

# Punitive Damages California-Style – In Light of *Simon and Johnson*

By Stuart R. Chandler

We have waited for over two years to see what the California Supreme Court would have to say about punitive damages in light of the landmark case of *State Farm v. Campbell* (2003) 538 U.S. 408, 123 S.Ct. 1513, 155 L.Ed.2d 585. In that time span, we have seen a plethora of appellate decisions and articles reaching very divergent interpretations.

On June 16, 2005, the California Supreme Court weighed in on the topic in two cases: *Simon v. San Paolo U.S. Holding Company, Inc.* (2005) 35 Cal.4th 1159, 29 Cal.Rptr.3d 379, 113 P.3d 63, and *Johnson v. Ford Motor Company* (2005) 35 Cal.4th 1191, 29 Cal.Rptr.3d 401, 113 P.3d 82. Taken together these decisions dispel some errant and damaging applications of *State Farm*. The *Simon* and *Johnson* cases provide a framework for seeking and obtaining jury verdicts which include damages for the purpose of deterring wrongful conduct and setting an example. (Civ. Code § 394.) This article will summarize those cases and provide the reader with some practical approaches to handling a case with punitive damages potential.

## REVIEW OF THE STATE FARM GUIDEPOSTS

In *State Farm*, the U.S. Supreme Court reviewed and discussed what are now commonly referred to as the three “guideposts” for appellate review of an award of punitive damages. Awards that fail to pass muster under the guideposts are prohibited as violating the due process rights of the tortfeasor. Those constitutional guideposts are:

(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. (*State Farm*, 538 U.S. at p. 413.)

Within the “reprehensibility” guidepost, factors to consider are 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 the harm was the result of intentional malice, trickery, or deceit, or mere accident. (*Id.* at p. 419.)

## **SIMON V. SAN PAULO U.S. HOLDING COMPANY, INC.**

*Synopsis.* Simon attempted to purchase an office building from San Paulo. Negotiations led to a tentative written agreement with a sale price of \$1.1 million. Simon then hired attorney to assist him, paying a non-refundable retainer of \$5,000. San Paulo, however, proceeded to sell the building to another party. Simon sued, alleging breach of contract and fraud. Simon’s expert testified the building was worth \$1.5 million. The jury rejected the contract claim but agreed that Simon was defrauded, awarding \$5,000 in compensatory damages and \$2.5 million in punitive damages. Simon declined the Court’s remittitur of punitive damages to \$250,000.

A subsequent trial on punitive damages resulted in a jury verdict of \$1.7 million. That amount, plus the \$5,000 compensatory damages, became the judgment that was affirmed on appeal on the premise that the punitive damage award was just over 4



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times the claimed loss of \$400,000. The California Supreme Court reversed and remanded with directions to reduce the punitive damages award to \$50,000. The decision was based largely on the Court’s conclusion that the claimed lost profit of \$400,000 was not a proper consideration in the punitive damages evaluation.

*Practice Pointers.* Despite the fact that the punitive damage award was decimated by the Supreme Court, the opinion contains a number of significant holdings that should provide hope instead of despair.

## 1. Potential Harm

The Court devoted a substantial portion of the opinion to reaffirm the proposition that uncompensated “potential harm” is properly included in evaluating the ratio of punitive damages. The Court observed that the “United States Supreme Court precedents appear to contemplate, in some circumstances, the use of a measure of harm beyond the compensatory damages.” (*Simon, supra*, 29 Cal.Rptr.3d 379, 388.) “The potential harm that is properly included in the due process analysis is ‘harm that is likely to occur from the defendant’s conduct.’” (*Id.* at p. 391; emphasis in original.) As to *Simon*, the Court concluded that:

defendant’s fraud neither caused nor foreseeably threatened to cause \$400,000 in harm to plaintiff. Under

these circumstances, the \$1.7 million punitive damages award must be measured against the \$5,000 compensatory award, and so measured it is grossly excessive. (*Id.* at p. 383.)

The practice point in handling a punitive damages case is to develop discovery and trial preparation to include evidence of uncompensated or potential harm. In light of *Simon*, this factor is more important than ever. For an excellent in depth article on this topic, read Michael Bidart's article in the *Forum* ("From *TXO* to *Campbell*: How Potential Damages Can Maximize Punitive-Damage Recoveries in Insurance Bad Faith Cases," July/Aug 2003).

