STATE COURT

DOCKET WATCH

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Litigation over State Education Financing in Kansas

"The history of education since the Industrial Revolution shows a continual struggle between two forces: the desire by members of society to have educational opportunity for all children, and the desire of each family to provide the best education it can afford for its own children." *Rodriguez* v. *San Antonio Independent School District*, 411 U.S. 1, 49 (1973) (citation omitted).

As a case currently pending before the Kansas Supreme Court, *Montoy* v. *Kansas*, No. 04-92032-S, aptly demonstrates, after decades of litigation and scholarly debate, this struggle has transformed into ongoing litigation over how to measure the equality and adequacy of educational opportunity and which entities are best suited to do that measuring – legislatures or courts. Increasingly, state courts are called upon to evaluate the equality and adequacy of the education financing systems adopted by state legislatures, with results that carry weighty implications for the separation of powers – between branches of government as well as political subdivisions – within the states.

Background

In *Rodriguez*, the Supreme Court effectively foreclosed federal constitutional challenges to inter-district funding disparities by rejecting a federal equal protection challenge based on inequality in funding between local school districts within Texas. The Court found no fundamental right at issue, and accordingly applied rational basis scrutiny. Because the state's education system assured a basic education for every child in the state and encouraged local control of each district's schools, the Court concluded that it bore a rational relationship to a legitimate state purpose and did not violate the equal protection clause of the Fourteenth Amendment.

By contrast, early state court decisions provided a viable alternative to federal litigation over state education financing. In 1971 the California

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Recent Developments in State Corporate Criminalization

Following the recent spate of corporate accounting scandals, popular attention has focused on legislative responses at the federal level, particularly on the Sarbanes-Oxley Act of 2002. This attention certainly is merited as Sarbanes-Oxley has opened a new chapter in the federalization of criminal law. Among other things, the Act creates additional protections for corporate whistleblowers, 18 U.S.C. § 1513(e), prohibits officers and directors of any public company from seeking to improperly influence outside auditors, and amends the federal obstruction of justice statute to prohibit anyone from destroying documents related to a securities fraud investigation. 18 U.S.C. §§ 1519-1520. Nonetheless, the various states have not allowed Congress' recent activity to diminish their own efforts to regulate business activity and to formulate their own legislative responses to the real and perceived problems facing corporate America. Indeed, a recent study conducted by Stateside Associates of Arlington, Virginia, reveals that since January 2000, twenty-eight states have made significant changes to their criminal laws governing business conduct, including new statutes, stronger criminal penalties for existing crimes, and developments in case law and attorney general procedures. This essay highlights some of the study's findings on the recent developments in state corporate criminalization.

Stateside Associates undertook its Criminalization Assessment to

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New Limit on Punitive Damages? A Look at *State Farm* v. *Campbell*

State Courts React to Recent U.S. Supreme Court Decision

In April of 2003, the United States Supreme Court again undertook to define what limits the due process clause of the Fourteenth Amendment places on the award of punitive damages in state courts. *State Farm Mut. Automobile Ins. Co.* v. *Campbell*, 123 S.Ct. 1513 (2003). *State Farm* v. *Campbell* was an insurance bad faith case that arose as the result of an automobile accident. The 1981 accident was caused by Curtis Campbell's attempt to pass six vans that were traveling ahead of him on a two-lane road. Though Mr. Campbell and his passenger were uninjured, this passing attempt resulted in an oncoming vehicle being forced off the road, ultimately colliding with a third vehicle. Both drivers of the additional cars – the one forced off the road and the one with which it collided — were injured, resulting in the death of one and the permanent disability of the other. Mr. Campbell was sued in a Utah state court.

State Farm was Mr. Campbell's insurer having issued a policy with a limit of $50,000. Despite this policy limit and the facts in this case, State Farm denied Campbell had any liability for the accident and refused to settle the matter for the policy limits by providing $25,000 to each of the other two drivers or their representatives; State Farm assured Mr. Campbell he had no personal exposure and did not need to retain separate counsel, despite the potential exposure in excess of his insurance coverage. However, when the jury in the wrongful death and negligence case rendered a verdict for $185,849, State Farm refused to pay the amount that exceeded the policy limits and refused to post the bond necessary for Mr. Campbell to appeal the verdict. A representative of State Farm told Mr. Campbell he "may want to put for sale signs on [his] property to get things moving." While the appeal was pending, Campbell settled the matter with the claimants, in part by agreeing to bring a bad faith action against State Farm. The appeal was denied, affirming the jury's verdict. Though State Farm eventually paid the entire verdict, Campbell filed the bad faith action in Utah state court as agreed.

The bad faith action resulted in a jury verdict against State Farm for $2.6 million compensatory damages and $145 million punitive damages. The trial court reduced this verdict to $1 million compensatory and $25 million punitive damages, but the Utah Supreme Court reinstated the $145 million punitive award. The case was then appealed to the United States Supreme Court.

The U.S. Supreme Court granted certiorari and, applying the factors first set forth in *BMW of N. Amer., Inc*. v. *Gore*, 517 U.S. 559 (1996), reversed the decision of the Utah Supreme Court, remanding the case for further proceedings consistent with its opinion. This Supreme Court decision sent ripples through the legal community as lawyers and judges began opining on whether it changed the legal standards for the assessment of punitive damages. Indeed, the Court's less than clear opinion raises a number of issues that now must be resolved by state and federal courts, including but not limited to the following issues: (1) to what extent is evidence of out-of-state conduct by the defendant relevant and admissible in determining punitive damages? (2) does it matter whether the out-of-state conduct was legally permissible in the state in which it occurred? (3) to what extent is evidence of dissimilar but egregious conduct of the defendant relevant and admissible, (4) can a ratio between compensatory and punitive damages

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FROM THE EDITORS…

The Federalist Society, in an effort to increase knowledge of and dialogue about state court jurisprudence, presents this second issue of *State Court Docket Watch*. This publication, which will be issued six times a year, is one component of the Society's State Courts Project. *Docket Watch* will present original research on state court jurisprudence, illustrating new trends and ground-breaking decisions in the state courts. The articles and opinions reported here will, we hope, help to focus debate on the role of state courts in developing the common law, interpreting state constitutions and statutes, and scrutinizing legislative and executive action. We hope this resource will increase the legal community's interest in more assiduously tracking state court jurisprudential trends.

This issue presents six case studies. An important case regarding education financing in Kansas is highlighted, as it has significant implications for the separation of powers. *Docket Watch* reports on Stateside Associates' research detailing the rise of corporate criminalization in state legislatures. We examine *State Farm* v. *Campbell*, a case that could be interpreted to limit the application of punitive damages. A case before the Supreme Judicial Court of Massachusetts concerns a claim of a tort of compelled self-defamation, and could have implications for the practice of employees being terminated at will. Finally, two cases from Minnesota are highlighted: one dealing with eminent domain and judicial review, and another on new ideas about compensible takings.

We look forward to hearing your comments and suggestions. Please feel free to contact us at fedsoc@radix.net.

Opposing a New Theory of Tort Liability for Employers

White v. Blue Cross and Blue Shield of Mass., Inc.

Employers in Massachusetts closely watched a recent case to see if the state's high court would recognize the tort of compelled self-defamation, in which a discharged employee sought recovery for feeling compelled to repeat to prospective employers his former employer's reasons for discharging him. The Supreme Judicial Court has declined to recognize this tort. If it had been adopted, the tort would have had the potential to erode an employer's right to fire an at-will employee and affect communication between employers and employees.

Roy Albert White, an at-will employee of Blue Cross, claimed he was fired because a client hospital told Blue Cross that White had divulged the details of a confidential financial settlement between the hospital and Blue Cross. White claimed that Blue Cross's statement explaining his termination was false and defamatory, and that he had been compelled to repeat the reason for his discharge to potential employers. White sued Blue Cross on the theory of compelled self-defamation. The trial court dismissed the claim on the ground that Massachusetts does not recognize the claim, and White appealed. While the case was still pending in the intermediate appellate court, the Supreme Judicial Court took the case for direct appellate review on its own initiative. The Court has heard oral argument, and the case is under advisement.

