

Does California Make a Good Neighbor For *State Farm*? Or Are California Courts Misapplying the Supreme Court's Punitive Damages Analysis? – Part I

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California Courts are struggling to apply the punitive damages analysis mandated by the United States Supreme Court in *State Farm Mutual Auto. Ins. Co. v. Campbell*, 123 S. Ct. 1513 (April 7, 2003). *State Farm* represents a paradigm shift in punitive damages analysis. Since *State Farm*, four California appellate courts have been faced with applying this new paradigm to punitive damages awards. Though deferential to *State Farm* to a greater or lesser extent, these decisions reflect what might be considered as an understandable resistance to abandoning traditional analytic constructs, rationalizations, and subjective viewpoints. We believe that at least some of these decisions violate the letter and spirit of *State Farm*, and that punitive damages awards in California will continue to be overturned until California trial and appellate courts adopt and implement a meaningful *State Farm* analysis.

The four recent California appellate decisions that have sought to apply *State Farm* are: (1) *Diamond Woodworks, Inc. v. Argonaut Ins. Co.*, 109 Cal. App. 4th 1020 (June 13, 2003); (2) *Henley v. Philip Morris*, 112 Cal. App. 4th 198 (Sept. 25, 2003), *rev. granted and cause transferred* (Dec. 23, 2003); *Romo v. Ford Motor Company*, 113 Cal. App. 4th 738 (Nov. 25, 2003); and (4) *Simon v. San Paolo U.S. Holding Company*, 2003 WL 22847318 (Dec. 2, 2003). *Diamond Woodworks* and *Romo* are, in significant respects, fair applications of *State Farm*, though they fall short in other respects. The same cannot be said of *Henley* and *Simon*. These latter decisions misapplied *State Farm* by placing undue emphasis of the "reprehensibility" of the defendants' conduct, while ignoring *State Farm* by (1) relying on evidence unrelated to plaintiff's injury, including evidence of "injuries" to non-parties; (2) authorizing constitutionally excessive ratios; (3) evaluating the wealth or financial condition of defendants; and/or (4) relying upon out-of-state conduct.

Punitive Damages Analysis In The Post-*State Farm* Era

The Supreme Court's April 7, 2003

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decision in *State Farm* held that a \$145 million punitive damages award violated the Due Process Clause of the 14th Amendment where compensatory damages were \$1 million. *State Farm* is the most recent pronouncement by a Court clearly troubled by the litigation lottery called punitive damages. See, e.g., *Cooper Indus., Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424 (2001); *BMW North America, Inc. v. Gore*, 517 U.S. 559 (1996); *Honda Motor Co. v. Oberg*, 512 U.S. 415 (1994).

In *State Farm*, the Supreme Court reaffirmed the bedrock principle that: "Elementary notions of fairness enshrined in our constitutional jurisprudence dictate that a person receive fair notice not only of the conduct that will subject him to punishment, but also of the severity of the penalty that a State may impose." *State Farm*, 123 S. Ct. at 1520 (quoting *Gore*, 517 U.S. at 574). The problem is that punitive damages cases are like Monday morning quarterbacking. Typically jury and judicial (including appellate) consideration of punitive damages awards involves *post hoc* evaluations of conduct that, though characterized as reprehensible in the crucible of litigation, is not something of which the defendant had fair notice would subject it to punitive damages. And, some jury awards, both before and after judicial review, far exceed anything approaching fair notice of "the severity of the penalty that a state may impose."

State Farm also extended, amplified, and clarified *Gore*'s guideposts for analyzing the constitutionality of punitive damage awards. Under the *Gore* guideposts, lower courts must consider: "(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 award; and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases." *State Farm*, 123 S. Ct. at 1520.

In *State Farm*, the Supreme Court curtailed runaway punitive damage awards in several respects. Among the primary lessons to be drawn from the decision

are: (1) "A defendant should be punished for conduct that harmed the plaintiff, not for being an unsavory individual or business" (*id.* at 1523); (2) States cannot punish defendants for "conduct that may have been lawful where it occurred" (*id.* at 1522); and States do not, "as a general rule," have a legitimate interest in imposing punitive damages even for "unlawful acts committed outside of the State's jurisdiction" (*id.* at 1522); (3) "in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process," and "[w]hen compensatory damages are substantial, a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee" (*id.* at 1524); and (4) "the presentation of evidence of a defendant's net worth creates the potential that juries will use their verdicts to express biases against big businesses, particularly those without strong local presences" (*id.* at 1520, quoting *Honda Motor Co. v. Oberg*, 512 U.S. 415, 432 (1994)).