## 2. Ratios Are "Instructive" and Not "Binding"

The Court stated: "[T]he presumption of unconstitutionality applies only to awards exceeding the single-digit level 'to a significant degree.'" (*Simon*, *supra*, 29 Cal.Rptr.3d at p. 395, fn. 7.) It specifically rejected the notion advanced by *Diamond Woodworks, Inc. v. Argonaut Insurance Company* (2003) 109 Cal.App.4th 1020, 1057, that the "outer constitutional limit" is approximately four times compensatory damages. Instead, the Supreme Court referenced language from *State Farm* that ratios are "'not binding,' but only 'instructive.'" (*State Farm*, *supra*, 538 U.S. at p. 425.) Also, quoting from *Mathias v. Accor Economy Lodging, Inc.* (7th Cir. 2003) 347 F.3d 672, the Court observed that "the judicial function is to police a range, not a point." (*Simon*, *supra*, 29 Cal.Rptr.3d at p. 395.)

## 3. Defendant's Financial Condition a Factor

Some defense counsel have argued that *State Farm* should be read to preclude consideration of the defendant's financial condition. *Simon* clearly reaffirms *Neal v. Farmers Ins. Exchange* (1978) 21 Cal.3d 910 and *Adams v. Murakami* (1991) 54 Cal.3d 105 for the proposition that "the defendant's financial condition remains a legitimate consideration in setting punitive damages." (*Id.* at p. 398.) The practice point to take away from this aspect of the *Simon* decision is that discovery regarding the defendant's financial condition remains a necessary part of trial prepara-

tion.

## 4. Maximum Award Analysis

In discussing the role of the reviewing court, the Court cautioned: "An appellate court should keep in mind, as well, that its constitutional mission is only to find a level higher than which an award may not go; it is not to find the 'right' level in the court's own view." (*Id.* at p. 400.) "[A]n appellate court does not sit as a replacement for the jury but only as a check on arbitrary awards." (*Ibid.*)

Whether in post-trial motions or on appeal where the defense may argue for remittitur, this language should be referenced to the court when reviewing a jury's award of punitive damages. Remind the reviewing court that its function is not to impose its own view on the appropriate level of punitive damages but only to identify the constitutional maximum.

## 5. Ratio of Punitive to Economic Damages

In *Simon*, the Supreme Court directed the appellate court to enter judgment to include punitive damages of \$50,000 – ten times the economic damages. Considering the guideposts discussed above, this is encouraging news. Under the reprehensibility component, San Paolo's conduct failed to satisfy four of the five criteria. Indeed, the Court observed that "In the universe of cases warranting punitive damages under California law, the fraudulent promise or promises that led to San Paolo Holding's liability have to be regarded as of relatively low culpability" (*id.* at p. 395) and "not highly reprehensible." (*Id.* at p. 396.)

The harm to *Simon* was economic, not physical. There was no risk to anyone's health or safety. There was no evidence that *Simon* was financially vulnerable. There was no repeated misconduct. The punishable conduct involved false promises in a Southern California commercial real estate transaction. What is so unusual about that? And yet, the California Supreme Court set the constitutional maximum for punitive damages – not as some courts have done post *State Farm* at 1.5 times or 4 times economic damages – but at 10 times economic damages! So while on first reading *Simon* may appear to be a discouraging

result, the analysis and the final "ratio" adopted by the Supreme Court under the particular circumstances will lend support for punitive damage awards in the future not being restricted to an artificially low multiplier.

## JOHNSON V. FORD MOTOR COMPANY

*Synopsis.* Mr. and Mrs. Johnson purchased a used Ford Taurus from a Ford dealer in Fresno. On request, they were shown a repair history with no significant problems. In fact, the vehicle had a significant history of transmission troubles, as the Johnsons soon learned. They had repeated transmission troubles and were eventually shown a complete repair history evidencing the problems experienced by the former owner.

The case went to trial on claims of misrepresentation, concealment, and lemon law violations. The evidence showed Ford had a practice of avoiding lemon law expenses (estimated at \$8,500 to \$13,500 for each lemon) by taking problem vehicles in trade and giving the owner a discount (in the form of an "Owner Appreciation Certificate") on another purchase. Plaintiffs' counsel showed that Ford saved \$6,000 – \$10,000 per vehicle by offering a discount instead of designating a vehicle a lemon. Since about 1,000 such certificates were issued each year, the argument was that Ford profited \$6 – \$10 million annually (in California) by this practice.

