

**UNITED STATES SUPREME COURT STRENGTHENS STANDARDS
ENFORCING DUE PROCESS LIMITATIONS ON PUNITIVE DAMAGE AWARDS**

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MAY 5, 2003

INTRODUCTION

The United States Supreme Court recently issued a landmark decision in *State Farm Mutual Automobile Insurance Company v. Campbell*, ___ S.Ct. ___, No. 01-1289, 2003 WL 1791206 (April 7, 2003) (“*State Farm*”), holding that a punitive damage award of \$145 million, where full compensatory damages were \$1 million, is excessive and violates the Due Process Clause of the Fourteenth Amendment.

In *State Farm*, the Court clarified and refined the standard for judicial review of punitive damage awards under the three guideposts it first mandated in *BMW of North America, Inc. v. Gore*¹: (1) the degree of reprehensibility of the defendant’s misconduct (the “reprehensibility analysis”), (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award (the “punitive damages multiplier”), and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases. Rejecting the expansive reading of these principles as applied by the Utah Supreme Court below, the Supreme Court entered a number of rulings that, taken together, both narrow the scope of conduct on which punitive damages may be granted and further constrain the size of such awards in relation to compensatory damages. In strengthening the standards for appellate review enforcing due process limitations on punitive damage awards, *State Farm* significantly expands the protections accorded defendants against the imposition of excessive and repetitive punitive damage awards.

¹ 517 U.S. 559, 575 (1996); see also *Cooper Industries, Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424, 424 (2001) (mandating *de novo* appellate court review of a trial court’s application of the *Gore* guideposts to a jury’s award).

BACKGROUND

State Farm arose out of litigation involving a 1981 fatal car accident in the Cache Valley of Utah, for which a State Farm policyholder, Curtis Campbell, was subsequently found 100% liable for third party claims substantially in excess of his available insurance coverage. Although investigators and witnesses concluded that Campbell caused the accident, State Farm declined all offers to settle the case within the Campbell's \$50,000 policy limit. Instead, the insurer took the case to trial, "assuring the Campbells that 'their assets were safe, that they had no liability for the accident, that [State Farm] would represent their interests and that they did not need to procure separate counsel.'" ² However, when the jury returned a judgment against Campbell more than \$135,000 in excess of his coverage, State Farm initially refused either to cover the excess judgment or to post the supersedeas bond required for appeal, and suggested the Campbells "put for sale signs" on their property to get things moving. ³

State Farm ultimately paid the full judgment, including amounts in excess of the policy limit, but the Campbells brought an action against the insurer alleging bad faith failure to settle, fraud and intentional infliction of emotional distress. In the first phase of a bifurcated trial, the jury found that State Farm acted in bad faith in unjustifiably putting its policyholder at risk by failing to accept settlement offers within policy limits when liability was clear. In the punitive damages phase before a second jury, plaintiffs argued that the insurance company's decision to try the liability case was the result of a national scheme to meet corporate fiscal goals by capping payouts on claims company wide. Over State Farm's objection, the trial court allowed the Campbells to introduce extensive evidence regarding State Farm's claims handling and compensation practices across the United States over a 20-year period (the "institutional case"). Most of these practices bore no relation to third-party automobile insurance claims of the type underlying the plaintiffs' complaint against the company. The jury awarded the Campbells \$2.6 million in compensatory damages and \$145 million in punitive damages. The trial court remitted the damages to \$1 million and \$26 million, respectively.

On appellate review, the Utah Supreme Court sought to apply the three *Gore* guideposts to evaluate *de novo* the reasonableness of the jury's award and the trial court's remittature. First, relying in large part on the extensive evidence concerning State Farm's national practices introduced in support of plaintiffs' institutional case, the Utah court concluded State Farm's conduct was reprehensible. Second, referencing State Farm's "massive wealth," together with testimony indicating that because of their clandestine nature State Farm's actions would be punished at most in one out of every 50,000 cases, the court concluded a 145:1 ratio between punitive and compensatory damages was not unwarranted. Third, the court noted that the

² *State Farm* at *4 (quoting the findings of the Utah Supreme Court).

³ *Id.*

punitive damages award was not excessive when compared to the aggregate criminal and civil penalties that could be assessed for the various acts of fraud implicated by the company's national profit scheme. The Utah Supreme Court reinstated the jury's full \$145 million punitive damage award, setting the stage for United States Supreme Court review.

