

## **Recent Developments in Punitive Damages**

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The recent development with the most impact on punitive damages is the United States Supreme Court opinion in *State Farm v. Campbell*, 123 S.Ct. 1513, 538 U.S. 408, 155 L.Ed.2d 585 (2003). In *Campbell*, insureds brought an action against State Farm to recover for bad faith failure to settle within the policy limits, fraud and intentional infliction of emotional distress. The underlying case was filed in Utah. At the trial court level, the jury entered a verdict in favor of the insureds and awarded \$145 million dollars in punitive and \$1 million in compensatory damages. The United States Supreme Court, Justice Kennedy, held that an award of \$145 million dollars in punitives on \$1 million dollars in compensatory damages violated due process. Here, the United States Supreme Court went to great lengths to declare the punitive damages award excessive. In part, the Court held as follows:

Punitive damages awards serve the same purpose as criminal penalties. However, because civil defendants are not afforded the protections afforded criminal defendants, punitive damages pose an acute danger of arbitrary deprivation of property, which is heightened when the decision maker is presented with evidence having little bearing on the amount that should be awarded. Thus, this court has instructed courts reviewing punitive damages to consider (1) the degree of reprehensibility of the defendants 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.

*Campbell*, 123 S.Ct. 1513, 1515, citing *BMW of North America, Inc. v. Gore*, 517 U.S. 559, 116 S.Ct. 1589, 134 L.Ed.2 809 (1996).

As in *Gore*, the Supreme Court found that the trial court improperly allowed evidence of State Farm's misconduct from other states. The Court stated as follows:

Under *Gore's* guideposts, this case is neither close nor difficult...in this case, State Farm's handling of the claims against the Campbells merits no praise, but a more modest punishment could have satisfied the state's legitimate objectives. Instead, this case was used as a platform to expose

and punish the perceived deficiencies of State Farm's operations throughout the country. However, a state cannot punish a defendant for conduct that may have been lawful where it occurred...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.

*Campbell*, 123 S.Ct. 1516.

The *Campbell* court went on to discuss compensatory and punitive damages within the confines of state's rights as follows:

Compensatory damages are intended to regress the concrete loss that the plaintiff has suffered by reason of the defendant's wrongful conduct. By contrast, punitive damages survey broader functions; they are aimed at deterrents and retribution. Punitive damages may properly be imposed to further a state's legitimate interests in punishing unlawful conduct and deterring its repetition. Punitive damages are imposed for the purposes of retribution and deterrence.

While states possess discretion over the imposition of punitive damages, it is well established that there are procedural and constitutional limits on these awards. The Due Process Clause of the Fourteenth Amendment prohibits the imposition of grossly excessive or arbitrary punishments on a tortfeasor.

*Cambell*, 123 S.Ct. 1519-1520 (internal citations omitted).

Decided on April 7, 2003, the *Campbell* opinion has yet to work its way into the opinions of the Alabama Supreme Court. Accordingly, there are still questions as to what proposition this case truly stands for. Defense lawyers will trumpet this opinion as another reason and/or rule for courts to strike down the imposition of punitive damages by the jury. By contrast, the Plaintiff's bar will argue that this opinion stands only for the proposition that, under these specific facts, a punitive damage ratio of 145:1 is excessive.

Interestingly, Justice Thomas, one of the more conservative on the court, dissented in this case on the issue of state's rights. Justice Thomas' dissent reads in pertinent part as follows:

I would affirm the judgment below because I continue to believe that the constitution does not constrain the size of punitive damages awards.

Justice Scalia and Justice Ginsberg also dissented, stating that the award of punitive damages was more properly left up the states.

In the wake of *Campbell*, Judge Posner in the Seventh Circuit provided practitioners with an explanation of its practical affect on punitive damages. In *Mathias v. Accor Economy Lodging, Inc.*, 347 F.3d 672 (7<sup>th</sup> Cir. 2003), two motel guests who were bitten by bed bugs sued the hotel chain. At trial, the jury awarded the plaintiffs one hundred and eighty-six thousand dollars in punitives, a ratio of 37.5:1 to compensatory damages. Judge Posner set the stage for the court's decision as follows:

The plaintiffs, a brother and sister, were guests there and were bitten by bed bugs, which are making a come back in the U.S. as a consequence of more conservative use of strong pesticides...The plaintiffs claim that in allowing guests to be attacked by bed bugs in a motel that charges upwards of a hundred dollars a day for a room and would not like to be mistaken for a flophouse, the defendant was guilty of willful and wanton conduct and thus under Illinois law is liable for punitive as well as compensatory damages. The jury agreed and awarded each plaintiff \$186,000 in punitive damages though only \$5,000 in compensatory damages.