White argued that the Court should recognize the tort in order to provide a remedy to an employee who has been discharged for false and defamatory reasons and who is unable to secure a new job because he is compelled to repeat these reasons to prospective employers. White contended that it is foreseeable, if not inevitable, that a prospective employer will ask a candidate why his former employer discharged him. Lying, White argued, is not an option that the law should recognize. White asserted that he seeks only to expand the "publication" element of defamation. This element traditionally requires the plaintiff to prove that the defendant repeated a defamatory statement to a third party. White argued that publication should also include statements by the plaintiff himself when the plaintiff is compelled to repeat the false and defamatory reasons for his discharge to prospective employers. The employee would still have the burden, White argued, of showing in each case that he was actually compelled to make the statement, and that such compelled disclosure was foreseeable. As with any other defamation claim, the employer would remain protected by the conditional privilege to make good-faith disclosures of information necessary to its business, even if such information later proves to be false. And, as with any other defamation claim, the employee would have the burden of showing that the employer has lost this privilege by publishing the reason for his discharge with knowledge of its falsity, or with reckless disregard for the truth.

Blue Cross argued that compelled self-defamation ignores the publication element of traditional defamation and is a questionable and much-criticized doctrine recognized in only a minority of jurisdictions. Expanding defamation law this way would expose an employer to potential liability merely for communicating to an at-will employee the reasons for discharging him. This tort could chill open communica-

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Eminent Domain in Minnesota

The Minnesota Court of Appeals has affirmed a landowner's constitutional right to judicial review of the public purpose and necessity of a taking prior to the actual condemnation and taking. The litigation was the result of the City of St. Paul's attempted acquisition of temporary and permanent easements from a Sinclair gas and convenience station for a roadway project.

In March of 2000, the city instituted condemnation proceedings. Rather than proceed under the state statutory eminent domain procedures, the city chose to commence proceedings pursuant to the less onerous provisions of Chapter 13 of the St. Paul City Charter. On April 5, 2000, the city council, after required notice to affected landowners, held a public hearing on the acquisitions for the roadway project. Despite objection by Sinclair, the city council approved the final condemnation order. Then, as required by the city charter provisions, the city made a determination as to the value of the property taken. On December 20, 2000, the city council held another public hearing to confirm and ratify the taking and valuation.

While the condemnation was proceeding according to the city charter provisions, the Minnesota Court of Appeals reviewed the constitutionality of a similar state statute that granted counties authority to condemn property for highway purposes. On January 16, 2001, the Minnesota Court of Appeals handed down its decision in *In Re Rapp*, 621 N.W.2d 781 (Minn.App. 2001). The statutory condemnation procedure at issue in the *Rapp* case only allowed landowners to appeal the award of damages as determined by the county, but failed to provide a procedure that allowed landowners to challenge the propriety of the taking. The Court of Appeals held that the statute violated the takings clause of the United States and State Constitutions because the statute did not provide for judicial review of the public purpose and necessity of the condemnation prior to the actual taking of the property.

Because of the similarity of the statute at issue in the *Rapp* case and the St. Paul City Charter condemnation procedure, Sinclair immediately sent a copy of the *Rapp* decision to the City. In doing so, Sinclair placed the city on notice that, based on the *Rapp* decision, Sinclair intended to challenge the constitutionality of the city charter condemnation proceedings for failing to provide for judicial review if the City did not commence condemnation proceedings pursuant to Minnesota Statute Chapter 117. Despite Sinclair's notice, on February 7, 2001, the city

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"A Cloud of Condemnation:" Expanding the Definition

Friedrich Hayek, the renowned Austrian economist, opined in his epic *Road to Serfdom* that "[t]he more the state 'plans' the more difficult planning becomes for the individual."[1] Giving light to Hayek's observation regarding government planning and its effect on free-market behavior, the Minnesota Supreme Court in *Johnson* v. *City of Minneapolis*[2] recognized that egregious drawn-out government planning creating a "cloud of condemnation"[3] over private property constituted a compensable taking under the Minnesota Constitution.

On December 16, 1983 the City of Minneapolis ("City") adopted a redevelopment plan for an area of south downtown Minneapolis, including south Nicollet Mall, one of the downtown's major retail centers. The City's primary objectives were to promote and assist development of a new convention center located in the area and to preserve downtown Minneapolis as a major retail center. Through the redevelopment plan, the City also sought to increase the downtown tax base. During 1983 and 1984, however, the City was unable to persuade local property developers to submit a redevelopment plan. In 1985, the City approached a French developer, La Societe Generale Immobiliere (LSGI), to submit a redevelopment plan. LSGI submitted a redevelopment plan, which proposed the construction of a dome over part of Nicollet Mall and a tunnel under the street to accommodate traffic. In August 1985, the City granted LSGI exclusive negotiating rights to redevelop the area.

One year later, the City approved the proposed redevelopment contract with LSGI and approved a $73 million bond sale to finance property acquisition for the LSGI redevelopment plan. The City's actions, however, were resisted by the Mayor of Minneapolis, who consistently vetoed steps taken to close the redevelopment contract between LSGI and the City. The City ultimately overrode the mayor's vetoes and the City and LSGI subsequently executed the redevelopment contract on November 3, 1986. The redevelopment contract provided that the City would acquire the properties in the redevelopment area and lease the properties to LSGI for the construction of a shopping mall and office tower. The parties expected the redevelopment plan to comprise 900,000 square feet of retail shopping space and 400,000 square feet of office space, at an estimated cost of $300 million.

On October 27, 1987, LSGI informed the City that it had fulfilled its obligation under the redevelopment contract by securing anchor tenants for the redevelopment project by obtaining a letter of intent to lease retail space from Nordstrom, a local retailer, and by obtaining a letter of interest from Nieman Marcus expressing its interest in leasing space for one of its stores. The redevelopment contract, however, contained a confidentiality provision that prohibited LSGI and the City from informing local property owners about the status of the project, including notifying them that their properties would likely be condemned to make room for new tenants such as Nordstrom and Nieman Marcus.

On the date the redevelopment contract was supposed to close, however, the City adopted a resolution directing the Minneapolis Community Development Agency to adopt new design guidelines that rejected LSGI's original plan for a dome over Nicollet Mall and an underground traffic tunnel. The new guidelines would maintain Nicollet Mall "as an open urban street with no enclosure and at-grade transportation." The resolution effectively directed LSGI to create a new redevelopment plan radically different from the one it previously proposed in the redevelopment contract. On November 8, 1987, the City and LSGI closed on the redevelopment contract and the City executed a 99-year-lease with LSGI for all of the properties involved in the litigation.

Later that month, the City sent form letters to the Johnson plaintiffs informing them that the City was going forward with the LSGI project and that their properties would be appraised as an initial step toward condemnation. The letter cautioned, however, that by "appraising the property the City [was] not making a definite commitment to acquire the same." At trial, the author of the letter on behalf of the City testified that this formulaic language was included in every form letter from the City. Indeed, the plaintiffs took this letter as an affirmative statement that the LSGI redevelopment project was going forward and that their proprieties would ultimately be condemned.

Based on their belief that the redevelopment project was moving forward and that their properties were going to be appraised and condemned by the City, the plaintiffs prepared for their properties to be appraised—which occurred in December 1987. Eventually, however, and despite numerous negotiations between the City and LSGI, the City's redevelopment contract with LSGI fell through. On June 1, 1989, the City advised LSGI that it was in default and terminated the redevelopment contract. During this time—December 1987 through June 1989— the City never informed the plaintiffs that it was no longer pursuing acquisition of their properties despite numerous telephone calls and letters sent by plaintiffs to the City's elected officials requesting a report on the status of the redevelopment project and the acquisition of their properties.

In June 1989, LSGI sued the City in federal court requesting specific performance of the redevelopment contract. An order for specific performance would have required the City to acquire plaintiffs' properties and perform its remaining obligations under the redevelopment contract. Also in 1989, adding insult to injury, and despite that it had taken no further action to acquire plaintiffs' properties, the City assessed plaintiffs significant special assessments as part of the redevelopment project. The LSGI lawsuit lasted four years. In July 1993, a jury awarded LSGI approximately $31 million in damages against the City. The Eighth Circuit Court of Appeals ultimately reversed the jury award against the City based on its interpretation of the redevelopment contract.