The Direct Relationship Or Nexus Requirement

The most important lesson of *State Farm* is the Supreme Court's reaffirmation of the requirement that there must be a direct relationship or nexus between the conduct for which punitive damages are imposed and the injury to the plaintiff. In *State Farm*, the Court left no doubt on this point: "A defendant should be punished for conduct that harmed the plaintiff" because "[d]ue 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." 123 S. Ct. at 1523. Although earlier Supreme Court decisions said much the same thing – including *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 22 (1991) (The due process clause requires that there be "some understandable relationship" or nexus between the conduct that caused the underlying injury and the imposition of punitive damages.); *Gore*, 517 U.S. at 580 (Due process requires a punitive damage award to bear a "reasonable relationship" to the actual harm caused by the conduct at

issue.); *Cooper Indus., Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424, 435 (2001) (The Supreme Court characterized the reasonable-relationship inquiry as "the relationship between the penalty and the harm to the victim caused by the defendant's actions.")¹ – some lower courts continued to obfuscate or ignore this limitation. Under *State Farm*, they can no longer do so.

The Fifth Appellate District recognized this in *Romo*. It concluded that *State Farm* represents a paradigm shift that fundamentally altered California's "broad view" by making "it clear that the permissible punishment is for the harm inflicted on the present plaintiffs" (*Romo*, 113 Cal. App. 4th at 750 & n. 4), a result that it found squarely conflicts with *Grimshaw v. Ford Motor Co.*, 119 Cal. App. 3d 757 (1981). The *Romo* court explicitly recognized that this was not a mere difference in judicial philosophy, but rather that the Supreme Court had "articulated a constitutional due process limitation on both the goal and the measure of punitive damages." 113 Cal. App. 4th at 749.²

This aspect of the *Romo* court's decision caused shock and awe among the plaintiffs' bar, according to contemporaneous reports in the *Daily Journal* and *The Recorder*. It was, however, clearly mandated by *State Farm*.

It was also reflected in the Fourth Appellate District's earlier decision in *Diamond Woodworks*. In that case, the court rejected plaintiff's "contention that reprehensibility should be measured by Argonaut's conduct toward the world at large, rather than as directed at [plaintiff] alone." *Diamond Woodworks*, 109 Cal. App. 4th at 1053. The Court did so because *State Farm* "makes clear that such matters cannot provide a legitimate basis for the plaintiff's punitive damages award." *Id.* at 1054.

No such concerns were articulated or applied by the First Appellate District in *Henley*. Rather, the *Henley* Court paid lip service to *State Farm*, and then essentially regurgitated its earlier angry opinions,³ shifting rationales where necessary, and granting a grudging, conditional reduction in the amount of punitive damages to redress any constitutional violation. 112 Cal. App. 4th at 246-247. The court reasoned that, despite *State Farm*, its approach was acceptable because the defendant's conduct was "directed at the entire public . . . an entire category of persons to which plaintiff squarely belongs." *Id.* at 247.

¹ Accord *Burke v. Deere & Co.*, 6 F.3d 497, 507, 511 (8th Cir. 1993) ("Only evidence which is relevant to the conduct for which liability is imposed can support an award of punitive damages." Allowing plaintiffs to introduce conduct evidence unconnected to the underlying torts would allow plaintiffs to assume the mantle of a "roving commission" on defendant's conduct).

² The *Romo* court's reprehensibility discussion was not fully faithful to its own conclusions: The court rationalized its result in part on the impact of Ford's conduct on "consumers" as a whole. 113 Cal. App. 4th at 806-807.

³ *Henley v. Philip Morris Cos., Inc.*, 93 Cal. App. 4th 824 (2001), vacated, No. S102941 (Cal. Jan. 29, 2002), on retrial, No. A086991 (Cal. App. Mar. 19, 2003) (not for publication), *rev. granted and cause transferred* (Dec. 23, 2003).

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