Litigation

State Farm v. Campbell: Federalism and the Constitutional Limitations on Punitive Damages

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Punitive damages will be back before the United States Supreme Court this fall. The Court granted certiorari in *State Farm Mutual Automobile Insurance Company v. Campbell*, No. 01-1289, to consider whether a Utah jury's $145 million punitive damage award against the insurer State Farm violates the Constitution. The case presents a host of important questions concerning federalism and due process, including whether a jury in one State can punish a corporation for the way it does business in another State—and whether the jury may impose a harsher punishment on a corporation solely because it is very profitable.

The *State Farm* case is the latest in a series of recent high-profile punitive damage rulings. Last fall, a federal appeals court struck down a $5 billion punitive damage award an Alaska jury had imposed against Exxon Corporation for its conduct leading to the *Exxon Valdez* oil spill. *See In re Exxon Valdez*, 270 F.3d 1215, 1246-47 (9th Cir. 2001). And a few weeks before the *Exxon* ruling, another federal appeals court erased a South Carolina jury's $250 million punitive damage award imposed against DaimlerChrysler Corporation in a design defect case. *See Jimenez v. DaimlerChrysler Corp.*, 269 F.3d 439 (4th Cir. 2001).

These rulings—and the Supreme Court's decision to grant *certiorari* in *State Farm*—suggest a growing judicial awareness that in recent years punitive damage awards have spiraled out of control and often bear little relation to the corporate conduct supposedly deserving of punishment. But despite the guidance provided by the Supreme Court and several federal courts of appeals, it is not clear that this teaching has filtered down to the trial courts and some state appellate courts, many of which continue to permit juries to impose excessive and unconstitutional punitive damage awards on large corporations. *State Farm* thus offers the Court an opportunity to reaffirm the constitutional limitations on punitive damages and send a strong message to the lower courts that it is their duty to ensure these limitations are enforced with consistency and rigor.

I. The *State Farm* case exemplifies how a skillful plaintiffs' lawyer can manipulate and misuse evidence of a corporation's business practices and aggregate wealth to persuade a jury to impose a mammoth and wholly unjustified punitive damage award. Plaintiffs Curtis and Inez Campbell sued Mr. Campbell's insurer, State Farm, in Utah state court for declining to settle third-party claims against Mr. Campbell arising from his involvement in an automobile accident. (The facts are drawn from the opinion of the Utah Supreme Court, available at 2001 WL 1246676.) The trial was bifurcated. In the first phase, the jury found that State Farm's decision not to settle within policy limits was unreasonable because there was a substantial likelihood of an excess judgment against Mr. Campbell.

The jury considered the plaintiffs' punitive damage claim in the second phase. Although State Farm moved *in limine* to exclude evidence of alleged conduct that occurred outside of Utah, the trial court denied the motion. The plaintiffs proceeded to introduce large amounts of evidence of State Farm's alleged extraterritorial conduct, including evidence supposedly showing State Farm's business practices in other States. The plaintiffs portrayed this alleged out-of-state conduct, the vast majority of which had no bearing on Utah or its citizens, as part of a purported nationwide "scheme" to reduce claims payouts. The plaintiffs also introduced evidence they claimed showed State Farm's overall "wealth" and nationwide profits.

The plaintiffs expressly based their claim for punitive damages on State Farm's alleged out-of-state conduct. In his opening statement during the trial's second phase, counsel for plaintiffs argued that this case "transcends the Campbell file" because it "involves a nationwide practice." He then asked the jury to punish State Farm for its business practices in other States, telling the jurors that they were "going to be evaluating and assessing, and hopefully requiring State Farm to stand accountable for what it's doing across the country, which is the purpose of punitive damages."

The jury awarded the plaintiffs $2.6 million in compensatory damages and $145 million in punitive damages. State Farm moved for remittitur, arguing that the punitive damage award was unconstitutional because it improperly punished out-of-state conduct and was excessive under *BMW of North America, Inc. v. Gore*, 517 U.S. 559 (1996). The trial court reduced the compensatory award to $1 million and cut the punitive award to $25 million.

Both parties appealed. The Utah Supreme Court held that the trial court erred in remitting the punitive damages award, and it reinstated the jury's $145 million verdict. In canvassing the evidence supporting the award, the court noted that "the trial court allowed the Campbells to introduce extensive expert testimony regarding fraudulent practices by State Farm in its nation-wide operations," and underscored the trial court's finding that "State Farm is an enormous company with massive wealth."

