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Supreme Court Decision In State Farm Mutual Automobile Insurance Co. v. Campbell Restricts Punitive Damages Claims

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[Editor's Note: James M. Beck is of counsel in the Philadelphia Trial Team of Dechert LLP and is primarily engaged in the defense of and appellate practice involving complex personal injury and product liability matters and insurance-related litigation. He represented Medtronic Sofamor Danek, a major bone screw defendant, throughout that litigation and was its counsel of record on the Buckman Supreme Court appeal. He is currently involved in other mass tort litigation including Baycol, tobacco and firearms. He is a member of the Product Liability Advisory Committee (PLAC), and has sat on PLAC's case selection committee since 1997. Mr. Beck published the article "FDA, Off-Label Use and Informed Consent: Debunking Myths and Misconceptions" in the Food & Drug Law Journal which the Supreme Court cited in Buckman. He drafted the motion, the grant of which ultimately led to the Buckman decision. Mr. Beck graduated from Princeton University in 1978 and the University of Pennsylvania Law School in 1982. Copyright 2003 by the author. Replies to this commentary are welcome.]

On April 7, 2003 a solid 6-3 majority of the U.S. States Supreme Court reiterated constitutional limitations upon the authority of states to impose punitive damages, and articulated much more detailed guidelines determining when an award of punitive damages is unconstitutional. State Farm Mutual Automobile Insurance Co. v. Campbell, No. 01-1289, 123 S.Ct. 1513 (U.S. 2003) (available online at < http://supct.law.cornell.edu/supct/html/01-1289.ZO.html >). The State Farm decision is likely to have considerable impact on the treatment of punitive damages in mass tort litigation.

I. The Punitive Damages Award In State Farm

State Farm involved misconduct by an insurer towards its insured, not personal injuries, and certainly not a "mass tort" of the sort commonly encountered by subcommittee members. The insurer, having assumed the defense of the insured in an automobile accident case, allegedly refused to settle within the policy limits, suffered verdict in excess of the coverage, and despite previous assurances to the insured that his personal assets were not at risk, refused to pay the excess — thereby exposing the insured to possible execution by the judgment holder. 123 S.Ct. at 1517-18. Ultimately, however, the insurer paid the entire amount of the verdict. Id.

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An insurance bad faith action in Utah state court followed, and at trial the plaintiffs undertook to prove what they characterized as "a national scheme to meet corporate fiscal goals by capping payouts on claims company wide." Id. (citation and quotation marks omitted). Evidence supporting this theory consisted of:

extensive expert testimony regarding fraudulent practices by State Farm in its nation-wide operations . . . [and] [e]vidence pertaining to . . . [defendant's] business practices for over 20 years in numerous States. Most of these practices bore no relation to third-party automobile insurance claims, the type of claim underlying the [plaintiffs'] complaint against the company.

Id. At 1519. The jury awarded $2.6 million in compensatory damages, and $145 million in punitive damages. Id. This award was affirmed by the state's highest court against a constitutional challenge. Id.

In the Supreme Court, State Farm challenged the constitutionality of both the amount of punitive damages and of the imposition of such damages on the basis of dissimilar and out of state conduct.

II. The Legal Standard For Constitutionality Of Punitive Damage Awards

The six-justice majority produced one, unified opinion of the Court finding that the unconstitutionality of the punitive damages award was "neither close nor difficult." 123 S.Ct. at 1520. Both the size of the award, and the procedure by which it was obtained, violated the Due Process Clause of the Fourteenth Amendment, as applied to the states.

The Court reaffirmed that punitive damages awards are subject to *de novo* review in all respects, because "[e]xacting appellate review ensures that an award of punitive damages is based upon an application of law, rather than a decisionmaker's caprice." Id. at 1520-21 (quoting Cooper Industries, Inc. v. Leatherman Tool Group, Inc., 532 U.S. 424, 436 (2001)).

III. New Restrictions Upon Imposition Of Punitive Damages For Conduct Occurring In States Other Than Where Suit Was Brought

The Court also reiterated its prior holding in BMW of North America, Inc. v. Gore, 517 U.S. 559 (1996), that states cannot constitutionally award punitive damages for conduct occurring in other states:

A State cannot punish a defendant for conduct that may have been lawful where it occurred. Nor, as a general rule, does a State have a legitimate concern in imposing punitive damages to punish a defendant for unlawful acts committed outside of the State's jurisdiction.

