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Issues & Answers

COMMERCIAL LITIGATION ALERT

Business Community Scores U.S. Supreme Court Victory, Reigning in Punitive Damage Awards

State Farm Mut. Auto. Ins. Co. v. Campbell

On Monday, April 7, the business community scored a major victory in its efforts toward reigning in runaway punitive damages awards. In *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. ___ (2003), a 6-3 decision, the Supreme Court of the United States found unconstitutionally excessive a $145 million punitive damages award entered against State Farm in a third-party bad faith case in Utah in which the plaintiff was also awarded $1 million in compensatory damages for State Farm's exposure of its insured to personal liability beyond the limit of the plaintiff's auto insurance policy.[1]

In essence, the *Campbell* decision clarifies and strengthens the constitutional limits on punitive damages. According to *Campbell*, a punitive damage must be "both reasonable and proportionate to the amount of harm to the plaintiff and to the general damages recovered" to satisfy the prohibition against arbitrary deprivation of property in the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

Although the Supreme Court failed to adopt a bright-line ratio that a punitive damages award may not exceed, it emphasized that "few punitive awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process." The Court reiterated its statement in a previous decision that "an award of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety." The Court even went so far as to state that, "[w]hen compensatory damages are substantial, then a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee."

The Supreme Court also emphasized that the evidence used to support a punitive damages award "must have a nexus to the specific harm suffered by the plaintiff" and the state in which the tortious conduct occurred.[2] Although "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," that conduct cannot be used to support the amount of a punitive damages award. The Court reasoned that a State has no right to "punish a defendant for conduct that may have been lawful where it occurred[,]" and it has no "legitimate concern in imposing punitive damages to punish a defendant for unlawful acts committed outside of the State's jurisdiction."

Critically, *Campbell* determined that it is improper for punitive damages to be "used as a platform to expose, and punish, the perceived deficiencies of [a defendant's] operations throughout the country" and that "the wealth of a defendant cannot justify an otherwise unconstitutional[ly excessive] punitive damages award."

In overturning the $145 million punitive damage award in *Campbell*, the Supreme Court suggested that an appropriate punitive damages award under the specific

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[1] The jury had awarded plaintiff $2.6 million in compensatory damages, but the trial court reduced that award to $1 million. The trial court also reduced the punitive damages award to $25 million. On appeal, the Utah Supreme Court reinstated the $145 million punitive damages award.

[2] For example, the Court found that State Farm's egregious handling practices with respect to first-party insurance claims nationally did not have a sufficient nexus to its similar handling practices with respect to third-party insurance claims in Utah, such as the one underlying the case, to be considered for purposes of punitive damages.

facts of the case would be "at or near the amount of compensatory damages." The Court found it significant that the compensatory damages award was substantial for the claims asserted, that the harm plaintiff had suffered arose from exposure to the potential of financial loss, as opposed to any actual or threatened physical harm, and that State Farm actually paid the excess verdict entered against its insured before the bad faith action was filed.

Campbell does not completely foreclose the possibility of substantial punitive damages awards, however. The Supreme Court acknowledged that there could be cases, e.g., "where 'a particularly egregious act has resulted in only a small number of economic damages'" or "where 'the injury is hard to detect or the monetary value of noneconomic harm might have been difficult to determine[,]'" in which greater ratios of punitive-to-compensatory damages might be constitutional.

Nonetheless, *Campbell* increases the arsenal of constitutional arguments that business defendants have to combat punitive damage claims in litigation.

It strengthens the ability of defendants to preclude from consideration on punitive damages evidence of prior, out-of-state conduct that does not replicate the tortious conduct at issue in the case. It limits plaintiff's ability to use a defendant's wealth as a basis for awarding punitive damages. And, it requires judges to be much more vigilant in reducing punitive damages awards for excessiveness. ■

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