The financial impact of the failed redevelopment plan and litigation between LSGI and the City was

disastrous for the plaintiffs who had patiently waited for the City to acquire their properties. Before the LSGI redevelopment plan, vacancies in plaintiffs' building were low and plaintiffs' properties were profitable. During the LSGI redevelopment project, however, numerous tenants inquired—both of the City and plaintiffs—regarding the status of the project. Because the plaintiffs could not obtain any status reports due to the City's failure to communicate with them, plaintiffs were unable to reassure their tenants that they would be able to honor their leases through the end of their terms. Fearing that they would soon be displaced through condemnation, plaintiffs' tenants vacated the properties in droves and plaintiffs had difficulty attracting replacement tenants. As a result, plaintiffs' rental income decreased dramatically. Plaintiffs' buildings also deteriorated because the City did not urge plaintiffs to make necessary improvements to the properties.

Plaintiffs eventually brought an inverse condemnation lawsuit in Minnesota state district court and the Court, after a three-week trial with an advisory jury, found that the City had misled plaintiffs about the planned acquisition of their properties. The "cloud of condemnation" over plaintiffs' properties between November 1987 and February 1995, according to the Court, impacted their business opportunities making them commercially impracticable and substantially deprived plaintiffs of most of the economically viable and feasible uses for the property. Lending support to Hayek's observation regarding government planning and the free market, the court concluded,

> Where government action specifically targeting Plaintiffs' properties so substantially and directly affects their use, business opportunity, freedom of choice of use of their property [the City] violated Plaintiffs' constitutional right to be free from unjust taking and/or damage to their private property under both the United States Constitution and Minnesota Constitution . . .

The Court awarded plaintiffs collectively $4,348,000 plus interest as damages.

The City appealed and the Minnesota Court of Appeals reversed the district court holding that because the City never "significantly controlled" plaintiffs' properties the City's actions did not amount to a constitutional taking.[4] Plaintiffs appealed and the Minnesota Supreme Court reversed holding that the City's actions constituted a regulatory taking compensable under the Minnesota Constitution.

The Minnesota Supreme Court began its analysis by noting that, because the City never took physical control over plaintiffs' properties, the United States Supreme Court's decision in *Penn Central Transportation Co.* v. *City of New York*, 438 U.S. 104 (1978) governed plaintiffs' claim under the United States Constitution. Under *Penn Central*, where there is less than a complete taking of the property in question, a three-factor balancing test is used to determine whether there has been a compensable taking. The three factors to consider are: (1) the economic impact on the claimant; (2) the extent the regulation interfered with the claimant's investment-backed expectations; and (3) the character of the regulation.[5]

According to the Minnesota Supreme Court, the Court of Appeals had erred by placing all weight on whether the City had "significant control" over the properties instead of evaluating that factor within the *Penn Central* three-factor framework. Having stated the proper framework for evaluating plaintiffs' claim under the U.S. Constitution, however, the Court declined to decide whether plaintiffs were entitled to relief under the U.S. Constitution because, in the unanimous opinion of the Court, plaintiffs were "entitled to compensation under the Minnesota Constitution."[6]

Analyzing plaintiffs' claim under the Minnesota Constitution, the Court first observed that the Minnesota Constitution's takings clause is broader than that clause found in the U.S. Constitution. The Minnesota Constitution provides: "Private property shall not be taken, destroyed or damaged for public use without just compensation."[1] The Court acknowledged that, contrary to the opinion of the Court of Appeals, "no physical invasion of [plaintiffs'] property" is required for a compensable taking to occur.[2] The Court then distinguished its earlier decision in Orfield v. Housing and Development Authority of St. Paul, in which it did not conclude that a compensable taking had occurred, noting that in the instant case the City never informed plaintiffs that the City was not obligated to proceed with LSGI's redevelopment plan, plaintiffs were not apprised of the status of the redevelopment plan, and, finally, plaintiffs were not informed when the City decided to abandon the LSGI redevelopment plan. These considerations, in addition to the fact that the City "specifically targeted" plaintiffs' properties for the redevelopment project, acted in bad faith by failing to use its best efforts, and failed to cooperate with LSGI in meeting redevelopment deadlines, considered together, constituted a compensable taking under the Minnesota Constitution.

The Minnesota Supreme Court concluded:

> We conclude that the cumulative effect of the City's actions with respect to the LSGI development, which the district court concluded substantially interfered with appellants' property rights, constituted an abuse of the City's condemnation authority and that appellants are therefore entitled to compensation under Orfield. . . . While each action taken by the City, analyzed separately, could be viewed as normal condemnation activity, the cumulative effect of the actions rendered appellants' properties unmarketable for years while the development was being negotiated and,

later, in litigation. Because of the unique circumstances of this case, we find no basis for reversing the district court's findings and conclusions of law that the City specifically targeted appellants' properties and acted in bad faith and conclude that this case presents a narrow and rare instance in which precondemnation activity constituted a taking under the Minnesota Constitution.

-------By our decision today, we do not adopt a sweeping rule that property owners are entitled to compensation for any diminishment in value or loss of income caused by the prospect that their property will be condemned at some future date. Rather, our decision is limited to the particular facts presented.[9]

Whether the Minnesota Supreme Court's decision in *Johnson* is a first-step in expanding private-property rights under the Minnesota Constitution remains to be seen; indeed, the Minnesota Supreme Court was quick to caution that the decision was "limited to the particular facts presented."

What is clear, however, is that the *Johnson* decision is a judicial directive to state and local government that they should engage in deliberate and measured decisionmaking when proceeding with redevelopment plans which possibly could place a "cloud of condemnation" over affected private property. At least one elected official already has taken notice; the current Mayor of Minneapolis has acknowledged that the *Johnson* decision is another reason why he is "streamlining how the city handles development projects."[10]

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[1] F.A. Hayek, Road to Serfdom 76 (1944).
[2] Johnson v. City of Minneapolis, 667 N.W.2d 109 (Minn. 2003).
[3] Siegel v. City of Minneapolis, Nos. 94-17966, 94-17968, slip. op. at 26 (Minn. Distr. Ct. Mar. 14, 2001).

Education Financing in Kansas (Continued from pg. 1)

Supreme Court held that education was a fundamental right under the California constitution. *Serrano* v. *Priest*, 557 P.2d 929 (Cal. 1971). And, just a few weeks after the Supreme Court's rejection of a federal equal protection challenge in *Rodriguez*, New Jersey's Supreme Court found that state's system of financing public education, which relied heavily on local taxation and lead to disparities in spending per pupil, violated the state constitution's provision requiring the state to furnish a thorough and efficient system of public schooling. *Robinson* v. *Cahill,* 303 A.2d 273 (N.J. 1973).

Encouraged by *Serrano* and *Robinson*, advocates for equalization and centralization of school funding have given numerous state courts occasion to evaluate their education finance systems in light of state constitutional requirements. As the progeny of these two benchmark cases, education finance litigation generally attacks state funding schemes on one or both of two theories: an equity challenge under a state equal protection clause, or an adequacy challenge under a state education clause. Results have been mixed. "Since *Serrano*, the highest courts in 36 states have issued opinions on the merits of funding litigation suits, with 19 upholding state funding systems and 17 declaring state funding systems unconstitutional." John Dayton, Anne Dupre, & Christine Kiracofe, Education Finance Litigation: "A Review of Recent State High Court Decisions and Their Likely Impact on Future Litigation," 186 Ed. Law Rep. 1 (2004) (collecting cases). Indeed, litigation is ongoing and public policy advocates seeking to reform the provision of education across the nation plan to initiate more litigation in the near future.[1]

Montoy v. *Kansas*

During the week of August 30, 2004, the Kansas Supreme Court is scheduled to hear oral argument in *Montoy* v. *State of Kansas*, the most recent litigation battle over equity and adequacy in education financing. This case will serve as an indicator of whether the use of civil litigation to challenge states' school finance systems is destined to dramatically reshape the states' traditional approach to public education. If the Plaintiffs prevail, this trend will have significant consequences for the continued vitality of states' decisions about how to structure their internal self-governance and fundamental notions of separation of powers between the judiciary and the legislatures within states.

In 1999, two school districts and approximately three dozen students filed suit in the District Court of Shawnee County, Kansas, alleging the financing system established by the state Legislature does not meet the Kansas Constitution's requirement that the Legislature "make suitable provision for finance of the educational interests of the state," Art. 6, § 6(b), that it runs afoul of plaintiffs' equal rights under the Kansas Bill of Rights, § 1, and violates their substantive due process rights.