II. The Supreme Court will likely decide whether the Due Process and Commerce Clauses permit state courts to do what the Utah Supreme Court did here: invoke a company's

out-of-state business activities, and its aggregate nation-wide wealth, as a basis for a punitive damage award. Basic principles of federalism, and the Court's ruling in *BMW*, strongly suggest the answer is no.

A. The Constitution enshrines the bedrock principle that "[n]o State can legislate except with reference to its own jurisdiction. . . . Each State is independent of all the others in this particular." *Bonaparte v. Tax Court*, 104 U.S. 592, 594 (1881). Consequently, a State's laws are "presumptively territorial and confined to limits over which the law-making power has jurisdiction." *Sandberg v. McDonald*, 248 U.S. 185, 195 (1918). Both the Commerce Clause and the Due Process Clause protect state autonomy by generally prohibiting each State from punishing or regulating conduct occurring within the jurisdiction of sister States.

The Supreme Court has applied these principles in a variety of contexts. Recognizing that the Commerce Clause acts as "a limitation upon the power of the States," *Freeman v. Hewit*, 329 U.S. 249, 252 (1946), the Court has repeatedly "'preclude[d] the application of [state law] to commerce that takes place wholly outside of the State's borders, whether or not the commerce has effects within the State.'" *Healy v. Beer Institute*, 491 U.S. 324, 336 (1989) (quoting *Edgar v. MITE Corp*., 457 U.S. 624, 642-43 (1982) plurality opinion). Similarly, in *Barclays Bank PLC v. Franchise Tax Board of California*, the Court stated that "[t]he Due Process and Commerce Clauses of the Constitution . . . prevent States . . . 'from tax[ing] value earned outside [the taxing State's] borders.'" 512 U.S. 298, 303 (1994) (quoting *ASARCO, Inc. v. Idaho State Tax Comm'n.* 458 U.S. 307, 315 (1982)) (brackets in original).

In *BMW*, the Court rejected an Alabama court's attempt to impose punitive damages on the basis of the defendant's business activities in other States. The Court explained that "each State has ample power to protect its own consumers, [and] none may use the punitive damages deterrent as a means of imposing its regulatory policies on the entire Nation." 517 U.S. at 585. The Court emphasized that "one State's power to impose burdens on the interstate market . . . is not only subordinate to the federal power over interstate commerce, . . . but is also constrained by the need to respect the interests of other States." *Id*. at 571. Consequently, "principles of state sovereignty and comity" dictate "that a State may not impose economic sanctions on violators of its laws with the intent of changing the tortfeasors' lawful conduct in other States," because such punishment would unconstitutionally interfere with the policy choices of other States. *Id*. at 572. To safeguard the autonomy of other States, a punitive damages award therefore "must be analyzed in light of [in-state conduct], with consideration given only to the interests of [the State's] consumers, rather than those of the entire Nation." *Id*. at 574.

In reaching this conclusion, the *BMW* Court expressly relied on *Healy*, in which the Court underscored "the Constitution's special concern both with the maintenance of a national economic union unfettered by state-imposed limitations on interstate commerce and with the autonomy of the individual States within their respective spheres." 491 U.S. at 335-36. The *Healy* Court had struck down a Connecticut statute that regulated commercial conduct in other States, emphasizing that the Commerce Clause bars "the projection of one state regulatory regime into the jurisdiction of another State." *Id*. at 337.

Permitting courts to predicate punitive damage awards on a defendant's alleged out-of-state conduct would allow States to circumvent the Constitution's ban on extraterritorial regulation and punishment and evade *BMW* and *Healy*. Although a State plainly has a legitimate interest in "protecting its own consumers and its own economy," *BMW*, 517 U.S. at 572, it has no interest in regulating and punishing conduct occurring in other States. Such punishment amounts to "the application of [state law] to commerce that takes place wholly outside of the State's borders," *Healy*, 491 U.S. at 336 (quoting *Edgar*, 457 U.S. at 642-43), and is constitutionally forbidden.

Moreover, allowing a State to punish extraterritorial conduct would effectively enable that State to project its laws and establish public policy on a national level, thus overriding the laws of the forty-nine other States in the process. By imposing punishment for business activities that other States have declared permissible, the decision of a single state court could effectively supplant and override the considered policy judgments of other States.

