

Evaluating Punitive Damages

BY MARK J. HANCOCK and
STEVEN D. WASSERMAN



The moment when the jury returns with a verdict is one of the scariest for a trial lawyer—particularly for one who specializes in corporate defense. Even scarier is when that verdict is read and it contains a huge award of punitive damages. And make no mistake: California juries are not bashful—they have been known to render massive punitive damages awards that dwarf the award of compensatory (actual) damages. For example, in one securities fraud case jurors awarded \$5.7 million in compensatory damages and \$165 million in punitive damages (*Clagharn v. Edsaco, Ltd.*, No. 98-3039 (N.D. Cal.) verdict entered April 19, 2002). In another dispute involving the sale of medical testing equipment, the jury awarded \$2.9 million in compensatory damages but a whopping \$931 million in punitive damages (*Beckman Coulter Inc. v. Flextronics Int'l Ltd.*, Orange Co. Super. Ct. No. 01CC08395 (verdict filed Sept. 24, 2003)). And in a tobacco case with \$5.5 million in compensatory damages, the jury awarded \$3 billion in punitive

damages (*Boeken v. Philip Morris*, 127 Cal. App. 4th 1640 (2005)).

A vexing question lingers over every punitive damages verdict: How much is too much? Both the U.S. Supreme Court and the California Supreme Court have provided considerable guidance on this important issue.

THE GOVERNING STATUTE

A proper analysis begins with section 3294 of the California Civil Code, which governs when punitive damages may be awarded. The statute provides that in a non-contract case, when clear and convincing evidence proves that the defendant is guilty of “fraud, oppression or malice” the trier of fact can award punitive damages to the plaintiff “for the sake of example and by way of punishing the defendant.” (Cal. Civil Code, § 3294 (a).)

But how large should the award be? The statute does not set a fixed standard. Rather, once there has been a finding of fraud, oppression, or malice—and when the defendant is an entity, a finding that the wrongdoing was committed, authorized, or ratified by an officer, director, or managing agent—the court gives

the jury three factors to consider. These factors are listed in the standard jury instructions on punitive damages (see Judicial Council of Calif. Civil Jury Instructions, CACI 3940–3949).

First is the degree of reprehensibility of the defendant’s conduct. On that issue, the jury may take into account whether the defendant caused physical harm; disregarded the health or safety of others; took advantage of a financially vulnerable plaintiff; acted pursuant to a pattern or practice; and acted with trickery or deceit. (See *State Farm Mut. Ins. Co. v. Campbell*, 538 U.S. 408, 419 (2003).)

The second factor is whether there is a reasonable relationship between the amount of punitive damages and the plaintiff’s harm.

Third and last, the jury may weigh the defendant’s financial condition in determining an amount of punitive damages necessary to punish the defendant and discourage future wrongful conduct. (See CACI 3940.)

Massive awards are not surprising, given the reality that jurors tend to get angry when they hear evidence about fraud, trickery, and taking advantage of vulnerable plaintiffs. Also, juries are asked to apply the stated factors without being given any specific points of reference for the dollar amount of an appropriate punitive damages award. As a result, punitive damages verdicts lack consistency and predictability.

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DUE PROCESS CONSIDERATIONS

For many years, defendants have sought refuge from punitive damages awards by invoking the due process clause of the Fourteenth Amendment. The classic argument centers on the theme that a defendant is entitled to fair notice in advance of the type of conduct that will spark punishment, as well as notice of the severity of any penalty that can be imposed to punish and deter that conduct.

The U.S. Supreme Court began responding to the defense argument in the early 1990s. Ever since, the Court has struggled to define when and why punitive damages awards are too severe.

The Court upheld awards with punitive-to-compensatory damages ratios of 4:1 in one case and 526:1 in another. (See *Pac. Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1 (1991)) and *TXO Prod. Corp. v. Alliance Res. Corp.*, 509 U.S. 443 (1993).) However, in 1996 the Court identified the ratio of the punitive damages award to the actual harm inflicted on the plaintiff as being the “most commonly cited indicium of an unreasonable or excessive punitive damages award” and reversed a punitive damages award that was 500 times the amount of the actual injury (*BMW of N. Am., Inc. v. Gore*, 517 U.S. 559 (1996)).

In 2003 the Court issued specific guidance. It stated that, “in practice few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process.” The Court commented that even a 1:1 ratio between actual and punitive damages might be appropriate: In a case where the actual damages are substantial, the Court noted, “[T]hen a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee.” (*State Farm*, 538 U.S. at 425.)

THE CALIFORNIA PERSPECTIVE

With these cases as a backdrop, the California Supreme Court took up the gauntlet recently when it reviewed a \$15 million punitive damages award in

an employment discrimination case. In *Roby v. McKesson Corp.* (47 Cal. 4th 686 (2009)), the court considered the *State Farm* guideposts and in so doing provided a thoughtful opinion that can help attorneys analyze whether a given award of punitive damages will stand up on appeal.

