis, but we have no doubt that the Utah Supreme Court did that here.[4]

It added that courts cannot admit evidence of extraterritorial conduct. Federalism prohibits punishment for conduct that occurs out-of-state.[5]

These restrictions are intended to limit the cases in which punitive damages are available and, at the same time, control the amount of the punitive damages awarded. The Court starts with the assumption that the plaintiff has been made whole by the compensatory damage award. Given that assumption, the questions to be resolved are whether the defendant's conduct is so reprehensible and injury so severe as to warrant further sanctions to achieve punishment or deterrence.

Courts should look to whether the harm was physical or economic in nature, Justice Kennedy stated.

Recidivism, he added, may be a proper reason for punishment if the conduct in question replicates the prior transgression in the claim at issue and there has been a frequency of similar past conduct. The Court, however, rejected general allegations of "recidivism," assertions of an unsavory character, and improper, but dissimilar, independent acts as bases for a finding of reprehensible misconduct. It expressly rejected the argument that a corporate competitive advantage created by improper conduct should be grounds for punishment.

The Court noted that admitting the wrong evidence of reprehensible conduct raises a danger of multiple awards for the same conduct. Defendants can thank Professor Laurence Tribe, who argued the case for the Campbells, for this point. He raised this issue not once but twice during oral argument when the Court was casting about for a workable standard. The justices' questions at the oral argument related to considering and rejecting previous formulations of limitations, such as the territorial limitation alone, because of the danger of 50 cases nationwide involving 50 different plaintiffs. It was during the discussion of multiple cases that the question of whether there was a possibility of multiple cases within the state of Utah arose. Tribe then "alerted" the justices to the double punishment problem. The *State Farm* decision ultimately admonished against the danger of "multiple punitive damage awards for the same conduct" and "double counting."

B. Single-Digit Ratio Rule

The Court declined to impose a rigid benchmark that a punitive damage award may not surpass, but stated:

> Our jurisprudence and the principles it has now established demonstrate, however, that, in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process.[6]

This means that the punitive damages cannot be greater than nine times the compensatory damages. If the conduct of the defendant was particularly egregious, with small compensatory damages, a ratio greater than the single-digit multiplier might be allowed. The converse also is true, however. If the compensatory damages are large, then a smaller amount of punitive damages will be necessary to serve the purpose of punishment.

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4. 123 S.Ct. at 1523.
5. Unlawful out-of-state conduct may be probative when it demonstrates the deliberateness and culpability of the defendant's action in the state where it is tortious.
6. 123 S.Ct. at 1524.

Physical damage, as opposed to economic loss, may justify a larger ratio. The Court noted that the compensatory damages awarded in the case before were $1 million for what it described as "minor economic injuries." Under these circumstances, there was complete compensation in the compensatory damage award. When the compensatory damages are substantial, it added, "a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee."

C. Civil Penalty

On the third *Gore* guidepost, the Court compared the punitive damages to the civil penalties authorized in comparable cases, noting that punitive damages are not a substitute for the criminal process. In this case, the available civil penalty, a $10,000 fine, was "dwarfed" by the punitive damage award. This disparity rendered the award excessive.

APPLICATION OF STATE FARM

The comments regarding evidence probative on the issue of reprehensibility will have far-reaching implications. Because these rules have their foundation in constitutional due process, they cannot be weakened by either state legislative or state judicial action.

Constitutional issues will now be injected into discovery battles in pattern-and-practice cases. Similar conduct—the same pattern and the same practice—will be the new touchstone of relevance and materiality. Objections to interrogatories and production requests regarding dissimilar conduct should include the constitutional grounds in addition to relevance, materiality to the subject matter, burden, and privacy.

Motions in limine on the admissibility of evidence, together with offers of proof and other evidentiary hearings out of the presence of the jury during trial, will be conducted with constitutional implications. Appeals now can be based on evidentiary rulings with the imprimatur of the Supreme Court supporting the argument that virtual prejudice attaches to the erroneous admission of dissimilar evidence.

The traveling road show of familiar "experts" and evidence will be hard pressed to establish the essential replication of prior transgressions or similarity to the conduct that caused the harm. In *State Farm*, for example, the Campbells had a third-party good faith case, yet much of the evidence they adduced at trial involved first-party claims.

The danger of double punishment also may become an available defense or limitation of evidence offered that is directly related to the conduct in the case in question. If a trier of fact considered the evidence in a previous case, this may provide a basis for exclusion in later cases. Defense counsel who represent product manufacturers sued for what is, in essence, the same conduct involving multiple claimants (for example, automobile manufacturers and asbestos manufacturers) should argue to the trial judge that an award of punitive damages would constitute double punishment based on previous awards.[7] This may be an especially potent argument where the wrongful conduct occurred many years ago and there is no longer a corporate defendant who will be "deterred" by another punitive damage award.