It is no answer to say that States may impose extraterritorial punishment for certain types of conduct—such as "fraud" or "negligence"—that are considered wrongful in all fifty States. As an initial matter, highly generalized characterizations of primary conduct are improper bases for imposing specific liability. In *BMW* itself, for example, the Court might have reasoned, but did not, that all States prohibit "deceptive practices." The Court instead chose to focus on the details of the specific type of wrongdoing alleged by the plaintiff. Moreover, the essence of federalism is that States may (and do) elect to address even the same general problems in different ways, balancing the risks and benefits of particular activities in whatever manner is suitable to the particular circumstances of each State. That many States share the same general goals says nothing about the precise contours of a particular State's law. For example, torts that share the same name may have different elements in different States, or may lead to different remedies--not all States permit punitive damages for all torts (or even for any torts), and some States put strict limits on punitive damages when they are available. As the Court has observed, it "frustrates rather than effectuates legislative intent" to assume that "*whatever* furthers" a conceded legislative objective "must be the law." *Rodriguez v. United States*, 480 U.S. 522, 525-26 (1987) (emphasis in original).

B. The Utah Supreme Court's decision offends the Constitution in another respect. Although *BMW* sets forth three constitutionally mandated "guideposts" for determining when a punitive damages award is unconstitutionally exces-

sive,[1] the Utah court relied upon State Farm's alleged wealth and national "profits" as a means of trumping the three guideposts. Particularly where there has been no showing that all of the company's wealth or profits resulted from the challenged conduct, it is unfair and unconstitutional to use these types of aggregate numbers as a basis for calculating a punitive damage award.

A defendant's wealth cannot by itself justify a heightened penalty. In *BMW*, the plaintiff had argued before the Supreme Court that a defendant's aggregate wealth should be part of the constitutional calculus and that BMW's great wealth justified upholding the $2 million punitive damage award. But the Court rejected that argument, declining to adopt the defendant's wealth as a guidepost and declaring: "The fact that [a defendant] is a large corporation rather than an impecunious individual does not diminish its entitlement to fair notice of the demands that the several States impose on the conduct of its business. Indeed, [a corporation's] status as an active participant in the national economy implicates the federal interest in preventing individual States from imposing undue burdens on interstate commerce." 517 U.S. at 585.

Evidence of a defendant's wealth, to the extent it has *any* legal relevance, does not trump the three-factor constitutional analysis required under *BMW* and salvage a punitive damage award that would otherwise be deemed excessive. As the Court recognized in *Pacific Mut. Life Ins. Co. v. Haslip*, "the factfinder must be guided by more than the defendant's net worth." 499 U.S. 1, 19 (1991); *see also Pulla v. Amoco Oil Co*., 72 F.3d 648, 659 n.16 (8th Cir. 1995) (opinion of retired Justice White, sitting by designation) ("[A] defendant's wealth cannot alone justify a large punitive damages award"); *Cont'l Trend Res., Inc. v. OXY USA*, 101 F.3d 634, 641 (10th Cir. 1996) ("From the [*BMW*] Court's statements we conclude that a large punitive damage award against a large corporate defendant may not be upheld on the basis that it is only one percent of its net worth or a week's corporate profits."). The Utah court's reasoning amounts to an end-run around *BMW* and the Due Process Clause by automatically deeming large corporations to have had "fair notice" of virtually *any* monetary punishment that a jury conceivably could impose.

The court further erred by looking to State Farm's *overall* profits, rather than the profits directly resulting from the alleged misconduct. Allowing a jury to consider a large corporation's overall wealth is a recipe for a punitive damages award that is grossly disproportionate to the challenged conduct. A punitive damages award—to the extent that it may be supported by reference to a defendant's wealth or profits *at all*—must be directly linked to the wealth or profits that are shown to have resulted from the alleged wrongdoing. In other words, a punitive damages award must closely reflect the precise amount of the wrongful gain, and be reduced by any compensatory damage award arising from the challenged conduct. *See Cooper Indus., Inc. v. Leatherman Tool Group, Inc*., 532 U.S. 424, 442 (2001) (punitive damage award based on sales revenues is unconstitutionally excessive when "it would be unrealistic to assume that all of [the defendant's] sales . . . would have been attributable to its misconduct").

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As one federal court of appeals put it, "a sort of game-show mentality leads some contemporary juries to award punitive damages in amounts that seem utterly capricious." *Moreno v. Consolidated Rail Corp*., 99 F.3d 782, 792 (6th Cir. 1996) (en banc). The *State Farm* case provides the Court with an excellent opportunity to eliminate these types of arbitrary and unfair verdicts, and reaffirm the constitutional limitations on punitive damage awards.

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Footnote

[1] Those three guideposts are the reprehensibility of the defendant's conduct, the ratio of the compensatory award to the punitive award, and the amount of civil or criminal penalties that could be imposed for comparable misconduct. *See BMW*, 517 U.S. at 574-75.