State Farm, 123 S.Ct. at 1522 (citing Gore) (other citations omitted).

One state cannot constitutionally apply it common law to impose punishment for acts occurring outside of its borders, and cannot punish a defendant for conduct directed against third parties — except under the law of the state in which that conduct occurred and with the involvement of those adversely affected:

Any proper adjudication of conduct that occurred outside Utah to other persons would require their inclusion, and, to those parties, the Utah courts, in the usual case, would need to apply the laws of their relevant jurisdiction.

Id. Furthermore, "[a] jury must be instructed . . . that it may not use evidence of out-of-state conduct to punish a defendant for action that was lawful in the jurisdiction where it occurred."

123 S.Ct. at 1522 (citation omitted). Furthermore, "[a] jury must be instructed . . . that it may not use evidence of out-of-state conduct to punish a defendant for action that was lawful in the jurisdiction where it occurred." Id. at 1522-23 (citation omitted).

The implications of these holdings upon the litigation of punitive damages issues, both in the context of mass torts and elsewhere, are profound. The prohibition against one state's law applying to conduct in other states could be significant. What is "legal" and what is "illegal" in the tort context will vary from state to state — particularly, as is often the case in mass tort litigation, where novel theories of liability are involved.

This ruling should also help defeat any suggestion of a "punitive damages class action" in mass tort litigation. Even if a class action could overcome the joinder issue, the constitutional requirement of applying multiple state's laws would remain, and similar requirements, even without a constitutional basis, have consistently barred the use of multi-jurisdiction class actions.

IV. Limiting Punitive Damages To The Harm Suffered By The Particular Plaintiff

The State Farm court reiterated the three constitutional "guideposts" for punitive damages, the first and "most important" being "the degree of reprehensibility of the defendant's misconduct." 123 S.Ct. at 1521 (citing Gore, 517 U.S. at 575). The Court found evaluation of this element to involve a number of factors, several of which were individualized to the plaintiff:

- whether the harm caused was physical as opposed to economic;

- the tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others;

- the target of the conduct had financial vulnerability;
- the conduct involved repeated actions or was an isolated incident; and
- whether the harm was the result of intentional malice, trickery, or deceit, or mere accident.

123 S.Ct. at 1521 (citing Gore, 517 U.S. at 576-77).

The Court held that is was constitutional error for a state court to use the punitive damages phase of a trial "as a platform to expose, and punish, the perceived deficiencies of [defendant's] operations throughout the country," and to punish a defendant "for its nationwide policies rather than for the conduct direct toward the [plaintiff]." 123 S.Ct. at 1521 (citation omitted).

Nor could broad admissibility of other bad acts be justified as proof of "motive." To the extent that other instances of tortious conduct are admissible at all, they must be tied to the particular plaintiff bringing the action:

Lawful out-of-state conduct may be probative when it demonstrates the deliberateness and culpability of the defendant's action in the State where it is tortious, but that conduct must have a nexus to the specific harm suffered by the plaintiff.

Id. at 1522.

Furthermore, allegations that the defendant was seeking to profit from improper activity are not enough to permit admission of otherwise unrelated unsavory conduct:

Plaintiff's attempt to justify the courts' reliance upon this unrelated testimony on the theory that each dollar of profit made by underpaying a third-party claimant is the same as a dollar made by underpaying a first-party one. . . . For the reasons already stated, this argument is unconvincing. The reprehensibility guidepost does not permit courts to expand the scope of the case so that a defendant may be punished for any malfeasance.

Id. at 1523-24 (citation omitted).

State Farm is thus persuasive authority that proof of entitlement to punitive damages can no longer involve picking and choosing the most egregious instances of somehow-related misconduct by a defendant. Rather, entitlement to punitive damages can be proven solely by conduct that is causally related to a particular plaintiff's compensatory damages. Thus actions involving such matters

as: (1) a different, but similar, product model not involved in the plaintiff's accident, (2) advertisements or promotional information not seen by the plaintiff, (3) other toxic releases that did not affect the plaintiff, or (4) conduct that could not be causal by reason of time or place, cannot be constitutionally used to establish entitlement to punitive damages under State Farm. Such evidence may or may not be relevant to other aspects of punitive damages, but should be inadmissible with respect to the threshold question of entitlement — which after State Farm must involve a "nexus" to the injuries of the particular plaintiff.