The single-digit ratio will create some level of predictability in punitive awards, allowing defendants to weigh the risks and make rational assessments of the exposure. Both in new trial motions and in appeals, trial and appellate judges will have some basis for assessing what constitutes an "excessive" award. The Supreme Court previously has instructed that both trial and appellate judges should review the punitive damages award de novo.[8] These courts

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7. *See* In re Northern Dist. of California "Dalkon Shield" IUD Prod. Liab. Litig., 526 F.Supp. 887, 899 (N.D. Cal. 1981).

8. Honda Motor Co. v. Oberg, 512 U.S. 415 (1994), *rev'g and remanding* 851 P.2d (Ore. 1993) (trial judge should review the punitive damage award on new trial de novo), and Cooper Industries Inc. v. Leatherman Tool Group Inc., 532 U.S. 424 (2001), *vacating and remanding* 205 F.3d 1351 (9th Cir. 1999) (courts of appeals should review punitive damage award de novo).

now have some guidance as to how big is too big.

The civil penalty disparity analysis, often overlooked, may be the most useful tool in limiting the award once rendered. The civil penalty will almost always be much smaller than even the compensatory damages.

More restrictive jury instructions incorporating the three *Gore* guideposts should be offered and viewed with favor by the trial judges.

Precisely because we do not know with certainty what the future holds, all answers in punitive damage cases should include affirmative defenses challenging the unconstitutionality of punitive damages awards based on substantive and procedural due process, equal protection, excessive fines and penalties and double punishment under both the U.S. and state constitutions.

WHAT MOTIVATED THE COURT?

For years the U.S. Supreme Court has dabbled in the area of punitive damages, always viewing it as a significant economic problem. From time to time over the last 20 years, the Court has dropped hints to state courts and legislatures about the nature of the problem, hints that have not been acted on. The Court knew jurors were rendering arbitrary awards and thus discussed a constitutional upper limit on punitive awards in *Pacific Mutual Life Insurance Co. v. Haslip*.[9] It knew jurors were unpredictable and thus instructed trial judges to review punitive awards carefully in order to ensure against grossly excessive or arbitrary punishments.[10] It knew that attorneys got carried away with the evidence and instructed that it should be limited to the jurisdiction in which the case was pending.[11] Finally, it became apparent that neither the jurors nor trial judges were applying the appropriate standards, and the Supreme Court instructed the courts of appeal in *Cooper Industries Inc. v. Leatherman Tool Group Inc.*[12] to conduct a de novo review.

In a bizarre twist, two lower courts completely misconstrued the Supreme Court's directives. A California Court of Appeal applied the more relaxed "any substantial evidence" standard as a basis for affirming a $290 million punitive damage award.[13] The other example is *State Farm* itself, in which the Utah Supreme Court used the de novo review as a basis for restoring a nine-figure punitive damage award that had been reduced by the trial judge.

The Supreme Court has been appalled by the problem and by these awards. It was forced to action by the inaction of state courts and state legislatures. *State Farm*, in part, has set the Court as the final arbiter of evidentiary rulings on a constitutional stage. This is probably the last thing the Court wanted, but it had no choice other than to take control of the issue.

CONSTITUTIONAL DEFENSES

There has been a major shift in the constitutional bases for the punitive damage challenges. The Supreme Court now has authorized the use of the excessive fines clause of the Eighth Amendment and the substantive and procedural limitations contained in the due process clause of the 14th Amendment. The Court also has stated that the concepts of state sovereignty do not allow extraterritorial punishment. Finally, it has rejected the argument that de novo review by trial and appellate courts violates a plaintiff's Seventh Amendment right to trial by jury.

The application of these constitutional challenges to punitive damages is a recent development.

In 1986, in *Aetna Life Insurance Co. v. Lavoie*,[14] the Court raised the question of the application of the due process clause and the equal protection clause of the 14th

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9. 499 U.S. 1, 18 (1991).
10. Honda, 512 U.S. at 421.
11. Gore, 517 U.S. at 571,.
12. 532 U.S. at 431.
13. Romo v. Ford Motor Co., 122 Cal.Rptr.2d 139 (Cal.App. 2002), *rev. denied*, 2002 Cal. Lexis 7254, *cert. granted and remanded in light of State Farm*, 123 S.Ct. 2072 (2003).
14. 475 U.S. 813, 837 (1986), *vacating and remanding* 470 So.2d 1060 (Ala. 1984).