*Mathias*, 347 F.3d 673-4.

On appeal, the defendant claimed that the punitive damage award was excessive under the United States Supreme Court ruling in *Campbell*. Specifically, the defendant argued that *Campbell* stood for the proposition that a punitive damages ratio should be limited at 4:1. In response, the Court held as follows:

The Supreme Court did not, however, lay down a 4:1 or single digit ratio rule - - it said merely that there is a presumption against an award that has a 145:1 ratio, and it would be unreasonable to do so. We must consider why punitive damages are awarded and why the court has decided that due process requires that such awards be limited. The second question is easier to answer than the first. The term punitive damages applies to punishment, and the standard principle of penal theory is that the punishments should fit the crime in the sense of being proportional to the wrongfulness of the defendant's action, though the principle is modified when the probability of detection is very low (a familiar example is the heavy fines for littering) or the crime is potentially lucrative (as in the case of trafficking illegal drugs). Hence, with these qualifications, which in fact will figure in our analysis of this case, punitive damages should be proportional to the wrongfulness of the defendant's actions.

\* \* \* \*

If the total stakes in the case were capped at \$50,000 (two times [\$5,000 + \$20,000]), the plaintiffs might well have had difficulty financing this lawsuit. It is here that the defendant's aggregate net worth of \$1.6 billion becomes relevant. A defendant's wealth is not a sufficient basis for awarding punitive damages. That would be discriminatory and would violate the rule of law, as we explained earlier, by making punishment depend on status rather than conduct. Where wealth in the sense of resources enters is in enabling the defendant to mount an extremely aggressive defense against suits such as this and by doing so to make litigating against it very costly, which in turn may make it difficult for the plaintiffs to find a lawyer willing to handle the case, involving as it does, only modest stakes, for the usual 33-40 percent contingency fee.

In other words, the defendant is investing in developing a reputation intended to deter plaintiffs. It is difficult otherwise to explain the great stubbornness with which it has defended this case, making a host of frivolous evidentiary arguments to spite the very modest stakes even when the punitive damages awarded by the jury are included.

*Id.* at 676-7.

Accordingly, this case allows plaintiffs to argue that while a ratio of 145:1 may be excessive, a ratio of 37.5:1 is acceptable.

In *McClain v. Metabolife International, Inc.*, 256 F.Supp.2d 255 (N.D. Ala. 2003), Judge Acker was faced with a jury award of a punitive damage ratio of 9:1. In

expressing frustration with the ambiguity of the *Campbell v. State Farm* decision, the court noted as follows:

The court hoped that *State Farm* would provide help for ruling on Metabolife's claim that the punitive damages imposed in these cases are excessive. Now the court is not sure that the wait was worth it. In the first place, the court is not sure that it fully comprehends all of the possible lessons in *State Farm*. The court does know that the facts and procedural circumstances in *Metabolife* do not fit neatly into the factual and procedural framework of *State Farm*, in which six members of the Supreme Court undertook the daunting task of taking *BMW v. Gore*...another step toward finishing something lower courts can use when called upon to trim outlandish punitive awards.

*McClain*, 259 F.Supp.2d 1228-9 (internal citations omitted).

The Alabama legislature has enacted Alabama Code § 6-11-21, which governs the award of punitive damages. In part, it states that: no award of punitive damages shall exceed three times the compensatory damages of the party claiming punitive damages or \$500,000, whichever is greater. With respect to small businesses (net worth of \$2 million or less), the statute limits punitives to "\$50,000 or 10% of the businesses net worth, whichever is greater." For physical injuries, punitives are limited to three times the compensatory damages or \$1,500,000, whichever is greater. The statute does not apply to class actions. The statute is attached.

Without question, 2004 is destined to bring about additional new developments in punitive damage law. Look for the United States Supreme Court to clarify the holding in *Campbell v. State Farm*, as various lower courts will continue to interpret it differently. Also, look for the Alabama Supreme Court to comment on *Campbell* and interpret Alabama Code § 6-11-21.