ANALYSIS

The *State Farm* Court begins its analysis by affirming that appellate review of punitive damage awards under the *Gore* guideposts is required to ensure that the imprecise manner in which such awards are administered by trial courts does not result in an irrational and arbitrary deprivation of a tortfeasor's property in violation of constitutional due process. Where compensatory damages are grounded in the concrete loss that the plaintiff has suffered by reason of a defendant's wrongful conduct, punitive damages, together with criminal penalties, fall within the discretion of each State in exercising its interest in punishing unlawful conduct and deterring its repetition. Yet the defendant in a civil trial is not accorded the protections applicable in criminal proceedings. Jury instructions governing punitive damages often do little to aid the jury in assigning appropriate weight to evidence that is relevant as opposed to evidence that is tangential or only inflammatory. Further, presentation of evidence of a defendant's net worth creates the potential that a jury will express biases against big business, particularly those without a strong local presence. The resulting system poses an acute danger of arbitrary awards that violate the basic due process principle that "a person receive fair notice not only of the conduct that will subject him to punishment, but also of the severity of the penalty that a State may impose."⁴

For this reason, appellate review under the principles set forth in *Gore* must be implemented with care to ensure the reasonableness and proportionality of punitive damage awards. As applied by the Utah courts, however, the *Gore* guideposts resulted in rulings that replicated, rather than cured, tendencies toward arbitrary and excessive awards. In setting forth the standard for the proper calculation of punitive damages, the *State Farm* Court addressed each of the *Gore* guideposts in detail.

The "Reprehensibility" Guidepost

It should be presumed that a plaintiff has been made whole by compensatory damages, so punitive damages should be awarded only if the defendant's culpability is so reprehensible as to warrant the imposition of further sanctions to achieve punishment or deterrence.⁵

⁴ *Id.* at *6.

⁵ *Id.*

Under the Court's punitive damages jurisprudence, the most important indication of an award's reasonableness is the degree of reprehensibility of defendant's conduct. In *Gore* the Court instructed that reprehensibility is to be determined on the basis of five criteria: (1) is the harm caused by a defendant physical as opposed to economic; (2) does the tortious conduct evince an indifference to or reckless disregard of the health and safety of others; (3) did the target of the conduct have financial vulnerability; (4) does the conduct involve repeated actions or an isolated event; and (5) was the harm the result of intentional malice, trickery or deceit, or a mere accident.

These criteria were expansively read by the Utah courts to invite a broad, if not limitless, scope of evidence regarding State Farm practices for the purpose of establishing motive, deliberateness and culpability. But as *State Farm* makes clear, "[t]he reprehensibility guidepost does not permit courts to expand the scope of the case so that a defendant may be punished for any malfeasance."⁶ Thus, the scope of evidence admissible to determine punitive damages is limited by two distinct, but interwoven considerations: first, the jurisdictional boundaries on any State's interest in deterring and punishing certain conduct, and second, a required nexus with the conduct giving rise to the defendant's liability.

A basic rule of federalism is that each State may make its own reasoned judgment about what conduct is permitted or proscribed within its borders, and what measure of punishment, if any, to impose upon those who act within its jurisdiction. Thus, the *Gore* Court held a State cannot punish a defendant for conduct in other States that is lawful where it occurred. *State Farm* further clarifies that, as a general rule, a State has no legitimate interest in imposing punitive damages to punish unlawful acts committed outside of the State's jurisdiction. Extraterritorial conduct is admissible under the reprehensibility guidepost only if probative of the deliberateness and culpability of a defendant's tortious in-state actions, and further, only if such conduct has a nexus to the specific harm suffered by the plaintiff.⁷

The nexus requirement imposed on evidence of extraterritorial conduct is but one expression of the more fundamental principle that "a defendant's dissimilar acts, independent from the acts upon which liability was premised, may not serve as the basis for punitive damages."⁸ A defendant is to be punished for the conduct that harmed the plaintiff, not for being an unsavory individual or business. Nor is this requirement weakened by the Court's prior recognition under *Gore* that repeated conduct is more reprehensible than an individual incidence of malfeasance. Where punitive damages are justified on grounds of recidivism, the

⁶ *Id.* at 11.

⁷ *Id.* at *9.

⁸ *Id.* at *10.

courts must ensure the conduct in question “replicates the prior transgressions.”⁹ In failing to require such a nexus, a court violates due process by effectively “adjudicat[ing] the merits of other parties’ hypothetical claims against a defendant under the guise of the reprehensibility analysis.”¹⁰ Further, the Court found, because nonparties are not bound by the resulting judgment, punishment on such bases creates the possibility of multiple punitive damage awards for the same conduct.