Initially, the District Court found the claims to be insufficient as matters of law, but the Kansas Supreme Court reversed, finding sufficient questions of fact and allowing the plaintiffs' case to proceed. *Montoy* v. *State*, 275 Kan. 145 (2003). Back before the District Court, the plaintiffs challenged various elements of Kansas' financing system, which, pursuant to the School District Finance and Quality Performance Act ("SDFQPA"), establishes a base or foundation rate for the minimum level of revenue a district will receive per pupil. The base rate set by the state is then adjusted based on "weights" for various district and student characteristics deemed by the legislature to necessitate different funding levels. Examples of "weights" at issue in this

case include adjustments for declining enrollment, new facility start-up costs, transportation, as well as the prevalence of students enrolled in vocational, bilingual and at-risk education programs. In addition to the "weights" that adjust per pupil revenues, the state permits school districts to adopt a local option budget ("LOB") to supplement their spending through an additional tax levy. This LOB is capped and districts raising too little funds per pupil statewide receive state supplemental aid. Finally, Kansas law authorizes school districts to assess property taxes for certain capital expenditures that are separate and distinct from state funding mechanisms.

Plaintiffs alleged that these mechanisms resulted in unconstitutional disparities in educational expenditures per pupil between districts, and that the overall state level of funding failed to provide an adequate or suitable education for certain groups of students. The state defended the system by arguing that each category and weight was rationally related to a legitimate government purpose. For example, the new facilities weight was enacted in recognition of generally higher start-up expenses facing new schools, and the transportation weight is generated based on a district's density and the number of students who live more than 2.5 miles from the school. These weights are not necessarily based on the actual costs attendant to any one particular student or district, but rather are based on formulae derived from legislative determinations about district characteristics and the differential funding needs likely created by those characteristics. The state noted that many of the weights challenged in this litigation were previously upheld by the state Supreme Court under rational basis review. See *U.S.D. No. 229* v. *State*, 256 Kan. 232, 266 (Kansas 1994). The state further told the court that the LOB and local property tax mechanisms enacted by the state Legislature promote the state's legitimate interest in fostering local control over various aspects of education. According to the state, these legitimate state interests, coupled with evidence of high achievement, such as the high national rankings of the state's schools, rendered the state system of education financing constitutional under both provisions of the state constitution.

Legal Standards Crafted by the Trial Court

On September 8, 2003, Judge Terry Bullock issued a Memorandum Decision and Order laying out a series of legal conclusions that would frame the court's analysis of the Plaintiffs' challenge. See *Montoy* v. *State,* 2003 WL 23171455 (Kan. Dist. Ct., Sept 8. 2003) ("Pre-trial Order"). The court elucidated standards for both prongs of the Plaintiffs' challenge to the constitutionality of the school finance system: (1) equity, and (2) suitability.

Critical to the court's equity analysis was the allocation of the burden under rational basis review. Notably, the court acknowledged that rational basis scrutiny applied to per pupil spending discrepancies, but found that it had been refined in *U.S.D. No. 229* v. *State,* 256 Kan. 232 (1994) and in an unpublished district court case, *Mock* v. *State,* Case No. 91-CV-1009, 31 Washburn L.J. 475 (Kan. Dist. Ct., Oct. 14, 1991), to shift that burden. The language in U.S.D. 229 interpreted by the Judge as a refinement of rational basis scrutiny provided that the test "contains two substantive limitations on legislative choice: legislative enactments must implicate legitimate goals, and the means chosen by the legislature must bear a rational relationship to those goals. In an alternative formulation, the court has explained that these limitations amount to a prescription that all persons similarly situated should be treated alike." Pre-trial Order, at *18 (quoting U.S.D. 229, 256 Kan. at 260). Judge Bullock interpreted this quote, which he found "fundamentally synonymous" with the unpublished opinion in Mock, to mean that "if challenged, the legislature must be prepared to justify spending differentials based on actual costs incurred in furnishing all Kansas school children an equal education opportunity." Pre-trial Order, at *18. In so holding, the Judge placed the burden on the state to justify spending differences between districts based on actual costs, rather than placing the burden on the plaintiffs to show an absence of a rational basis for such differences. On appeal, the state argues this allocation of the burden was directly contrary to established precedent governing rational basis review, and irretrievably tainted the trial and decision with fundamental legal error.

With respect to suitability, the analysis depended heavily on what standard the court adopted to gauge the adequacy of the overall spending level in the state. Judge Bullock stated in both his Pre-trial Order and his December 2 Memorandum Decision that he found no guidance in case law, the state constitution or statutes, or even in the State Board's accreditation standards. "Accordingly, in the absence of any appellate court or even legislative suitability standard, this court must craft one." Memorandum Decision and Preliminary Interim Order, *Montoy* v. *Kansas,* No. 99-C-1738, 2003 WL 22902963, at *23 (Kan. Dist. Ct. Dec. 2, 2003) ("Memorandum Decision"). Explaining his intent to craft such a standard, the Court's Pre-trial Order explicitly eschewed the "objective criteria" preferred by some courts for determining the adequacy of states' provision of education. Rather, he held that "a constitutionally suitable education (much like an efficient or an adequate education as provided for in the constitutions of our sister states) must provide all Kansas students, commensurate with their natural abilities, the skills necessary to understand and successfully participate in the world around them both as children and later as adults."

Factual and Legal Conclusions of the District Court

On December 2, 2003, after an eight day trial, Judge Terry Bullock issued his Memorandum Decision and Preliminary Interim Order. Judge Bullock found Kansas' school funding system unconstitutional under the state and federal equal protection clauses because it permitted inter-district funding disparities unsupported by empirical evidence of actual differences in the cost of education in those districts, and under the state education clause because it failed to provide what the court considered adequate total resources to provide all Kansas children with a suit-

able education, as defined by the court. See Memorandum Decision, at * 49.

Finding Kansas' inter-district disparities in per-pupil spending unconstitutional, Judge Bullock applied the reasoning contained in his September 8, 2003 conclusions of law. He reasoned that such disparities, even if caused by legislative policy choices, can pass rational basis scrutiny "only if there are rational reasons that are based on actual increased costs necessary to provide children, or particular children, in that district with an equal educational opportunity. Again, the increased costs must be essential in providing the students in that district with educational opportunities equal to that provided to students in that and other districts." Memorandum Decision, at *21. With the burden thus allocated, the court concluded that Kansas' system of weights and local control resulted in unconstitutional disparities, despite the explanations offered by the state, because there was no "evidence of any rational basis premised upon differing costs to educate the children who receive more," id. at *37, because the differences were not tied to actual and documented cost disparities, but rested on legislative determinations about general characteristics that affect costs, and on local districts' willingness and ability to raise supplemental revenue.

As for the Plaintiffs' suitability challenge, the court concluded that the system failed to provide a constitutionally adequate education. In coming to this conclusion, Judge Bullock applied the non-objective standard he had presaged in his September 8, 2003 pre-trial order, and relied heavily on a study commissioned by the state legislature in 2001. This study was an evaluation by consultants of "the cost of a suitable education for Kansas children." K.S.A. 46-1225. The firm, Augenblick & Myers, using independent criteria for evaluating whether the overall level of funding was sufficient, concluded that the then-current level of aggregate financing was inadequate because it excluded some of what it deemed "big ticket" items like transportation and capital outlay costs covered by localities. The state argues on appeal that the district court's reliance on that study is misplaced: the study was "policy research" not scientific analysis producing reliable results; the methodologies used were admittedly imprecise; and the questions addressed are not susceptible to "correct" or "incorrect" answers. Moreover, the state notes that the criteria in the report have not been adopted by the legislature or the state Board of Education, and should not be used to define the state constitution's mandate to "make suitable provision for finance of the educational interests of the state." Kansas Const., Art. 6, § 6(b).

...Judge Bullock's decision rejects any legitimate state interest in fostering local control as a justification for funding disparities.