Amendment to punitive damages, but it refused to reach the issues because the punitive damage award was reversed for other reasons.

In 1988, in *Bankers Life & Casualty Co. v. Crenshaw*,[15] it rejected a challenge to punitive damages based on the excessive fines clause and on violations of equal protection and due process because the defendant failed to raise these constitutional challenges in the courts below.

In 1993, in *TXO Production Corp. v. Alliance Resources Corp.*,[16] it stated that substantive due process as guaranteed by the due process clause prohibits the award of grossly excessive punitive damage awards, but it refused to reach issues of equal protection and procedural due process because they were not raised below.

In 1994, in *Honda Motor Co. v. Oberg*, it required the states to provide "meaningful" judicial review of the amount of punitive damage awards as part of procedural due process protection; an analysis of the punitive damage award based on the deferential "no substantial evidence" standard was "not enough."[17]

In 1995 in *BMW*, a sea change occurred. The Court attempted to define what constitutes an unconstitutionally excessive punitive award and concluded that a grossly excessive award violates the due process clause. It also applied the doctrine of state sovereignty—that is, one state has no power to punish wrongful conduct that occurs within another.[18]

In 2001, in *Cooper Industries*, the Court added the excessive fines clause of the Eighth Amendment to the list of constitutional bases for challenging punitive awards, concluding that the prohibition against excessive fines applied to the states through the 14th Amendment. This was in addition to and independent of the substantive due process prohibition against grossly excessive awards that also found its roots in the due process clause. *Cooper Industries* also concluded that the Seventh Amendment right to jury trial does not prohibit de novo review by trial judges and appellate courts because the determination as to the amount of punitive damages is "not a finding of fact."[19]

The only issues remaining to be addressed in the punitive analysis are the application of the equal protection clause of the 14th Amendment and the double jeopardy prohibition in the Fifth Amendment. The comments in *State Farm t*hese issues. One lesson that flows from all these cases, however, is that the defenses must be raised in the trial court.

THE FUTURE

While the vote in *State Farm* was 6-3, philosophically it was closer to 8-1. The two most conservative justices (Scalia and Thomas) do not view punitive damages as a constitutional problem, Justice Scalia stating that a "standard" is "insusceptible of principled application." Only Justice Ginsburg, who wrote the lone substantive dissent, believes everything she reads about State Farm and other defendants. Philosophically, the court is not likely to retrench from the frontiers that it established in *State Farm*.

California may provide the vehicle for some answers soon, however. The U.S. Supreme Court granted certiorari in *Romo v. Ford Motor Co*. and remanded the case to the California Court of Appeal for "further consideration" in the light of State Farm.[20] *Romo* involved three deaths after the rollover of a 15-year-old Ford Bronco. Compensatory damages in excess of $6 million were awarded, as well as punitive damages of $290 million. Despite *Cooper Industries*' directive that punitive damage awards were to be reviewed de novo, the California court had applied the less stringent "any substantial evidence" standard to test the amount of punitive damages. The California Supreme Court refused to review the case.

Romo falls within the "physical injury"

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15. 486 U.S. 71, 75-77 (1988), *aff'g* 483 So.2d 254 (Miss. 1985).
16. 509 U.S. 443, 468, 463-64 (1993), *aff'g* 419 S.E.2d 870 (W.Va. 1992).
17. 512 U.S. at 429.
18. 517 U.S. at 572-73.
19. 532 U.S. at 437, 440, 443.
20. *See* footnote 13, *supra*.

exception to the single-digit ratio, but it also satisfies the "high compensatory" exception for a lowered ratio. The punishment guidepost will allow for greater punitive damages, but the danger of using the civil process for punishment will be heightened. The case also will bring the "double punishment" and "double counting" issues to the fore.

If, after *State Farm*, the state legislatures and state courts do not get the message, there is a next step for this U.S. Supreme Court. It finally may impose criminal procedural protections on punitive damage claims.[21] As the Court noted in *State Farm*:

> Although these awards serve the same purposes as criminal penalties, defendants subjected to punitive damages in civil cases have not been accorded the protections applicable in a criminal proceeding. This increases our concerns over the imprecise manner in which punitive damage systems are administered.[22]

Such protections may include the right to a unanimous jury, the application of the "beyond a reasonable doubt" burden of proof, and rights against self-incrimination.

The U.S. Supreme Court has embarked upon a path that it intends to follow to provide for limitation, if not elimination, of punitive damages.

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21. To this point, the courts have rejected that path. *See* Toole v. Richardson-Merrell Inc., 60 Cal.Rptr. 398 (Cal.App. 1967).

22. 123 S.Ct. at 1520.