State Farm's constitutionality requirement of plaintiff-specific causation for entitlement to punitive damages presents another barrier to class-based punitive awards in mass tort litigation, since creation of a single punitive damages multiplier equally applicable to all plaintiffs based on widely diverse conduct that is not equally applicable to all plaintiffs is no longer constitutionally acceptable.

V. Reprehensibility Of Conduct May Only Be Shown By Similar Acts

One element of punitive damages that is not strictly limited to causally significant evidence is that of "reprehensibility," the second Gore factor of "the degree of reprehensibility of the defendant's misconduct." 123 S.Ct. at 1520. However, State Farm placed a limit on this form of evidence as well. Reprehensibility analysis is only constitutional where if involves conduct that is "similar" to what injured the plaintiff

The State Farm Court held that a general allegation of a company-wide "practice" to use claims handling as a "profit center" was an insufficient basis for allowing punitive damages evidence involving dissimilar unsavory activities across the nation. The Court observed that the other incidents relied upon by the plaintiff did not even involve third-party automobile claims. Such "dissimilar acts" cannot constitutionally establish a punitive damages claim:

A defendant's dissimilar acts, independent from the acts upon which liability was premised, may not serve as the basis for punitive damages. A defendant should be punished for the conduct that harmed the plaintiff, not for being an unsavory individual or business. Due process does not permit courts, in the calculation of punitive damages, to adjudicate the merits of other parties' hypothetical claims against a defendant under the guise of the reprehensibility analysis.

123 S.Ct. at 1523. See also id. at 1525 (criticizing introduction of evidence of punitive damages awarded against same defendant in dissimilar case).

The State Farm Court gave little guidance as to what kinds of evidence would be admissible under the newly adopted constitutional similarity test:

Although evidence of other acts need not be identical to have relevance in the calculation of punitive damages, the [state] court erred here because evidence

pertaining to claims that had nothing to do with a third-party lawsuit was introduced at length.

Id. at 1523. It is likely that, in the aftermath of State Farm, courts analyzing punitive damages evidence will be performing a constitutional analysis of evidence similar to that already employed in product liability litigation in cases where the admissibility of "similar occurrence" evidence is challenged.

Further, similarity must be proven, not assumed. The Supreme Court refused to allow large awards of punitive damages based upon speculation that a defendant frequently engaged in similar reprehensible conduct, but only rarely got caught. Id. 1525 (rejecting contention that defendant "will only be punished in one out of every 50,000 cases as a matter of statistical probability").

The Supreme Court's holding that "other events" evidence must "replicate" the conduct that injured the plaintiff, id. at 1523, when combined with its prior holding that entitlement to punitive damages must be based upon in-state plaintiff-specific evidence, id. at 1522-23, suggest that bifurcation will become a frequent feature of trials involving punitive damages, mass tort and otherwise. "Similar occurrence" evidence, while inadmissible to prove entitlement, remains admissible to prove reprehensibility, and juries cannot realistically be expected to keep the two purposes separate in a single-phase trial. Therefore, bifurcation seems the logical approach to balance the differing evidentiary requirements of the two elements.

Constitutional considerations should also play a much greater role in trial sequence in the post-State Farm litigation environment. With entitlement to punitive damages now required to rest on plaintiff specific conduct, the practice in some mass tort cases of first adjudicating entitlement to punitive damages generically with an overall lump sum verdict, and only later determining individual entitlement is probably unsound.

VI. Punitive Damage Ratios Presumptively Limited To Single Digits

The second "guidepost" for the constitutionality of punitive damages is "the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award." 123 S.Ct. at 1520 (following Gore). While State Farm declined to establish any "bright-line" ratio, id. at 1524, the Court decided that punitive damages awards that were more than ten times the amount of a "substantial" compensatory award were presumptively unconstitutional:

Our jurisprudence and the principles it has now established demonstrate, however, that, in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process. . . . Single-digit multipliers are more likely to comport with due process.