Remedy

Though it found the Kansas education finance system unconstitutional under both its equity and suitability standards, the court delayed entering a final order in the case to afford the state legislature time to remedy the deficiencies. As widely reported in the press, the legislature did not jettison or reform its school funding system during that session. Accordingly, in May 2004, after his "grace period . . . encompassing the entire 2004 legislative session" expired, the court concluded that "the legislative and executive branches failed to utilize the time provided by the court and none of the adjudicated constitutional defects in the school funding scheme were addressed and none corrected." Thus, the court entered its remedial order in which Judge Bullock ordered schools to close statewide if the problem is not remedied by the state legislature. Decision and Order Remedy, *Montoy* v. *State,* 2004 WL 1094555, at *1 (May 11, 2004). The Supreme Court of Kansas has stayed this order pending appellate review. Order, *Montoy* v. *Kansas*, No. 92,032 (May 19, 2004)

Implications of this and Other Nationwide Litigation

Though few other cases have included such sweeping remedial orders, Judge Bullock is correct in noting that he is not the first state court judge to invalidate statewide educational financing systems. However, the litigation presently pending in Kansas demonstrates uniquely well the fundamental jurisprudential and public policy ramifications that accompany judicial intervention in, and invalidation of, statewide education finance systems.

As a matter of legal reasoning, in reaching its conclusion the court in *Montoy* fundamentally modified the rational basis test traditionally applied to equity challenges. By repudiating – under the rubric of rational basis scrutiny – any rationale other than evidence of actual, essential, and incurred cost differentials for inter-district per pupil funding differences, Judge Bullock's decision rejects any legitimate state interest in fostering local control as a justification for funding disparities. By contrast, in rebuffing a similar challenge, the United States Supreme Court declined what it saw as an invitation "to condemn the State's judgment in conferring on political subdivisions the power to tax local property to supply revenues for local interests." *Rodriguez,* 411 U.S. at 40. Such a challenge was described as "nothing less than a direct attack on the way in which Texas has chosen to raise and disburse state and local tax revenues." Id. Since *Rodriguez,* the Supreme Court has recognized that "[n]o single tradition in public education is more deeply rooted than local control of the operation of schools," *Martinez* v. *Bynum,* 461 U.S.

321, 329 (1983), and that this local control has intrinsic value even though it may generate some funding disparities based on different local wealth. See *Papasan* v. *Allain,* 478 U.S. 265, 287 (1986). Indeed, numerous state high courts continue to recognize the importance of local control to the states' administration of public school systems. See e.g., *Committee for Educational Rights* v. *Edgar,* 174 Ill.2d 1, 39 (Ill.1996); *City of Pawtucket* v. *Sundlun, 662 A.2d 40, 62 (R.I. 1995).*

In addition to occasioning the forced departure from a long-standing tradition of local control over school financing and administration, the invalidation of state education financing systems implicates the traditional separation of powers between branches of government within states. The state argues on appeal that Judge Bullock's decision usurps the proper role reserved to the legislative branch of state government by substituting his judgment for that of the legislature, and cites numerous cases espousing deference to state legislatures or declining to adjudicate what are essentially political questions. Indeed, Judge Bullock's May 11, 2004 Decision and Order Remedy demonstrates the political tension inherent in judicial oversight of an inherently political question such as education funding. He takes the Kansas legislature to task for its inaction and perceived disrespect in failing to remedy the deficiencies he found: "[i]n fact, rather than attack the problem, the Legislature chose instead to attack the court. From the outset, legislative leaders openly declared their defiance of the court and refused to meaningfully address the many constitutional violations within the present funding scheme, all of which were created by the Legislature itself." *Montoy* v. State, 2004 WL 1094555 at *5. The court concluded that "[g]iven these facts, coupled with the attitudes and inaction of the Legislature, the court now has no choice but to act and to act decisively." *Id.* at *5.

Conclusion

The resolution of *Montoy* v. *Kansas* will indicate the willingness – or lack thereof – of state judicial officers to invalidate and reorder their states' systems of education financing. If more states follow this path, redefining the traditional rational basis scrutiny and reducing deference to legislatures in administering school systems, the jurisprudential and practical effect may be to substantially erode the functional and structural separation of power between branches of state government, as well as the traditional reliance on political subdivisions to implement, finance and administer local public school systems.

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[1] *See* "Adequacy Lawsuits Planned in at Least Four States," available at http://www.accessednetwork.org/litigation/8-8-03AdequacyLawsuitsPlanned.htm. (last visited June 21, 2004).

Constitutional Challenges to State Financing of Education

State	Date/Nature of Constitutional Challenge	Outcome of Lawsuit/ Legislative Effect
AZ	1994-Equity suit challenging state education financing system and uniformity requirements in education clause of state constitution	Plaintiffs; funding formula violated constitution
	1998-Students FIRST Act	Plaintiffs; Certain provisions of act ruled unconstitutional
	2003 Pending: constitutional challenge to "adequacy" of funding for lower income students	Awaiting outcome
AR	1983-funding system violates equal protection clause of state constitution	Plaintiffs; see below
	2002-Supreme Court affirms lower court's ruling on unconstitutionality	Supreme Court gives legislature until January 1, 2004 to correct system
CO	1982-equality challenge under education clause of constitution	Defendants; "absolute equality in educational services or expenditures not required"
FL	1995-adequacy of funding	Defendants; state supreme court held that court action would constitute judicial encroachment on legislative authority.
GA	1981-challenge to financing system	Defendants. No change.
ID	1997-adequacy challenge based on constitutional provision for "thorough education"	Plaintiffs; state supreme court reversed and remanded; special study commissioned
KY	1989-challenge to adequacy of funding	Plaintiffs; state supreme court declared "Kentucky's entire system of common schools unconstitutional." The court ordered the General Assembly to provide funding "sufficient to provide each child in Kentucky an adequate education" and to reform the property tax system. The court enumerated seven learning goals as required for an adequate education. Studies commissioned recommended $892 million extra in funding
LA	1989-challenge to adequacy	Defendants. No change
ME	1994-plaintiffs challenged the state's education funding cuts on equal protection grounds	Defendants; state supreme court held that plaintiffs had not proven inequity, but court left door open to inadequacy claim

Constitutional Challenges to State Financing of Education (continued)

State	Date/Nature of Constitutional Challenge	Outcome of Lawsuit/ Legislative Effect
MN	1993-challenge to adequacy of funding	Defendants; suit dismissed due to plaintiffs' concession that the schools provided an adequate education
	1995- NAACP sued the state, claiming that students were being denied a basic education, in violation of the state constitution	In 2000, the parties settled with an agreement creating a new accountability system for the Minneapolis schools and expanding the access of low-income families to magnet and suburban schools
MT	1989-challenge based on equity theory	Plaintiffs; state supreme court ruled that the state's education finance system was unconstitutional
NE	1990-plaintiff taxpayers and students filed an equity suit	Defendants; Supreme Court held that equal funding is not guaranteed by the state constitution
NJ	1973-challenge based upon "thorough and efficient education" language of state constitution	Plaintiffs. Changes to financing system and numerous follow-on challenges to education systems locally
NY	1982-challenge to the state's education finance system	Defendants; New York State's highest court held that the state constitution does not require equal funding for education
	1995- challenge to the state's school funding system	Plaintiffs; children in New York State are entitled to a "meaningful high school education." Court of Appeals ordered a costing-out study to determine the actual cost of decision
NC	1987-equity challenge	Defendants; the state supreme court denied review of an appellate decision dismissing plaintiffs' equity case.
	1997- adequacy	Plaintiff; the state supreme court declared that the state constitution "requires that all children have the opportunity for a sound basic education"
ND	1994-challenge to finance system	Plaintiffs; North Dakota requires super majority in Supreme Court cases which would invalidate a statutory scheme. Court held that the state's education finance system was unconstitutional, but not by the requisite "super majority"
OH	2002-challenge to finance system	Plaintiffs; state supreme court declared the state education finance system unconstitutional and directed the General Assembly to remedy the deficiencies
OR	1976,1991,1995,1999	Defendants
PA	1979-challenge under equity theory	Defendants; plaintiffs failed to state cause of action
	1998-equity claim	Defendants; the state supreme court affirmed the lower court's dismissal of plaintiffs' claim
	1998-adequacy claim	Defendants
RI	1995- equity and adequacy challenge	Rhode Island Supreme Court held that statutory scheme for financing public education did "not violate either the education clause or the equal protection provision of the State Constitution."
SC	1988-equity challenge	Defendants ; dismissed
	1999-appeal of dismissal of challenge based on education clause	Plaintiffs; reversed and remanded. State supreme court held that the education clause "requires the General Assembly to provide the opportunity for each child to receive a minimally adequate education."
TN	1993-challenge to equal protection clause of state constitution	Plaintiffs; supreme court's decision results in corrective legislation
	1995-challenge to adequacy of remedy in 1993 case	Defendants; revised funding formula deemed adequate
VT	1995-equity challenge based on equal protection and education clauses of state constitution	Plaintiffs; supreme court decision stated: "we are simply unable to fathom a legitimate governmental purpose to justify the gross inequities in educational opportunities."
VA	1994-equity challenge by low-income school districts	Defendants; state financing system deemed constitutional
WV	1979- equity and adequacy challenge based on education and equal protection clauses	Plaintiffs; supreme court remanded case for trial, holding that education was a fundamental right
WI	1989-challenge based on uniform education and equal protection provisions of state constitution	Defendants
	2000-equity challenge	Defendants; Supreme Court's decision left door open for adequacy claim

