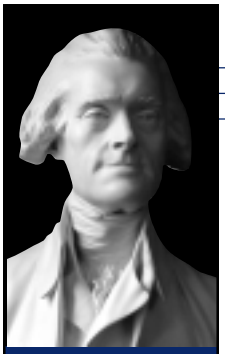

Jeffersonian Principles in Action

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Placing Constitutional Limits on Punitive Damages:

State Legislatures May Help

By The Honorable Scott Pruitt and Victor Schwartz *June 2003*

Introduction

Over the past decade, the Supreme Court of the United States has rendered a number of key decisions articulating constitutional limits on punitive damages. Most recently, on April 7, the Court decided *State Farm Mutual Life Insurance Co. v. Campbell*, 2003 WL 1791206 (2003). As this article will show, the *Campbell* case is thus far the most specific illustration of those limits.

Prior to *Campbell*, in *BMW of North America v. Gore*, 517 U.S. 559 (1996), the Supreme Court instructed lower courts to consider the following when reviewing punitive damages awards[1]:

1. *The degree of reprehensibility of the defendant's conduct;*
2. *The ratio of the actual or potential harm suffered by the plaintiff to the punitive damages award; and*
3. *The difference between punitive damages awarded by the jury and civil penalties authorized or imposed in comparable cases.*

The Supreme Court has indicated that state and lower federal courts have a duty to review awards of punitive damages very carefully. In fact, as a matter of procedural due process, appellate courts must review the constitutionality of punitive damages awards as a matter of first impression.[2] They owe no specific obligations to give special accord to decisions made by trial judges. There is an appreciation that in trial courts, evidence of bias and prejudice can arise to inflate awards of punitive damages.

Unfortunately, prior to the *Campbell* case, many state courts and lower federal courts either ignored, did not comprehend, or even misapplied the factors spelled out in the *Gore* decision. The *Campbell* case before the Supreme Court was a good example.

The Campbell Case

The *Campbell* case arose out of an automobile accident allegedly caused by State Farm's policyholder, Curtis Campbell. One person was killed and another person was permanently disabled. There was an offer to settle the case for the $50,000 limit of the insurance policy the Campbells had purchased, but State Farm believed it had a strong no-liability case and took the case to trial. State Farm assured Mr. and Mrs. Campbell that they had no liability for the accident, and that State Farm would represent their interests[3]. State Farm also told the Campbells that they did not need separate counsel[4].

Then, the legal problems for the Campbells began to unfold. A Utah jury returned a judgment that was more than $150,000, over three times the amount of their insurance policy and the amount offered for settlement. State Farm declined to appeal the case, and it was alleged that a State Farm lawyer told the Campbells that they might even lose their home to pay the judgment[5].

Ultimately, State Farm paid the entire judgment, and the Campbells were in actuality only "out of pocket" for less than $800 that they had paid a lawyer to advise them on how they should proceed against State Farm[6].

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The Campbells sued State Farm for wrongful failure to settle. The jury awarded $2.6 million in compensatory damages to Mr. and Mrs. Campbell. As we have indicated, their actual costs were less than $1,000. Most of the $2.6 million was awarded for "emotional harm." The jury also awarded $145 million in punitive damages[7].

The trial court reduced the compensatory damages to $1 million, and the punitive damages to $25 million. The Supreme Court of Utah, however, reinstated the $145 million award[8].

Actions of the Supreme Court in the *Campbell* Case

In an opinion delivered by Justice Anthony Kennedy and agreed to by five other justices, the Supreme Court of the United States demonstrated that the Supreme Court of Utah failed to properly apply the factors set out in the *Gore* case for determining the constitutionality of a punitive damages award.

First, and perhaps of greatest importance because it explains the $145 million punitive damages verdict, the Utah Supreme Court allowed the plaintiffs to show that State Farm's treatment of the Campbells typified its so-called "Performance, Planning and Review (PPR) Program" implemented by the company's top management in 1979, two years before the accident. The program's "explicit" objective was to use the claims-adjustment process as a means of augmenting profit[9]. The Utah Supreme Court allowed a wide dragnet throughout the United States to present evidence of State Farm's allegedly wrongful acts. These acts included the failure to inform corporate headquarters about a $100 million judgment in an unrelated first-party insurance case in Texas (the case was settled and the judgment was never entered); alleged discrimination against minority and female claimants; how the company handled allegations of a conflict of interest by an employee in California; and whether the company specified use of non-original equipment manufacturer parts in first-party automobile claims around the country.

The Supreme Court of the United States was clear that this type of dragnet showing of reprehensibility based on conduct in other states was improper under the Due Process Clause of the U.S. Constitution. The Supreme Court stated that:

> *[n]or as a general rule, does a State have a legitimate concern in imposing punitive damages to punish a defendant for unlawful acts committed outside the State's jurisdiction.*[10]

Although the Supreme Court stated that "lawful 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," the Court warned, "that conduct must have a nexus to the specific harm suffered by the plaintiff."[11] Thus, the action of a State Farm agent in suggesting to the Campbells that they might have to sell their home to pay the verdict was relevant. It focused on harm to the Campbells. On the other hand, actions of State Farm occurring out-of-state and having little or nothing to do with the Campbells must be excluded under the Constitution.

The Supreme Court indicated that a jury must be instructed that "it may not use evidence of out-of-state conduct to punish a defendant for action that was lawful in the jurisdiction where it occurred."[12] The Supreme Court indicated that irrelevant conduct would be excluded even if it were unlawful.