As applied in *State Farm*, these principles significantly narrow the evidence appropriately before a trial court in considering punitive damages. The Court specifically criticized the use of lawful out-of-state conduct to demonstrate, in a general sense, a defendant’s motive against the plaintiff, as well as the reliance on extensive evidence pertaining to claims handling practices that had nothing to do with third-party lawsuits, and further, broad evidence that State Farm claims policies had corrupted its employees. The Court also rejected plaintiffs’ efforts to establish the necessary nexus between such evidence of State Farm’s disparate national practices and its specific failure to settle the Campbell’s claim within policy limits by tracing all such practices back to a centralized, cohesive scheme on the part of State Farm management to use compensation policies to encourage employees to cap indemnity payouts.¹¹ Because the Campbell’s had identified no conduct by State Farm similar to that which harmed them, the Court held that the no conduct beyond that which harmed them was relevant to reprehensibility.

The “Ratio of Harm to Punitive Damages” Guidepost

Although the Court continues to reject a bright line test for the relationship of punitives to compensatories, the *State Farm* decision provides a number of guidelines regarding the limits due process imposes on the relative size of punitive damage awards. “Courts must ensure that the measure of punitives is both reasonable and proportionate to the amount of harm to the plaintiff and to the general damages recovered.”¹² The *State Farm* Court holds that few awards exceeding a single-digit ratio between punitive and compensatory damages will satisfy due process, and reiterates that an award of four times the amount of compensatory damages might be close to the line of constitutional impropriety. The Court further instructs that just as greater ratios may comport with due process where “a particularly egregious act has resulted in only a

⁹ *Id.* at *10.

¹⁰ *Id.*

¹¹ For a full exposition of the evidentiary basis for punitive damages rejected by the majorities’ holding, see Justice Ginsberg’s lengthy dissent, which asks “[w]hat is infirm about the Campbell’s theory that their experience with State Farm exemplifies and reflects an overarching underpayment scheme, one that caused ‘repeated misconduct of the sort that injured them.’?” *Id.* at *18.

¹² *Id.* at *12.

small amount of economic damages,” where compensatory damages are substantial, a lesser ratio can reach the outermost limit of the due process guarantee.¹³ Moreover, punitive damages may be further limited and/or eliminated where compensatory damages are based on a component, such as emotional distress, which is duplicated in the punitive analysis.¹⁴

The Court also criticized the Utah court’s reliance on an argument that the defendant will be punished only in the rare case, coupled with reference to defendant’s assets, as grounds for a high punitive damages multiple. The Court found such arguments to “bear no relation to the award’s reasonableness and proportionality to the harm.”¹⁵ In this context the Court also issued cautionary instructions regarding references to the wealth of a defendant in determining the amount of punitive damages. Wealth, the Court observed, provides an open-ended basis for inflating awards arbitrarily when the defendant is wealthy, potentially in violation of a defendant’s entitlement to fair notice of the demands the several States impose on the conduct of its business.¹⁶

The “Comparison to Civil Penalties” Guidepost

Although less expansive, the Court is no less critical of the Utah Supreme Court’s analysis under the final guideline requiring a court test the reasonableness of any punitive damages award against civil penalties authorized or imposed in comparable cases. The remote possibility of a criminal sanction does not sustain a comparable punitive damage award.¹⁷ Nor, the Court held, was it appropriate for the Utah Supreme Court to speculate about the significant costs following from the loss of business licenses, disgorgement of profits, and possible imprisonment based on evidence of out-of-state or dissimilar conduct. The appropriate and relevant comparison is to sanctions available for the specific conduct giving rise to plaintiffs’ harm – in this instance, a \$10,000 fine for a single act of fraud dwarfed by the \$145 million punitive award.

¹³ *Id.* at *11.

¹⁴ *Id.* at *12.

¹⁵ *Id.* at *12.

¹⁶ *Id.*

¹⁷ *Id.* at 13.

SUMMARY

State Farm is the most recent step in a line of Supreme Court jurisprudence enforcing due process limitations on punitive damages through increasingly stringent judicial review. The rulings of the Court significantly narrow the evidentiary grounds on which a punitive damage award can be erected and further effectively limit such damages to a single-digit multiple of compensatory damages in all but the most egregious of cases.

Certain significant areas of concern remain unaddressed. *State Farm* speaks directly to punitive damage awards in the context of economic damages involving an individual action. Defendants in mass tort class actions involving physical injuries and/or deaths must remain circumspect in evaluating the impact of these rulings. However, for many defendants the ruling promises significant relief from the uncertainty posed by excessive and repetitive punitive damage awards.

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If you have any questions or comments concerning the *State Farm* decision, please do not hesitate to contact Simpson Thacher & Bartlett attorney Andrew Amer (212-455-2953; aamer@stblaw.com).

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