State Farm v. *Campbell* (Continued from pg. 2)

that exceeds 10:1 ever be constitutionally permissible and, if so, under what circumstances? (5) when, if ever, can defendant's wealth be relevant to the award of punitive damages? (6) is bifurcation of liability and punitive damages portions of a trial a viable option to protect against the admission of evidence that may be relevant to liability but is no longer proper for consideration of punitive damages? (7) is the amount in controversy for federal diversity litigation going to be impacted where it would take a double digit ratio between compensatory damages sought in the pleadings and punitive damages for the total award to reach the $75,000 prerequisite? (8) how should available civil sanctions be compared to a damage award? The answer to these questions, at least until the Supreme Court again takes up this issue, will rest in the state courts, as they are the courts that will handle the largest portion of cases involving punitive damages,

This article provides a brief summary of some of the reaction, so far, to *State Farm* v. *Campbell* by state appellate courts that have had the opportunity to review or otherwise consider the award of punitive damages since April 2003.[1] As will become apparent, perhaps one of the most important developments is the application of the Supreme Court's warning that a double digit ratio between compensatory and punitive damages will rarely be constitutionally permissible. Some state courts that have considered punitive damages in the light of State Farm seem ready and willing to use that warning either to approve all such awards that do not reach a double digit ratio or to ensure that no double digit ratio is approached, despite the Supreme Court's additional caution that no bright line ratio exists.

Alabama

In *Shir-Ram* v. *McCaleb*, No. 1012112 (Ala. Dec. 30, 2003), the Alabama Supreme Court applied *State Farm* v. *Campbell* to an award of $176,572.82 in compensatory damages and $500,000 in punitive damages in a case in which the plaintiff injured her leg on a protruding piece of metal on a bed frame in the defendant's hotel. The Alabama Supreme Court affirmed the verdict and clearly characterized *State Farm* v. *Campbell* as a mere reprisal of the Supreme Court's criteria for analysis of a defendant's reprehensibility first established in *BMW* v. *Gore.* It appears from the Alabama court's discussion of the ratio of compensatory to punitive damages that court may not look suspiciously at punitive damage awards as long as those awards do not create a ratio of 10:1 or greater.

Though not a case involving an actual award of punitive damages, in *Anderson* v. *Ashby,* ____ So.2d ____, No. 1011740 (Ala. May 16, 2003), the Alabama Supreme Court applied the principles in *State Farm* to the analysis of whether a contract that limits punitive damages to five times economic damages was unconscionable. The court concluded such a contractual limit was not unconscionable by reference to *State Farm* in footnote 24 of the court's opinion.

Arizona

Though the Arizona courts have not yet directly addressed the impact of *State Farm* on their punitive damages analysis, a cite to *State Farm* highlights the focus on the Supreme Court's discussion of the appropriate ratio between compensatory and punitive damages. See *Bridgestone/ Firestone N. Am. Tire* v. *Naranjo,* 414 Ariz. Adv. Rep. 32 (Ariz. Dec. 10, 2003).

Arkansas

On at least three separate occasions the Arkansas appellate courts have had the opportunity to cite or otherwise discuss *State Farm. Advocat, Inc.* v. *Sauer,* 111 S.W.3d 346 (Ark. 2003); *Hudson* v. *Cook,* 105 S.W.3d 821 (Ark. App. 2003), *Superior Fed. Bank* v. *Mackey,* CA 02-1119 (Ark. App. Nov. 19, 2003). The most significant of these cases is *Advocat, Inc.* v. *Sauer,* 111 S.W.3d 346 (Ark. 2003). After a thorough summary of the *State Farm* opinion, the court proceeded to review the award of punitive damages in this case based on the three *Gore* factors – reprehensibility, ratio of compensatory to punitive damages, and the available civil sanctions for similar conduct. This wrongful death case, involving medical malpractice claims, resulted in a jury verdict of compensatory damages of $5 million on the ordinary negligence claim, $ 10 million for medical malpractice, $25,000 for breach of contract, and $100,000 for each surviving beneficiary. The total in compensatory damages was $15.4 million. Punitive damages of $21 million were awarded against each of the three defendants who appealed the judgment. In one of the most comprehensive discussions of *State Farm,* the court recognized that the Supreme Court elaborated on the considerations to be made when assessing reprehensibility of the defendant's conduct, including consideration of whether the harm caused was physical or merely economic, whether the conduct demonstrated indifference or reckless disregard for the health or safety of others, whether the target of the conduct had financial vulnerability, whether the conduct was repeated or isolated, and whether it resulted from intentional malice or deceit. In discussing the 4.2:1 ratio of compensatory to punitive damages, the court easily concluded such a ratio did not raise due process concerns. The court also undertook a much more detailed analysis of what civil sanctions were available under state law than the court might have undertaken prior to *State Farm*.

California

The California appellate courts have had ample opportunity to apply *State Farm* v. *Campbell,* having had several cases remanded by the Supreme Court for further consideration following that decision:

In one of the most recent such cases, *Simon* v. *San Paolo U.S. Holding Co., Inc.,* B121917 (Dec. 2, 2003 Cal.App.), a case remanded for the second time, the California Court of Appeals affirmed a fraud verdict awarding $5,000 in compensatory damages and $1.7 million in punitive damages. The case was actually tried twice. The first jury verdict awarded $2.5 million in punitive damages, but the trial court

granted a new trial unless the plaintiff agreed to a remittitur in punitive damages to $250,000. The plaintiff refused the reduction and obtained the $1.7 million punitive verdict in the second trial. Following this second trial, the trial court made no reduction of the verdict. The appellate court affirmed in large part based on the reprehensibility of the defendant's conduct, which included lying to the trial court about the wrongful conduct. This dishonesty with the court was viewed as demonstrating trickery or deceit and also indicated that the wrongful conduct was not an isolated incident – both proper considerations according to *State Farm* for determining the level of reprehensibility of the defendant's conduct. The court focused a great deal of its discussion on the Supreme Court's statements that no mathematical bright line exists in terms of the ratio of compensatory to punitive damages between constitutionally permissible and violative of due process. The California appellate court further discussed the Court's explanation in *State Farm,* which concluded that in cases where particularly egregious acts resulted in small economic loss, a larger ratio may be appropriate. This, the California court indicated, was just such a case.

In *Romo* v. *Ford Motor Co.,* F034241 (Nov. 25, 2003 Cal.App.), the Fifth District Court of Appeals had its opportunity to consider *State Farm.* That court conditionally affirmed the award of punitive damages in a personal injury, wrongful death suit that resulted from the rollover of the plaintiff's Ford Bronco. The affirmance was conditioned on a reduction of the punitive damages from $290 million, in light of a nearly $5 million compensatory award, to $23,723,287. In this opinion, the California court recognized that *State Farm* had "impliedly disapproved" the California courts' broad view of the goal and measure of punitive damages, which view had been that punitive damages were to achieve deterrence of a practice or course of conduct "by depriving the wrongdoer of profit from the course of conduct or making such conduct so expensive it put the wrongdoer at a competitive disadvantage." This view, according to the California appellate court, was implicitly disapproved by the Supreme Court. Thus, the court reduced the punitive award due to its acknowledgement that punitive damages must focus primarily on what the defendant did to the present plaintiff, not "the defendant's wealth of general corrigibility."

> ...the language set forth in the Court's opinion will be used by both sides–those seeking to limit and those seeking to expand punitive damage awards.

See also *Henley* v. *Philip Morris Inc.,* 112 Cal.App.4th 198 (2003); *Diamond Woodworks, Inc.* v. *Argonaut Ins.,* 109 Cal.App.4th 102 (2003).