Id. (citations omitted)

The constitutional threshold could be significantly less in particular cases. Id. (suggesting that "an award of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety"). In cases involving large compensatory awards, even a punitive damages verdict that merely exceeded the compensatory award could be constitutionally suspect. "When compensatory damages are substantial, then a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee." Id.

It remains to be decided the extent to which these ratios apply in personal injury litigation, since the Supreme Court left some ambiguity in its decision. In listing the reasons why the punitive award in State Farm was constitutionally excessive, the Court mentioned that "[t]he harm arose from a transaction in the economic realm, not from some physical assault or trauma; there were no physical injuries." Id. at 1524-25. Thus mass tort plaintiffs claiming personal injury have reason to argue that the ratios discussed in State Farm should be relaxed in personal injury cases.

VII. A Large Compensatory Award May Preclude Any Punitive Award At All

The third constitutional "guidepost" against which punitive damages must be measured is "the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases." 123 S.Ct. at 1520 (following Gore). The Court held that corresponding criminal penalties for equivalent conduct were not a particularly apt analogy in assessing the constitutionality of a punitive damages award because criminal prosecutions must satisfy higher procedural hurdles, such as the "beyond a reasonable doubt" proof standard. 123 S.Ct. at 1526. Nevertheless, the Court did comment that the most relevant criminal sanction, a fine of $10,000, was "dwarfed" by the punitive verdict. Id.

State Farm held that the goal of compensating a plaintiff was fulfilled by a compensatory award alone. Id. at 1521 ("[i]t should be presumed a plaintiff has been made whole for his injuries by compensatory damages"). Further, the Court recognized that some large compensatory awards, particularly for emotional distress, can be duplicative of punitive damages because there is a punitive element in the compensatory award:

The compensatory damages for the injury suffered here, moreover, likely were based on a component which was duplicated in the punitive award. Much of the distress was caused by the outrage and humiliation . . .; and it is a major role of punitive damages to condemn such conduct. Compensatory damages, however, already contain this punitive element.

Id. at 1525 (citing Restatement (Second) of Torts §908, comment c (1977)).

Thus after State Farm, a defendant facing a large, nominally "compensatory" award has grounds for arguing that the size of the compensatory award constitutionally precludes the award of any punitive damages at all. Further, since the amount compensatory damages may preclude any award of compensatory damages, as a matter of logical trial sequence the amount of compensatory damages must be known before a punitive damages claim can be tried. Thus any "reverse bifurcation" procedure that results in a trial of punitive damages issues before the amount of compensatory damages is set, probably suffers from fatal constitutional infirmity.

VIII. Evidence Of Wealth

While State Farm did not turn the law of punitive damages completely upside down by prohibiting admission of a defendant's net worth, the Supreme Court criticized attempts to justify outsized awards based upon wealth. A defendant's wealth "bear[s] no relation to the award's reasonableness or proportionality to the harm." 123 S.Ct. at 1525. Evidence of wealth, by itself, was ineffective to defeat a constitutional challenge to an excessive punitive damages award. "The wealth of a defendant cannot justify an otherwise unconstitutional punitive damages award." Id.

Wealth provides an open-ended basis for inflating awards when the defendant is wealthy. That does not make its use unlawful or inappropriate; it simply means that this factor cannot make up for the failure of other factors, such as "reprehensibility," to constrain significantly an award that purports to punish a defendant's conduct.

Id. (citation and quotation marks omitted).

Given the skepticism State Farm showed toward use of a defendant's wealth in the assessment of punitive damages, defendants in mass tort litigation have grounds to seek new and tighter restrictions upon wealth evidence, and probably upon discovery of wealth evidence as well.

IX. Jury Instructions

The challenge to punitive damages in State Farm was not directed to any particular jury instruction on the issue. Nevertheless, the Court made a comment in *dictum*, that appears to create a basis for constitutional challenge to standard jury instructions in many jurisdictions. The Court stated that "[v]ague instructions, or those that merely inform the jury to avoid 'passion or prejudice,' do little to aid the decisionmaker." 123 S.Ct. at 1520. The boundaries of this statement are entirely undefined, but it can be expected to be the source of many challenges to

the constitutionality of punitive damages instructions. Plaintiffs who wish to avoid constitutional challenges to punitive damages awards should take care to ensure that more substantial instructions are sought on punitive damages.