California Supreme Court Both Limits and Extends Punitive Damages

*By Don Willenburg and Raymond J. Tittmann**

The California Supreme Court has decided a pair of punitive damage cases, *Simon* v. *Sao Paolo U.S. Holding Co. Inc.*, 2005 DJDAR 7091 (June 16, 2005) and *Johnson v. Ford Motor Co.*, 2005 DJDAR 7101 (June 16, 2005), that are that court's first decisions to apply the United States Supreme Court's landmark *State Farm Mut. Ins. Co.* v. *Campbell,* 538 U.S. 408 (2003). Like that decision, these California Supreme Court decisions provide ammunition for attorneys to argue for and against limitations on punitive damages. The court held that the proper ratio between punitive awards and compensatory awards may be based only on harms actually resulting or likely to result from the defendant's conduct—thus lowering permissible punitive awards. The court also held that the punitive "multiplier" might be higher based on the wealth of the defendant and whether the harm to the plaintiff was an "isolated incident" or a "repeated corporate practice."

In *Campbell*, the United States Supreme Court held that due process requires that punitive damages be limited to a "reasonable and proportionate" award pursuant to three "guideposts": "(1) the degree of reprehensibility of the defendant's misconduct; (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award; and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases."[1] The court recommended punitive damages in an amount "at or near" the compensatory damages in the case before it, and punitive awards that exceeded the "single-digit multiple" of the compensatory award, "to a significant degree," would be constitutionally suspect.[2] "If, in *BMW*, the high court threw a lasso around the problem of what it had previously identified as 'punitive damage awards' 'run wild,' in *State Farm* it tightened the noose considerably."[3]

The first of the California Supreme Court decisions to apply *Campbell*, *Simon*, addressed and perhaps moved several of the pre-existing battle-lines in the ongoing war over punitive damages. Three points stand out.

First, *Simon* held that a punitive award must be based on the harm that the defendant's conduct actually caused or was likely to cause, and not on the potential harm. The plaintiff Simon attempted to purchase a building from the defendant San Paolo. San Paolo's representatives made various fraudulent misrepresentations about negotiating exclusively and sold the building to someone else. Simon recovered the $5,000 spent in reliance on San Paolo's false promises. However, Simon also sought to recover with his consequential damages the "potential harm" of $400,000 (the difference between his appraised value of the property and what he was to pay for it). Simon lost his contract claim because the parties had not entered into an enforceable agreement to sell him the building. Consequently, Simon could not count the $400,000 loss resulting from the failed contract among his consequential damages.

The court contrasted Simon's position with *Neal* v. *Farmers Ins. Exchange*, 21 Cal.3d 910 (1978), in which a statute barred recovery of damages that were actually caused. There, plaintiff died before judgment, precluding her estate's recovery for the substantial emotional distress she had suffered. The eventual "disparity between the relatively small compensatory damages award and the significant award of punitive damages did not require nullification" of the punitive award.[4] In *Simon*, on the other hand, the court found that defendant had not caused any "actual harm" to plaintiff other than reflected in the compensatory award. The misrepresentations caused only the $5,000 spent in reliance, so that was the proper amount against which the punitive award must be measured.

But *Simon* also permitted consideration of damages that are "reasonably likely" to result from, or "a goal" of, "the tortfeasor's conduct," even if they did not actually occur.[5] The distinction, arguably *dicta*, between damages that are merely "potential" and damages that are "reasonably likely" will no doubt be the subject of future legal skirmishes.

Second, *Simon* reduced a $1.7 million punitive damage award, and criticized the 340:1 ratio as a "breathtaking multiplier." The Court of Appeal had accepted Simon's claim to the $400,000 and thus found the $1.7 million award an acceptable 4:1 ratio. The punitive damages were reduced to $50,000. But *Simon* also held that "the presumption of unconstitutionality applies only to awards exceeding the single-digit level 'to a significant degree'."[6] Plaintiffs will cite this statement in *Simon* to urge approval of punitive damage ratios exceeding single digits, though the 10:1 ratio approved in *Simon* only barely exceeded single digits.