The Johnsons were awarded \$17,811.60 in compensatory damages. Punitive damages of \$10 million were awarded on a theory of disgorgement of profits. The court of appeal (in a post-*State Farm* decision) modified the judgment to allow punitive damages of only \$53,435 (three times compensatory).

The California Supreme Court held that the disgorgement approach was impermissible, but concluded that the appellate court may not have considered the reprehensibility of Ford's repeated conduct. Accordingly, the decision was reversed and remanded with instructions to the appellate court to determine the maximum allowable punitive damages consistent with the Supreme Court's decision.

*Practice Pointers.* As in *Simon*, the Supreme Court did much to dispel developing and damaging myths about how

courts should address punitive damages.

## 1. Recidivism

The Court held:

due process does not prohibit state courts, in awarding or reviewing punitive damages, from considering the defendant's illegal or wrongful conduct toward others that was similar to the tortious conduct that injured the plaintiff or plaintiffs. We therefore join numerous courts holding that a civil defendant's recidivism remains pertinent to an assessment of culpability. (*Johnson v. Ford Motor Company, supra*, 29 Cal.Rptr.3d 401, 411.)

## 2. Punish Overall Course of Conduct.

The Supreme Court observed that the appellate court's decision in *Johnson* relied upon another decision from the same appellate court on the same day: (*Romo v. Ford Motor Co.* (2003) 113 Cal.App.4th 738.) In *Romo*, the appellate court interpreted *State Farm* to require that punishment could only be imposed "for the particular affront to the plaintiff, not a broader sanction for an affront to society at large." (*Id.* at 747.) Since the appellate court outlined this approach in *Romo* and followed it in *Johnson*, it determined that Ford's punishment should only be relative to the affront to the Johnsons – not customers throughout the State.

The Supreme Court rejected that approach, stating "that a defendant has repeatedly engaged in profitable but wrongful conduct tends to show that 'strong medicine is required' to deter the conduct's further repetition." (*Johnson, supra*, 29 Cal.Rptr.3d at pp. 413-414.) It went on to state that "[n]othing the high court has said about due process review required that California juries and courts ignore evidence of corporate policies and practices and evaluate the defendant's harm to the plaintiff in isolation." (*Id.* at p. 414.)

Since repeated misconduct is one of the factors of reprehensibility, which is the most important factor in assessing punitive damages, it is important to obtain discovery and present evidence at trial of repeated similar misconduct.

## 3. Disgorgement of profits as a

## measure of punitive damages suspect

The punitive damages award was seemingly premised on the creative approach of plaintiffs' counsel to "anchor" punitive damages to the profits allegedly derived from a certain course of conduct, i.e., issuing discount certificates instead of branding certain vehicles as lemons. The Supreme Court noted "plaintiffs offered no proof that all OAC transactions – in any period – involved defective vehicles subject to California's Lemon Law, much less that all such vehicles were 'dangerous' or 'unrepaired.'" (*Id.* at p. 417.)

The Supreme Court left open the door to utilize profits as a justification for punitive damages when it concluded that "[w]e need not decide whether a plaintiff could ever, consistent with due process, justify the size of an award on a total profit basis ... these plaintiffs' attempt to calculate punitive damages on this basis was fatally deficient." (*Id.* at p. 418.)

The Court's discussion of the disgorgement approach to calculating punitive damages gives cause for caution. Specifically, the Court made statements such as an "approach calculating punitive damages in an individual tort case by the profits made through similar torts against hundreds or thousands of other individuals creates possibilities for unfairness – to the defendant and other possible claimants both – which may be of constitutional dimension." (*Id.* at p. 415.) It continued that "an award punishing the defendant for dissimilar hypothetical claims of others 'creates the possibility of multiple punitive damages awards for the same conduct; for in the usual case nonparties are not bound by the judgment some other plaintiff obtains.'" (*Ibid.*) The practice point to take away from this aspect of the *Johnson* case is to be cautious in trying to tie punitive damages to the profits from particular wrongful conduct.

## CONCLUSION

Although courts may be tempted to take the easy road and cap punitive damages at some single digit multiplier of economic damages, *Simon* and *Johnson* provide a framework for a more reasoned approach. Ratios are only instructive, not binding. And *Simon* is indeed instructive for the

proposition that a 10-times multiplier is permissible, even where there is minimal reprehensibility. With a discovery plan and trial approach to include demonstrating potential harm, the defendant's repeated similar conduct, and the defendant's financial condition, verdicts sufficient to punish and deter can pass constitutional muster. ■