Testing the Limits of Punitive Damages: California Supreme Court Weighs In

The California Supreme Court has issued its first rulings on the limits of punitive damages since the U.S. Supreme Court’s *State Farm* ruling in 2003 that punitive damages exceeding nine times actual damages are, except in rare cases, unconstitutional. On August 10, 2005, the California Supreme Court rejected a petition by Philip Morris USA to review a $50 million damages award in a tobacco case. The award had previously been reduced to a 9:1 ratio (punitive to compensatory damages), but the defendant urged for a further reduction arguing the trial court admitted improper evidence of acts in other jurisdictions without requiring a proper nexus to the state. A petition to the United States Supreme Court is expected to be filed in November. Previously, on June 16, 2005, the California Supreme Court found one appellate court too restrictive in its application of the *State Farm* principles and implied that a ratio of 3:1, under the circumstances, was not sufficient to deter and punish the defendant’s reprehensible conduct. In a second decision, the California Supreme Court found the appellate court was not sufficiently deferential to the principles elucidated in *State Farm* with a ratio of punitive to actual damages of 340:1, and reduced the award to a 10:1 ratio. Taken together, the cases encourage the lower courts in California to use punitive damages to punish and deter wrongful conduct, while being somewhat mindful of the limits established by *State Farm*.

State Farm Sets Constitutional Limits On Punitive Damages

Faced with the question of when punitive damages are so excessive as to violate a defendant’s rights under the due process clause of the U.S. constitution, the U.S. Supreme Court held, in *State Farm Mutual Automobile Insurance v. Campbell*, 538 U.S. 408 (2003), that “few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process.” *Id.* at 425. At the same time, the Court reiterated the factors that should be considered when assessing the appropriate level for punitive damages: “(1) the degree of reprehensibility of the defendant’s misconduct; (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages awarded; and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases.” *Id.* at 418 (citing *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 575 (1996)).
Although the Court declined to impose “a bright-line ratio which a punitive damages award cannot exceed,” it essentially adopted the standard that the ratio cannot exceed “single digits” except for arguably extraordinary cases. Awards within this single-digit ratio range were more likely to “comport with due process, while still achieving the State’s goals of deterrence and retribution, than awards with ratios in [the] range of 500 to 1.” Id. While the Court did not create a “rigid benchmark” for evaluating awards, it found that an award having a 145:1 ratio, like that in State Farm, is presumptively unconstitutional. The Court acknowledged, however, that punitive damage awards greater than single-digit ratios may be appropriate, where “a particularly egregious act has resulted in only a small amount of economic damages” and “when compensatory damages are substantial, then an even lesser ratio can reach the outermost limit of the due process guarantee.” Time Warner Entertainment v. Six Flags Over Georgia, 538 U.S. 977 (2003). It is important to keep in mind that an absolute dollar amount is not controlling. Rather, it is the ratio between the two awards that is critical. For instance, although the jury in Time Warner awarded $197 million in compensatory damages and $257 million in punitive damages, the Supreme Court denied certiorari, sending the message that it does not matter how high the award is as long as the ratio is a single digit (1.5:1).

The most successful strategies used by defendants to reduce punitive awards in cases after State Farm have been: (1) under the reprehensibility guidepost, to exclude collateral evidence based on an insufficient nexus between the alleged bad conduct and the injury suffered by plaintiff, see, e.g., Webb v. CSX Transportation, Inc., 615 S.E.2d 440, 450 (S.C. 2005) (Supreme Court of South Carolina reversing punitive damages award where “much of the evidence of acts in other jurisdictions, including CSX and other railroads, and of acts unrelated to crossing safety in South Carolina admitted in the trial [was] not constitutionally permissible under Campbell”); and (2) under the second guidepost, to focus on the ratio of compensatory and punitive damages when they exceed the single digit. Both strategies were tested recently in the California cases discussed below.

