

Develop Evidence of “Potential” Harm

Introduction

If the defense bar were to be believed, the United States Supreme Court’s decision in *State Farm Mutual Automobile Insurance Company v. Campbell*, 548 U.S. 2003, 123 S.Ct. 1513 (2003) (“*Campbell*”) has conclusively capped the punitive compensatory damages ratio in insurance-bad-faith cases at anywhere between 1-1 and 9-1. Some post-*Campbell* decisions by the California Appellate courts have suggested that in the “ordinary” punitive damages case, the ratio between compensatory damages and punitive damages cannot exceed 4 -1. (See, e.g., *Diamond Woodworks Inc. v. Argonaut Insurance Co.*, 109 Cal.App.4th 1020 (2003) (“no doubt that anything exceeding four to one would not comport with due process under *Campbell*.”) Others courts have resisted reading *Campbell* to impose rigid caps in all cases. (See, e.g., *Bardis v. Oates*, 119 Cal.App.4th 1 (2004)(applying 9-1 ratio and rejecting notion that punitive damages should be limited to 4:1.)

But the widely perceived 9-1 or 4-1 cap is neither the holding in *Campbell* nor as limiting as it may appear. As the *Diamond Woodworks* case completely omitted, and as the *Campbell* Court reaffirmed, the Supreme Court’s statement in *TXO Production Corp. v. Alliance Resources Corp.*, 509 U.S. 443 (1993) of the controlling law is that courts may place in the ratio’s denominator either actual or potential damages. *Diamond Woodworks*’ failure to consider any “potential damages” should therefore minimize the reach of its holding.

Developing evidence of potential damages as part of the ratio can have a significant impact on that analysis. For example, if actual damages are only \$50,000, but the potential damages from the defendant’s wrongful conduct are \$10,000,000, then a 9-1 ratio would yield a recoverable punitive award of not \$450,000 (\$50,000 multiplied by 9), but rather \$90 million (\$10 million multiplied by 9). As a result, punitive compensatory ratios may still be large when based on sufficient evidence demonstrating the potential damages arising from the insurer’s bad faith conduct.

Campbell v. State Farm

The issue in *Campbell* was whether, under the facts of that particular case, a \$145 million punitive award was excessive and in violation of the due process clause in the 14th Amendment to the U.S. Constitution. The Court’s opinion ultimately reduced the punitive-damages award to \$1 million, finding the \$145 million award to be an irrational, an arbitrary deprivation of State Farm’s property, excessive, and in violation of the due process clause.

In its reasoning, the *Campbell* Court relied heavily on its holding seven years earlier in *BMW of North America, Inc. v. Gore*, 517 U.S. 559, 116 S.Ct. 1589 (1996) (“*BMW*”), the first time ever that the Court invalidated a state-court punitive damages award as unreasonably large. The Court in *BMW* set the following three guideposts for reviewing punitive-damages awards:

(1) Reprehensibility of conduct – the most important factor;

(2) Ratio of punitive award to the actual or potential harm caused; and

(3) Difference between punitive award and civil penalties authorized in similar cases.

For the second guidepost, the ratio between punitive damages and the actual or potential damages caused, the Campbell Court explicitly and strongly stated that there did not exist, and it was not setting, any bright-line ratio, rigid benchmark, or mathematical formula to limit punitive awards. The Court emphasized that this ratio was ultimately dependent on the facts of each particular case. Specifically, the Campbell Court stated: “We decline again to impose a bright-line ratio which a punitive damages award cannot exceed.” (123 S.Ct. at 1524.). In *BMW*, the Court stated that the proper inquiry is “ ‘whether there is a reasonable relationship between the punitive damages award and the harm likely to result from the defendant’s conduct as well as the harm that actually has occurred.’ ” (*BMW*, 517 U.S. at 581, quoting *TXO*, 509 U.S. at 460) (Emphasis added).