Third, *Simon* held that a defendant's wealth may sometimes be considered in determining an appropriate ratio. *Campbell* held that deterrence is a permissible consideration (538 U.S. at 416), and *Simon* recognized that wealth can be relevant to the deterrent effect of a punitive award. "In some cases, the defendant's financial condition may combine with high reprehensibility and a low compensatory damage award to justify an extraordinary ratio between compensatory and punitive damages." Nevertheless, *Simon* did not permit consideration of the defendant's wealth in this case: "But when, as in the present case, the reprehensibility of the defendant's conduct is relatively low, the state's interest in punishing it and deterring its repetition is correspondingly slight."[7] The lines drawn by *Simon* on each one of these points leave plenty of open territory for future cases.

In *Johnson*, plaintiffs won just under $18,000 in compensatory damages where Ford had concealed the repair and "lemon return" history of a used car. The jury awarded $10 million in punitive damages upon plaintiffs' presentation of evidence that Ford had a corporate practice of engaging in this kind of fraud, representing disgorgement of profits from California consumers victimized by the same practices. The court of appeal reduced punitives to $53,435, about three times the compensatory damages, on the rationale that Ford could constitutionally be punished only for its fraud on plaintiffs—"the conduct that injured the present plaintiffs" and not for other acts or defendant's "overall course of conduct."

The Supreme Court agreed that $10 million was too high (both as a constitutional matter and under disgorgement law), but remanded because the court of appeal's focus was too narrow. On remand, the court of appeal was directed to consider that Ford's fraud was more reprehensible because it was part of a "repeated corporate practice rather than an isolated incident," and that "the scale and profitability of Ford's repeated conduct reflects on its reprehensibility." The Supreme Court explained that "a defendant [that] has repeatedly engaged in profitable but wrongful conducts tends to show that 'strong medicine is required' to deter the conduct's further repetition."[8] *Johnson* contrasted this with the wrongdoing that the United States Supreme Court found irrelevant in *Campbell*, because the *Campbell* conduct involved "bad acts" that were not like those that harmed the *Campbell* plaintiffs. Plaintiffs will likely cite *Johnson* in an attempt to justify wide-ranging discovery of national corporate practices, in search of finding some similar conduct from which to argue that the defendant needs a similar dose of "strong medicine."

Johnson also gave a victory to defendants. While repeated conduct "remains relevant" to analyzing reprehensibility, *Johnson* does not "approve plaintiffs' aggregate disgorgement theory of punitive damages." Such a theory would potentially "overpunish" defendants by using the same conduct in multiple cases, effectively punishing defendants many times for the same conduct. It would result in "disproportionate" awards to each plaintiff as well. The plaintiffs in *Johnson*, for example, had recovered profits allegedly obtained by Ford on thousands of transactions without any evidence that Ford had actually committed the same wrongdoing on each transaction. Defendants may cite this aspect of the holding to limit discovery to evidence that the specific conduct at issue was part of an ongoing and repeated pattern, but not to estimate or award the profits obtained from any such practice.

Johnson did not expand *Simon*'s discussion of wealth of a defendant as a permissible consideration in determining an appropriate punitive damage award, but impliedly agrees by identifying the "profitability" of wrongful conduct as a permissible consideration. *Johnson* remanded with directions to the lower court to consider increasing the size of a punitive award based on profitability, and so, along with *Simon*, keeps open the possibility of large awards in future cases.

While each side may claim victory in the various battles waged in *Simon* and *Johnson*, the war wages on.

* Don Willenburg's practice focuses on appeals, punitive damages, expert witnesses and evidentiary matters. He is currently vice-chair of the Appellate Practice Section of the Bar Association of San Francisco. Raymond J. Tittmann's practice focuses on insurance coverage matters. Both are in Carroll Burdick & McDonough LLP's San Francisco office.

Footnotes

1 538 U.S. at 418 (citing *BMW of North America, Inc.* v. *Gore* 517 U.S. 560, 575 (1996) (reversing $2 million punitive award on a $4,000 compensatory verdict).

2 538 U.S. at 425.

3 *Simon*, 2005 DJDAR at 7096.

4 *Simon*, 2005 DJDAR at 7094.

5 *Simon*, 2005 DJDAR at 7095.

6 *Simon*, 2005 DJDAR at 7096 n.7.

7 *Simon*, 2005 DJDAR at 7098.

8 *Johnson*, 2005 DJDAR at 7105.