Florida

In *Liggett Group Inc.* v. *Engle,* 3D00-3400 (Fla. App. 3 Dist. May 21, 2003), the court reversed an award of $145 billion against tobacco companies based on a number of lower court errors, including the failure to first award compensatory damages and based on the bankrupting impact of the award on the defendants whose net worth was under $9 billion. Providing further support for its decision, the court cited *State Farm* and its $145 million award as demonstrative that such a large verdict was clearly excessive and violative of due process.

New York

Citing *State Farm,* the Appellate Division of the Supreme Court of the State of New York, reversed the lower court's reduction of punitive damages from $50 million to $10 million in a two page opinion that concluded $50 million was excessive but that a more substantial penalty than $10 million was appropriate. *Mitsuhiro Honzawa, et al.* v. *Hirokuni Honsawa, et al.,* 1923 (1st Dept. October 21, 2003).

Conclusion

Numerous other courts have also considered the impact of *State Farm* v. *Campbell,* including the courts of Georgia, Indiana, Iowa, Kentucky, Massachusetts, New Hampshire, Ohio, Oregon, Pennsylvania, South Dakota and Wisconsin. And other state appellate courts are currently hearing oral argument or receiving briefs that discuss or argue the impact of this Supreme Court case for the first time. Whatever trends may develop, there can be no question that the language set forth in the Court's opinion will be used by both sides – those seeking to limit and those seeking to expand punitive damage awards. And that the ultimate decision as to the impact of this decision rests with these state courts.

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[1] A majority of state courts have not yet had the opportunity to apply the principles of *State Farm v. Campbell* to an award of punitive damages.

Eminent Domain in Minnesota (Continued from pg. 3)

adopted a resolution ratifying and confirming the condemnation and award of damages under the city charter and proceeded with the acquisition.

On March 13, 2001, Sinclair commenced two separate district court actions. First, Sinclair commenced an inverse condemnation action by serving and filing a petition for alternative writ of *mandamus* requesting the district court to compel the city to commence condemnation pursuant to Minnesota Statutes Chapter 117. Second, pursuant to St. Paul City Charter Chapter 13, Sinclair filed a notice of appeal of the city's condemnation resolution that confirmed and ratified the condemnation and award. Sinclair commenced this second action in order to meet the 30-day limitation period for appeal as set forth in the city charter and protect its right to appeal the award. During this time period, the city commenced construction of the project, physically appropriated Sinclair's property, and on August 9, 2001, the project was completed.

The inverse condemnation action was presented to the district court on Sinclair's motion for summary judgment. On November 26, 2001, the district court ruled in favor of Sinclair, determining that the St. Paul City Charter condemnation procedure was unconstitutionally void because it failed to provide for judicial review of the public purpose and necessity of the taking prior to the condemnation and actual taking of property. The district court ordered the city to commence condemnation proceedings pursuant to Minnesota Statutes Chapter 117. The city appealed this decision to the Minnesota Court of Appeals.

In analyzing the constitutionality of the relevant charter provision, the district court emphasized the long held principle that a condemnation must satisfy the public-use requirement imposed by the constitution. Article I, §13 of the Minnesota Constitution guarantees that "Private property shall not be taken, destroyed or damaged for public use without just compensation therefore, first paid or secured." In order to meet this requirement, the condemning authority must establish that the condemnation of is for a valid public use. Furthermore, Minnesota has the additional requirement that the condemning authority must also establish the necessity of the condemnation. The court concluded therefore, that when a condemning authority acquires private property, the landowner is entitled to judicial review in order to determine whether the condemnation is for a public purpose and is necessary.

The court also emphasized the *Rapp* court holding that there is a temporal requirement to judicial review in a condemnation proceeding. Specifically, the *Sinclair* court relied heavily upon the *Rapp* court's conclusion that "Land may be condemned only after a determination of public purpose and necessity. Therefore, a property owner is entitled to judicial review of the public purpose and necessity of a taking prior to the actual taking of property." *Rapp,* 612 N.W.2d at 785.

The court then analyzed the relevant portion of the city charter provision in order to determine if it complied with the constitutional and temporal requirements. St. Paul City Charter §13.03.5(1) states, "Any person whose interest is property has been condemned or taken may appeal, or an appeal may be taken on his or her behalf, from the ratification and confirmation of the condemnation or from the award of damages or both." Like the statute analyzed by the *Rapp* court, the St. Paul City Charter allows the City to condemn or take the property without providing for judicial review of public purpose and necessity.

The city's condemnation provisions also allow the condemning authority to acquire the property and commence construction even if an appeal has been filed. The city attempted to justify the constitutionality of the provision by arguing that so long as just compensation is paid or secured prior to the taking, the charter provision meets the constitutional requirements. However, the court held that the language of the ordinance "does not prevent the taking from occurring until after the court reviews the public purpose and necessity of the taking; it simply requires that money be paid into court." Under the ordinance, once payment is made, title to the property immediately transfers to the city and, unless the owner retains a right to continued possession, the city may immediately enter upon the property and commence construction . This clearly does meet the constitutional requirement of judicial review of public purpose and necessity *prior* to the taking of private property.

In addition to attempting to defend the constitutionality of its charter proceeding, the city made several other arguments. First, the city argued that Sinclair, by conceding during a public hearing before the City Council that the project was for a public purpose, had waived its right to challenge the public purpose of the taking in any subsequent proceeding. However, the Court of Appeals held that the city had presented no evidence that Sinclair voluntarily and intentionally waived its right to challenge the necessity of the taking.

The City also argued that as a result of Sinclair's acquiescence in the construction of the project, Sinclair was estopped from challenging the public purpose of the project. The Court of Appeals found to the contrary and held that Sinclair, by commencing the two district court actions, provided the city with ample notice that it was indeed challenging the propriety of the taking before construction began.

Finally, the city claimed that Sinclair could not obtain effectual relief on its claim that it was entitled to judicial review of the public purpose and necessity of the taking prior to the taking. The city argued that because the project had already been completed, the issue was moot. Again relying on the decision in *Rapp,* the court concluded that even though the property had been taken and the project constructed upon the property, Sinclair was entitled to relief in the form of the return of its property. The conclusions reached by both this court and the *Rapp* court with respect to mootness may have a profound impact on the nature of acquisitions for public projects. A condemning authority could find itself in a difficult and expensive situation if a court failed to find requisite public purpose and necessity to support the condemnation after the

project has already been constructed.

The Minnesota Court of Appeals ultimately affirmed the district court's declaration that the St. Paul City Charter condemnation procedure was unconstitutional because it failed to provide for judicial review of the public purpose and necessity of a taking prior to the actual taking. The Minnesota Supreme Court denied the City's Petition for Review. The case is currently proceeding under the constitutionally valid provisions of Minnesota Statute Chapter 117, and the district court has under advisement Sinclair's motion for attorney an award of attorneys' fees in the successful inverse condemnation case. This case is *Sinclair Oil Corporation* v. *City of St. Paul,* 2002 WL 1902920 (Minn. App. August 20, 2002).

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White v. *Blue Cross and Blue Shield* (Continued from pg. 3)

tion in the workplace. An employee who might improve substandard job performance through the employer's constructive criticism may now lose this opportunity, and her job, because the employer would be wary of making any negative statements to the employee. An employee falsely accused of misconduct could be needlessly terminated because, never confronted with the reason for the discharge, he had no chance to rebut the false accusation. The tort could foster an unhealthy "culture of silence" in the workplace.

Blue Cross also contended that the tort might encourage former employees to repeat defamatory statements gratuitously to prospective employers, when the employees could have otherwise avoided such statements or explained to prospective employers the true circumstances of their discharge. A former employee could state a new claim for self-defamation each time that she applied for a job and stated the former employer's reason for her termination.

Blue Cross also argued that the tort has a potentially broad reach, because it cannot be restricted to employment. Courts from other jurisdictions have recognized compelled self-defamation in other contexts, such as a physician's report to his insurance company about lost hospital privileges, a minister's repeating comments to his parishioners, a minor showing a letter to unspecified others, and a loan applicant's comments to a bank when seeking a loan. In short, recognizing the tort could expose individuals in many other contexts to liability simply for exercising their discretionary functions.