Actual and Potential Harm

Most significantly, the Campbell Court reaffirmed the prior holding in *BMW* that not just actual harm, but also “potential” harm should be considered when applying a multiple or ratio for punitive damages. That is, the Campbell Court held that the proper ratio or disparity to consider is between “the actual or potential harm suffered by the plaintiff and the punitive damages award.” (*Id.* at 1520; emphasis added.) The Court later referred to the ratio as “between harm, or potential harm, to the plaintiff and the punitive damages award.” (*Id.* at 1524; emphasis added.) Then, the Campbell Court quoted from a section in *BMW* that was citing to *TXO* about comparing “actual and potential damages to the punitive award,” with the Campbell Court’s repeating the italic emphasis that the *BMW* Court had already given to those words “and potential.”(*Ibid.*)

Even more significant is the fact that in *TXO*, the Court acknowledged that it is not merely the potential harm to the individual plaintiff that is relevant to this determination, but the potential harm to other victims of the same practice that is relevant to determining the reprehensibility of the defendant’s conduct and the appropriate ratio:

Taking account of the potential harm that might result from the defendant’s conduct in calculating punitive damages was consistent with the views we expressed in *Haslip*, *supra*. In that case we endorsed the standards that the Alabama Supreme Court had previously announced, one of which was “whether there is a reasonable relationship between the punitive damages award and the harm likely to result from the defendant’s conduct as well as the harm that has actually occurred.”(*TXO*,*supra*,at 460).

To demonstrate the rationale and importance of considering potential damages in a punitive award, the *TXO* Court noted the analogous case of a man wildly firing a gun into a crowd, luckily injuring no one, and causing the only damage to a \$10 pair of glasses. If there is only \$10 in compensatory damages, then thousands of dollars in punitive damages would still be allowable in order “to teach a duty of care” and “to discourage future bad acts” – because of the potential harm that might result from the defendant’s conduct.

As the *TXO* Court put it, “It is appropriate to consider the magnitude of the potential harm that the defendant’s conduct would have caused to its intended victim if the wrongful plan had succeeded, as well as the possible harm to other victims that might have resulted if similar future behavior were not deterred.” And so, there must be a reasonable relationship between the punitive award and “the harm likely to result from the defendant’s conduct as well as the harm that actually has occurred.” (*Ibid.*, quoting *Haslip* , 499 U.S. at 21; emphasis added.)

Develop Evidence of Potential Harm in Discovery and Trial

In light of the United States Supreme Court holdings in TXO, BMW, and Campbell, plaintiffs' attorneys pursuing punitive awards should develop evidence of potential harm to others for trial. Justice Kennedy, who wrote the majority Campbell opinion, noted in his TXO concurrence that a jury must consider only the evidence presented to it in arriving at a judgment; and in TXO there was no evidence, argument, or instructions regarding the potential harm from TXO's conduct and so would not have allowed a reasonable jury to render its verdict on that basis. In her dissent in TXO, Justice O'Connor argued that, while she had "no quarrel with the plurality that, in the abstract, punitive damages may be predicated on the potential but unrealized harm. . .", she noted that the potential harm theory in that case was "little more than an after-the-fact rationalization invented by counsel to defend the startling award on appeal." (TXO, supra, 113S.Ct.at 484-485.). Justice O'Connor explained that the record nowhere contained estimates of the potential damages, which was claimed only after the case was on appeal.

The lesson to be learned from these comments contained in TXO is to develop and introduce evidence of potential harm at the time of trial. Plaintiffs should retain forensic economists to explore all potential damages, particularly to California victims. From the outset, discovery should be geared to obtaining all the foundational data to demonstrate that the defendant's wrongful practices could potentially affect many others.

Once the discovery is obtained, work with a forensic economist to develop a model to quantify the potential harm or damage that the defendant's conduct could cause. The quantification of the potential harm can then be used in the ratio between the harm and punitive damages.

As the Campbell case held, and as even the Diamond Woodworks holding affirmed, defendants may be punished for conduct similar or bearing a relationship to that which injured the particular plaintiff in each case. The key, then, for plaintiffs is to introduce at trial sufficient evidence of repeated misconduct of the sort that injured the plaintiff, and could potentially harm others.

Conclusion

The law of punitive damages is currently in flux. Until the law is further clarified, the best course for plaintiffs will be to look to all of the Supreme Court's punitive damages cases, and to ensure that the defense does not pull snippets of Campbell out of context, to create a more restrictive punitive damages regime than the Court envisioned. Plaintiffs counsel must continue to focus on the potential harm of the defendant's conduct, and the deterrent purposes of a punitive damages award, to obtain the evidence necessary to create a trial record that will withstand appellate review.