As we argued in an *amicus* brief filed with the Supreme Court in the instant case, allowing consideration of out-of-state activity can ultimately result in a defendant being punished again and again for the same wrongful conduct.[13] That will occur if punitive damages awards focus on the defendant's general conduct rather than on the defendant's specific conduct towards the plaintiff. The Supreme Court recognized this fact in stating as follows:

Punishment on these bases creates the possibility of multiple punitive damage awards for the same conduct; for in the usual case, nonparties are not bound by the judgment some other plaintiff obtains.[14]

If the Campbells recovered against State Farm based on evidence of out-of-state wrongful conduct, and two years later someone else sued State Farm and presented evidence of the same wrongful conduct, State Farm could not automatically argue that the same evidence should not be considered. A constitutional rule was needed to achieve that goal.

The Supreme Court of the United States also found that the Supreme Court of Utah had improperly ap-

plied the second *Gore* factor, the disparity between actual or potential harms suffered by the plaintiff and the punitive damages award. In effect, the Supreme Court of Utah had sustained $145 million of punitive damages to $1 million compensatory damages. The Supreme Court of the United States has stated on many occasions that it would not impose "a bright-line ratio which a punitive damages award cannot exceed."[15] Without setting a bright-line ratio, the Supreme Court in *Campbell* provided more specific guidance due to its established jurisprudence and cases where excessive ratios have been allowed, as in the instant case. The Court stated that:

Few awards exceeding a single-digit ratio between punitive and compensatory damages . . . will satisfy due process.[16]

The Court explained that the development of its jurisprudence

> *demonstrate[s] what should be obvious: Single-digit multipliers are more likely to comport with due process, while still achieving the State's goals of deterrence and retribution, in awards than ratios of 500 to 1 . . . or, in this case, of 145 to 1.*[17]

The Supreme Court said the punishment needs to be reasonable and proportionate to the amount of harm to the plaintiffs and to the general damages recovered. The Supreme Court noted, and we concur, that "because there are no rigid guideposts," the ratio of punitive to compensatory damages might be higher where "a particularly egregious act has resulted in only a small amount of economic damages."[18] For example, if a person threw acid at another person, but missed his face and only damaged his clothing, the compensatory damages might be only $500 for a coat. A punitive damages award of $5,000 or even $10,000 might be insufficient.

Conversely, the Supreme Court explained, "[w]hen compensatory damages are substantial, then a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee. ..."[19] That was the case with the Campbells' award. Moreover, their substantial compensatory award for emotional injury was likely based on a component duplicated in the punitive award – outrage and humiliation due to the acts of their insurer. The Supreme Court noted that the high compensatory award might have "already contain[ed] this punitive element."[20]

While noting that there were no physical injuries to the Campbells, the Supreme Court did not confine its ruling to situations where physical harm was not at stake.

Finally, in applying the third guidepost contained in the *Gore* decision – the disparity between punitive damages awards and civil penalties that could be imposed in comparable cases – the Supreme Court observed that under Utah state law, the most relevant civil sanction appeared to be a $10,000 fine for an act of fraud – "an amount dwarfed by the $145 million punitive damages award."[21]

Consideration of ALEC Model Legislation to Assist Courts

While it is not an easy task to reduce complex cases by the Supreme Court of the United States to black-letter guidelines, all citizens of a particular state might be assisted if at least broad strokes of the essence of *Campbell* and other Supreme Court cases were put into statutory form. A model Constitutional Guidelines for Punitive Damages Act would also provide potential wrongdoers with what the Supreme Court has termed "fair notice" of penalties that might be applied if they strayed. Fair notice is a fundamental component of due process. As the Supreme Court has explained:

> *[e]lementary 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.*[22]

We in the Civil Justice Task Force will consider model legislation of this type, and stand ready to assist ALEC members if they wish to pursue that goal after model legislation is developed, either now or in the future. Such model legislation would not be a substitute for decisions to limit punitive damages based on non-constitutional measures. Instead, it would provide guidance for constitutional restraints on the outer limits of punitive damages, the dollars beyond which the states are not permitted to impose such penalties. Sound judgment and public policy may call for more restraints; for example, limiting punitive damages to a 2-to-1 or 3-to-

1 ratio of compensatory damages, or placing a cap on the maximum amount that can be awarded.

A number of states have enacted such approaches. Unfortunately, in some instances, when state legislatures have made such legitimate attempts to formulate public policy, some state courts have nullified such actions under state constitutions. Because state constitutions were used, there has been no means to challenge these decisions before the U.S. Supreme Court.[23]

If a state legislature were to undertake model legislation imposing constitutional limits on punitive damages that parallel the decisions of the Supreme Court of the United States, it would take a very bold court to nullify such action under state constitutions.

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The Honorable Scott Pruitt is a member of the Oklahoma Senate and serves on the Human Resources, Business and Labor, Transportation, Congressional Redistricting and Appropriations committees. He is Minority Whip for the 48th Legislature and will serve as Assistant Republican Floor Leader in the upcoming session. Senator Pruitt is co-chair of the American Legislative Exchange Council's Civil Justice Task Force. Senator Pruitt currently practices law in Tulsa, Oklahoma. He attended the University of Oklahoma and Georgetown College and received his J.D. from the University of Tulsa Law School.

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