New England Legal Foundation filed an amicus brief in support of Blue Cross. NELF argued that self-defamation is a thinly disguised claim of wrongful discharge and an evasion of the employment at-will relationship. By removing the publication element from the employer and placing it in the hands of the employee, the tort allows the employee to subject the employer's decision to a "just cause" standard of review. To defend against a claim of self-defamation, an employer would need to establish the traditional defamation defenses that its reasons for discharge were true, or at least that it did not act with recklessness to the truth. By contrast, an employer can discharge an at-will employee for any reason or for no reason at all. Thus, creating the tort would have increased the duties of an employer before discharging an at-will employee beyond those duties required under established law.

NELF also argued that White has a remedy under existing law, so that there is no need to expand defamation law to create a remedy for his alleged circumstances. He could have sued the client hospital for defamation or for tortious interference with contractual or advantageous business relationships.

Finally, NELF argued that Massachusetts has traditionally deferred to an employer's business judgment and is loath to interfere with the at-will relationship. Recognizing the tort, however, would involve courts in scrutinizing and second-guessing employers' business decisions to discharge at-will employees.

After the parties in this case submitted their briefs, the Connecticut Supreme Court issued a decision rejecting the tort of compelled self-defamation. Courts applying the law of at least 14 other states and Puerto Rico have also rejected the tort. Additionally, the legislatures of Colorado and Minnesota have expressly overruled decisions of their respective state supreme courts recognizing the tort. Courts applying the law of approximately 12 states have recognized the doctrine. Lower courts in two other states, New York and Texas, are split on the issue.

In June of 2004, the Supreme Judicial Court ruled in Blue Cross' favor. The court agreed with NELF's position and declined to recognize the doctrine of compelled self-defamation. The Court explained that "White could have demanded an employment contract with Blue Cross, but did not do so. The law should not permit him to secure indirectly what he failed to negotiate directly." The Court also observed that recognizing the doctrine of self-publication would contravene an employer's established privilege to disclose information about a former employee to prospective employers. Finally, the Court noted that if a discharged employee is free to file suit whenever he discloses information to prospective employers concerning his discharge, "the statute of limitations become[s] meaningless" and "the discharged employee may publish and republish the alleged defamatory statement for the remainder of his professional life."

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State Corporate Criminalization (Continued from pg. 1)

examine state policy that could affect business-related crimes. To complete this study, Stateside Associates reviewed all pending and enacted legislation from 2000-2003 for legislation that created new crimes for activities conducted in the course of business, changed the *mens rea* standard for crimes, or otherwise changed the exposure of a corporation and its employees to criminal prosecution. Stateside Associates also examined whether relevant state agencies provide any written or informal guidance as to how they interpret their respective state's new laws governing environmental protection, securities, and consumer protection. Finally, Stateside Associates reviewed the various states' caselaw for judicial precedents on criminal prosecutions of corporations and their effect on the *mens rea* standard.

The study reveals several trends in the states' laws governing white collar crime. First, several states have criminalized aspects of business conduct that previously had been governed by civil laws. Mississippi, for example, recently enacted a bill that seeks to make it easier to prosecute white collar crime by using a corporate conflict of interest theory. Specifically, Mississippi's H.B. 463 (2001) prohibits directors or officers, under pain of up to five years imprisonment, from taking any business actions that would create a conflict of interest between their personal interests and the interests of the corporation.

Mississippi has not been alone in enacting legislation to address corporate fraud. Several states have moved to align their corporate law with the requirements of Sarbanes-Oxley. California, for example, has recently enacted a trio of corporate anti-fraud bills, which closely resemble Sarbanes-Oxley's requirements. S.B. 777 (2003) creates a $10,000 fine for unjustified firings of a whistle-blower, and protects from retaliation workers who alert authorities about illegal practices. S.B. 523(2003) requires major corporations and publicly traded companies to quickly report to shareholders and other authorities important false or misleading statements made by corporate officers. It also establishes a fine up to $1 million for withholding this information. Finally, A.B. 1031 (2003) increases criminal penalties in California for securities fraud to $25 million and up to five years in prison. That provision also makes it illegal to destroy documents during a securities fraud investigation. Several other states, including Connecticut, Kansas, and Wyoming, also have enacted legislation to align their corporate law with Sarbanes-Oxley's various requirements.

The trend toward increasing criminal penalties for white collar offenses has not been limited to the fraud context. The Massachusetts legislature, for example, recently responded to an April 2003 oil spill in Buzzards Bay by enacting what some environmental experts have described as the toughest environmental protection law in the country. The Environmental Endangerment Act, H.B. 4004 (2003), creates criminal punishment for any person or organization that knowingly or recklessly commits an environmental violation and causes serious bodily injury to another person or damages natural resources. The potential penalties include prison sentences of up to 20 years and impose fines up to $500,000 for a first offense, and up to $2 million for subsequent offenses. Moving beyond the realm of environmental law, the Washington legislature has enacted a new law regarding the licensing and regulation of money services with criminal penalties for false statements, material misrepresentations, or deliberate omissions in records required under the Act. H.B. 1455 (2003). Texas, moreover, recently enacted H.B. 2424 (2003), which assigns new criminal penalties to advertising violations for tobacco products and auto dealers.

In addition, many other states are presently considering legislation which would create new criminal penalties. In Massachusetts, for example, S.B. 103 (2003) was approved and became effective on July 1, 2004, creating new criminal penalties for officers and directors of corporations when they knowingly sign a false statement or report. A bill was also considered (and eventually referred to study) that would have created new penalties for employers who attempt to restrict employees from selling or divesting the securities of the employer if it is in connection with an employee benefit plan (S.B. 59). Likewise, the Louisiana legislature recently considered a bill that would have provided that a business corporation may be subject to criminal liability in a felony case based on failure to maintain effective supervision by the board of directors, an executive officer, or any other person who is involved in forming company policy. H.B. 492 (2003). The bill further would have provided that acquittal of the individual upon whose conduct liability of the corporation is based is not a valid defense for the accused corporation.

The Stateside Associates' study also reveals that several states have recently moved to weaken the *mens rea* standard in the criminal laws governing business conduct. Some of these changes have occurred through legislation. Delaware, for instance, has recently toughened the mental state standard for filing environmental reports with the state Department of Natural Resources and Environmental Control. S.B. 60 (2003). Whereas the statute previously had been limited only to "knowing" violations, the amended version subjects even those who commit "reckless" violations to the possibility of up to 6 months imprisonment. In other instances, the courts of the various states have altered the *mens rea* standard. The study concludes that in twenty-four states, the courts have weakened the general *mens rea* requirement for criminal liability in the context of corporate white collar crime. In Pennsylvania, for example, the state courts have created a broad public-welfare exception to general criminal intent requirements, specifically in the context of corporate environmental violations. In *Commonwealth of Pennsylvania* v. *Sanico,* 830 A.2d 621 (Pa. 2003), the state supreme court affirmed the trial court's order finding the defendant guilty of hauling illegal solid waste because the transportation equipment did not indicate the type of waste. In examining the *mens rea* issues, the court noted that, "[a] criminal conviction typically

requires both an actus and a criminal negligence . . . As we noted in CSX, however, 'public welfare statutes' often dispense with the intent requirement imposing, instead, absolute liability." 830 A.2d at 626. The court reasoned that because the solid waste disposal statute was intended to protect the public health, and because the statute did not specifically annunciate a *mens rea* standard, the statue "was intended to be enforced without regard to criminal intent." 830 A.2d at 627-28.

Finally, the Stateside Associates study reveals that many states have responded to the real and perceived problems facing corporate America by enacting harsher criminal penalties for white collar offenses. For instance, Kansas enacted the 2003 Securities Penalties Act, S.B. 110, to increase criminal penalties levels based on the amount of loss. Under the Act, the maximum prison sentence for a defendant of white collar crimes (with no prior criminal convictions) would be 43 months—more than double the previous Kansas penalty. Likewise, Texas has enacted H.B. 1218 (2003), which increases the penalty for violating the Public Accountancy Act from a Class B misdemeanor to a felony and increases the administrative penalty the agency could levy from $1,000 to $100,000 per violation. Similar increases in penalties have occurred in Connecticut, Delaware, Illinois, and Massachusetts, and legislation intended to accomplish the same result is pending in New York.

To view an executive summary of the Stateside Criminalization Study, please go to www.fed-soc.org.

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