DEGREE OF REPREHENSIBILITY

The degree of reprehensibility of the defendant’s conduct is the most important guidepost to be considered in reviewing a punitive damages award. To assess reprehensibility, five factors should be considered, all of which are reflected in the standard CACI jury instructions.

The first factor is whether the harm caused was physical as opposed to economic. Physical harm—which may include harm to a plaintiff’s emotional and mental health, especially if it leads to physical symptoms—is considered more reprehensible than mere economic harm.

The second factor is whether the tortious conduct demonstrates an indifference to, or a reckless disregard of, the health or safety of others.

Reprehensibility is also greater if the third or fourth factors are present—that is, if the target of the conduct was financially vulnerable, or the conduct involved repeated actions rather than an isolated incident.

Finally, the fifth factor is whether the harm was the result of intentional malice, trickery, deceit, or mere accident. (See *State Farm*, 538 U.S. at 419.)

In considering these factors, it is important to focus only on conduct by the defendant that bears a relation to the harm suffered by the plaintiff. As the U.S. Supreme Court stated in *State Farm*, “A defendant should be punished for the conduct that harmed the plaintiff, not for being an unsavory individual or business. 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.”

(*State Farm*, 523 U.S. at 423.)

Likewise, when considering a corporate defendant’s conduct, the focus must be on the corporation’s institutional responsibility and not on the acts of an individual corporate employee who may have behaved badly. In other words, the analysis should address whether there was advance knowledge of the allegedly wrongful acts by corporate leaders, and whether there was conscious disregard, or authorization or ratification by an officer, director, or managing agent of the company. (See Civil Code 3294(b); CACI No. 3943.)

In *Roby* the California Supreme Court clarified its description in a prior case of a managing agent as someone with “discretionary authority” over corporate policy. The court explained that it was referring to “formal policies that affect a substantial portion of the company and that are the type likely to come to the attention of corporate leadership.” (*Roby*, 47 Cal. 4th 686, 714–715 (referring to *White v. Ultramar, Inc.*, 21 Cal. 4th 563 (1999)).) Only when this sort of “broad authority” exists is there justification for punishing an entire company for an otherwise isolated act of oppression, fraud, or malice.

Based on consideration of all five of these factors, the reviewing court reaches a conclusion about how reprehensible the defendant’s conduct was. By way of illustration, in *Roby* the court found the first three reprehensibility factors to be present: The defendant employer’s wrongful discharge of the plaintiff employee affected her emotional and mental health, and it was foreseeable that such conduct would affect her emotional well-being, thereby supporting a conclusion that the conduct evinced an indifference to her health. Likewise, the employee was considered to be financially vulnerable because she had a low-level job and her termination resulted in a depletion of her savings and the loss of her medical insurance. However, the court found the fourth factor to be absent: Though the plaintiff’s immediate supervisor had

engaged in repeated wrongful conduct, the company had not. Rather, the company's only action was to adopt a flawed attendance policy and to discharge the employee in accordance with its terms. Finally, the court concluded that the employer's conduct was neither "mere accident" nor "intentional malice," but a failure to prevent foreseeable discriminatory consequences. It was in the nature of "managerial malfeasance." (47 Cal. 4th at 717.)

In *Roby* the court acknowledged that the employer acted wrongfully and was deserving of civil penalties, but held that the reprehensibility of its conduct was at the low end of the range of wrongdoing that can support an award of punitive damages. Ultimately, the court viewed the degree of reprehensibility—the most important factor in assessing the reasonableness of a punitive damages award—as an inadequate basis for an award of the size that had been rendered.

RATIOS RULE

The second guidepost to be considered in assessing the constitutionality of a punitive damages award involves the disparity between actual or potential harm suffered by the plaintiff and the size of the award. When consequential damages include a substantial award of noneconomic damages, judges may be concerned that an award of actual damages will be duplicated in a punitive damages award, and thus call for a smaller ratio between compensatory and punitive damages. The standard jury instructions state that "there is no fixed standard for determining the amount of punitive damages" (CACI No. 3940); nevertheless, the California Supreme Court has followed the U.S. Supreme Court's lead in recognizing certain ratios as reflecting appropriate ranges for punitive damages awards that will pass constitutional muster.

In 2005 the state Supreme Court interpreted this guidepost to establish a presumption that a ratio of punitive-to-compensatory damages significantly

greater than 9:1 or 10:1 cannot survive constitutional scrutiny (*Simons v. San Paolo U.S. Holding Co.*, 35 Cal. 4th 1159, 1182 (2005)). When the ratio is higher than a single digit, a red flag goes up and the reviewing court will view the award as suspect.