**Award To Be Adequate To Deter And Punish Reprehensible Conduct**

In Boeken v. Philip Morris, Inc., 122 Cal. App. 4th 684 (Cal. Ct. App. 2004), pet. for cert. denied, (Ca. Aug. 10, 2005), defendant is appealing a punitive damages award with a ratio of 545:1 (punitive to compensatory) that has already been reduced to 9:1. The jury awarded $5.5 million in compensatory damages and $3 billion in punitive damages to a long-time smoker who died of lung cancer. The trial court reduced the punitive damages award to $100 million, and the California appeals court halved the award to $50 million, saying a 9:1 ratio satisfied due process. The court found defendant’s conduct reprehensible under all of the factors to be considered under Gore and State Farm. Plaintiff’s injuries were physical, not merely economic. The court found that although the health risks may have been publicized, defendant created a false controversy with its advertising, and plaintiff failed to understand and appreciate the risks. The court also found the jury properly considered harm to others. Defendant argued that the nexus was not sufficient because there was no evidence that its lawful sales practices in other states caused any injury to specific persons in other states. The court disagreed, stating that State Farm does not require proof of injury to any specific person other than the plaintiff when the conduct is identical. The court held that similar out-of-state conduct may be relevant to the issue of reprehensibility when it demonstrates deliberateness and culpability of the acts committed in the
state where they are tortuous as long as the conduct has a “nexus to the specific harm suffered by the plaintiff.” 122 Cal. App. 4th at 735.

With respect to ratios, defendant argued for a 1:1 ratio or at a minimum a 5:1 ratio, applied in Romo v. Ford Motor Co., 6 Cal. Rptr. 3d 793 (Cal. Ct. App. 2003). The court upheld the higher ratio, however, because defendant’s reprehensible conduct spanned four decades, and the resultant personal injury and death “justifies the highest single digit ratio that will satisfy due process while furthering California’s policy of punishment and deterrence.” 122 Cal. App. 4th at 741.

The California Supreme Court’s August 10, 2005 denial of Phillip Morris’ petition to review the 9:1 ratio in Boeken may indicate that the court will permit ratios at or around the constitutional limit when a finding of reprehensibility has been made and the court wishes to exercise its power to punish and deter.

**Award To Serve As “Strong Medicine” Where Fraudulent Act Recurs (i.e. Not An Isolated Incident)**

In another recent decision, Johnson v. Ford Motor Co., 2005 DJDAR 7101, the California Supreme Court agreed that punitive damages could not be used to punish Ford for its fraudulent conduct towards other potential claimants by recouping the profits from doing so. It ruled, however, that Ford’s pattern of conduct could be used in assessing the reprehensibility of such conduct, one of the factors set forth in State Farm for determining an appropriate award of punitive damages. The court stated, “California law has long endorsed the use of punitive damages to deter continuation or imitation of a corporation’s course of wrongful conduct, and hence allowed consideration of the conduct’s scale and profitability . . . . We do not read the high court’s decisions, which specifically acknowledge the states may use punitive damages for punishment and deterrence, as mandating the abandonment of that principle.” 2005 DJDAR at 7105.

In Johnson, a car dealer was found to have made certain omissions regarding problems with a used car’s transmission. The manufacturer resisted the original owners’ efforts to force a repurchase of the car under California’s “lemon law,” instead offering them a $1,500 “owner appreciation certificate” (“OAC”) credit towards the purchase of a new vehicle. The jury found that the manufacturer/dealer used the OAC program throughout California to bypass the lemon law and deceive buyers of used cars as to their history of problems. Punitive damages of $10 million were assessed, an amount found to equal Ford’s profits as a result of the OAC program. In contrast to plaintiff’s compensatory damages of just under $18,000, the punitive damages award was well over 500 times this amount.

The Fifth District Court of Appeal found it improper to assess punitive damages to punish Ford for its actions towards other potential claimants, and to use such damages to recoup Ford’s arguably ill-gotten gains throughout the state. Relying on State Farm, the appellate court ruled that punitive damages could only be used to punish Ford for its conduct in the particular case at hand. For unexplained reasons, it reduced the jury’s $10 million punitive damage award to $53,435 (three times compensatory damages) finding that to be an appropriate amount.
The California Supreme Court reversed, stressing that the appellate court had “apparently failed to adequately consider that Ford’s fraud was more reprehensible because it was part of a repeated corporate practice rather than an isolated incident.” The court remanded the case for further consideration of an appropriate award of punitive damages. 2005 DJDAR at 7101. The court concluded that where “a defendant has repeatedly engaged in profitable but wrongful conduct [this] tends to show that ‘strong medicine is required’ to deter the conduct’s further repetition.” Id. at 7105 (quoting Gore, supra, 517 U.S. at 575).