In *Roby* the court went a step further and applied *State Farm's* suggestion that a ratio of 1:1 might be the federal constitutional maximum in a case involving relatively low reprehensibility and a substantial award of noneconomic damages. As stated above, the degree of reprehensibility in *Roby* was low. The award of compensatory damages was deemed to be "substantial" because only \$605,000 of the total award of \$1.9 million was for the plaintiff's economic losses; the rest was for physical and emotional distress. When this total compensatory award was

consider instead that a variety of California statutes provide for treble damages for different types of fraudulent and bad faith conduct. In any event, this guidepost would weigh in favor of a smaller punitive damages award when a jury's award significantly exceeds the amount of any penalty that would be available had the plaintiff pursued the claim administratively.

After considering all three of the *State Farm* guideposts, the reviewing court will determine whether the amount of punitive damages awarded satisfies due process. In *Roby* the court concluded that \$15 million was too high for punitive damages, and it reduced the award to \$1.9 million to bring the award into an even 1:1 ratio with the compensatory damages. The court emphasized the relatively low degree of reprehensibility on the

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compared to the punitive damages award of \$15 million, the disparity appeared to be significant, warranting a reduction of the latter.

CIVIL PENALTIES

The third and final *State Farm* guidepost to be considered is the difference between the punitive damages awarded by the jury and civil penalties authorized or imposed in comparable cases. Examples include the administrative fine of up to \$150,000 available for a violation of the Fair Employment and Housing Act (Cal. Gov. Code § 12970(a)(3)) or an award of three times actual damages available for violations of constitutional rights (Cal. Civ. Code § 52(a)). In the case of intentional fraud—one of the most common grounds for awarding punitive damages—a statutory violation may not be clearly comparable; it may be useful to

employer's part, and the substantial award of noneconomic damages to the plaintiff, as especially significant to its decision.

In any case where the possibility of punitive damages exists, counsel must know the standards governing when such awards are appropriate and how much can be awarded consistent with due process principles. Armed with that knowledge, lawyers can properly evaluate the risks involved; fairly assess the evidence offered regarding each of the governing factors; make appropriate motions; and prepare correct jury instructions.

Then, hopefully, everyone can avoid an appellate debate on punitive damages after the case is decided. [▶](#)

Mark J. Hancock and Steven D. Wasserman are partners with Sedgwick Detert Moran & Arnold in San Francisco. They defend professional liability claims.

Evaluating Punitive Damages

- 1 Punitive damages are available in a breach of contract case.
 True False
- 2 The California Supreme Court has capped the amount of punitive damages that may be awarded.
 True False
- 3 Punitive damages may be awarded against a corporation if the wrongdoing was committed, authorized, or ratified by an officer, director, or managing agent.
 True False
- 4 In assessing the degree of reprehensibility of a defendant's conduct, the jury may consider whether it caused physical harm.
 True False
- 5 In deciding whether to award punitive damages, the jury may not consider the defendant's financial condition.
 True False
- 6 The U.S. Supreme Court has relied on the Equal Protection Clause in assessing the reasonableness of punitive damages awards.
 True False
- 7 The key guidepost in reviewing a punitive damages award is whether there is a reasonable relationship between the amount awarded and the defendant's financial condition.
 True False
- 8 In evaluating the reprehensibility of a defendant's conduct, the jury should focus on conduct that affected the plaintiff, rather than actions affecting third parties.
 True False
- 9 For purposes of Civil Code section 3294(b), a "managing agent" of an entity is someone with discretionary authority over corporate policy.
 True False
- 10 In a case involving relatively low reprehensibility and a substantial award of noneconomic damages, a 1:1 ratio of punitive damages to compensatory damages might be the maximum.
 True False
- 11 A jury must be instructed about the appropriate ratio of punitive damages to compensatory damages.
 True False
- 12 Proof of fraud, oppression, or malice needed to support a punitive damages award must meet a "clear and convincing" standard.
 True False
- 13 The U.S. Supreme Court has upheld an award of punitive damages that is 526 times the amount of compensatory damages.
 True False
- 14 Rigid benchmarks are used to evaluate punitive damages.
 True False
- 15 For purposes of assessing punitive damages, a person with discretionary authority over corporate policy is always a managing agent.
 True False
- 16 Courts consider physical harm to be more reprehensible than economic harm.
 True False
- 17 In considering the reprehensibility of a defendant's conduct, the merits of third parties' hypothetical claims may not be considered.
 True False
- 18 In California, a punitive damages ratio in excess of 10:1 will not be scrutinized.
 True False
- 19 Courts should compare the amount of punitive damages with civil penalties that are authorized or imposed in comparable cases.
 True False
- 20 If a punitive damages award significantly exceeds the civil penalty that would be available had the plaintiff pursued the claim administratively, a reduction may be appropriate.
 True False

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