Although the California Supreme Court found Ford’s conduct to be egregious, it remains to be seen whether the court thought such conduct presents an exception to the “single digit” ratio between punitive and compensatory damages advocated in State Farm. The following case indicates that the state courts in California must be mindful of the State Farm limit.

Award To Satisfy Ratio Guidelines

In Simon v. San Paolo U.S. Holdings Co., Inc., 2005 DJDAR 7091, the California Supreme Court put an end to what looked like a four-year contest of wills between the U.S. Supreme Court and a state court of appeal. The case arose out of plaintiff’s attempt to purchase an office building in Los Angeles. The parties executed a “letter of intent” for the purchase at a price of $1.1 million, but the deal was not concluded. At trial, the jury found there was no enforceable contract of sale, but that defendant defrauded plaintiff with false promises concerning its willingness and ability to conclude the sale. Compensatory damages of $5,000 were awarded, equal to a non-refundable retainer paid to an attorney to help plaintiff with the real estate transaction. The jury awarded punitive damages of $2.5 million, apparently based on evidence plaintiff would have purchased the building for $400,000 less than it was worth if the sale had gone through. The trial judge ordered a new trial on punitive damages unless plaintiff accepted a reduction to $250,000. Plaintiff declined, and on retrial, the jury reduced the punitive award to $1.7 million, an amount equal to approximately 340 times as much as the compensatory damages.

The Second District Court of Appeal affirmed the award, after which the U.S. Supreme Court granted certiorari and then remanded the case for further consideration in light of Cooper Industries, Inc. v. Leatherman Tool Group, Inc., 532 U.S. 424 (2001) (holding that the imposition of punitive damages is subject to limits under the U.S. constitution). The Court of Appeal affirmed its prior decision, whereupon the High Court again granted certiorari and remanded the case for further consideration, this time in light of State Farm, which had by this time been decided. Once again, the Court of Appeal affirmed, finding the punitive damage award to be permissible under State Farm in view of the reprehensibility of defendant’s conduct, and in view of the fact that it was only four times as great as plaintiff’s arguable loss of $400,000 had the deal been concluded. The California Supreme Court next had its say.

On review, rather than again remanding to the Court of Appeal, the California Supreme Court took it upon itself to reduce the punitive award to $50,000 or ten times plaintiff’s compensatory damages – barely greater than the “single digit” ratio set forth in State Farm. Interpreting and applying State Farm, the court found that, unlike Ford in the Johnson case, defendant San Paolo could not be “characterized as a repeat offender.” Id. at 7096. In addition, the court noted that
a punitive-to-compensatory damage ratio significantly above 9:1 is unconstitutional unless there is “substantial justification.” *Id.* In this regard, it referred to California Civil Code § 3294(a), which permits the recovery of punitive damages “for the sake of example and by way of punishing the defendant” where the defendant’s oppression, fraud or malice has been proven by clear and convincing evidence and where the defendant has engaged in repeated wrongful acts. *Id.* at 7096-97. The court also noted that, under *State Farm*, the acceptable ratio between punitive and compensatory damages might vary in inverse proportion – as the compensatory damages increase, the constitutionally-acceptable multiplier for punitive damages decreases (and vice versa). *Id.*; but see *Pestco Inc. v. Assoc. Prods., Inc.*, 2005 Pa. Super. 276 (Pa. Super. Ct. 2005) (even though compensatory damages of $1.00 might allow for a greater ratio, the court vacated punitive damages award of $25,000 (25,500:1) which “shocked the conscience”), see also *Planned Parenthood et al. v. American Coalition of Life Activists*, 2005 U.S. App. LEXIS 19228 (9th Cir. Sept. 6, 2005) (reversing and vacating punitive damages award that did not separately satisfy due process for each plaintiff and each defendant in a multi-party lawsuit).

The California Supreme Court’s pronouncements post-*State Farm* provide important guidance to courts and litigants regarding the constitutional limits in punitive damages actions governed by California law, but the absence of a bright-line test means the scope of such awards will continue to be hotly debated. Practitioners will want to watch for developments, including the petition to the United States Supreme Court in the *Boeken* case and for decisions in other jurisdictions around the country.

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