

Stumbling out of the starting gate: the first decision to apply
State Farm v. Campbell gets it wrong

By Jeffrey Isaac Ehrlich

Diamond Woodworks v. Argonaut Insurance Company (2003) 109 Cal.App.4th 1020, is the first published decision in California to apply the standards for appellate review of punitive damages awards announced by the United States Supreme Court in *State Farm Mut. Auto. Ins. Co. v. Campbell* (2003) ___ U.S. ___, 123 S.Ct. 1513. The *Diamond Woodworks* court discerned in *Campbell* a constitutionally-based four-to-one ratio between punitive and compensatory damages, even though the Supreme Court in *Campbell* expressly refused to adopt a rigid ratio between compensatory and punitive damages.

A review of *Campbell* and the Supreme Court decisions that preceded it shows that the Supreme Court has neither suggested nor imposed a four-to-one ratio between compensatory and punitive damages. The *Diamond Woodworks* court was therefore in error in imposing a cap on punitive damage awards. Hopefully, the Supreme Court will remedy this error by depublishing the decision.

The *Diamond Woodworks* decision

The judgment reviewed in *Diamond Woodworks* was for fraud, breach of contract, and insurance bad faith. The gravamen of the action was that Argonaut Insurance improperly refused to defend or indemnify its insured for a worker's compensation claim, falsely claiming that its policy did not cover the claim. The jury awarded the employer (Argonaut's insured) compensatory damages of \$424,100 for Argonaut's fraud, and awarded punitive damages of \$14 million, based on fraud. After the employer accepted the trial court's remittitur, judgment was entered against Argonaut for compensatory damages of \$404,270 and punitive damages of \$5.5 million.

The Court of Appeal affirmed the judgment for fraud, but determined that both the award of compensatory damages and of punitive damages should be further remitted. In adopting the four-to-one ratio between punitive and compensatory damages, the Court of Appeal made the following general observations about *Campbell*:

- *Campbell* declined to adopt a bright-line ratio between compensatory and punitive damages awards;
- *Campbell* observed that the Court's earlier cases demonstrate that, in practice, "few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process."
- Alluding to its decision in *Pac. Life Ins. Co. v. Haslip* (1991) 499 U.S. 1, 111 S.Ct. 1032, and its discussion of a 700-year legislative history providing for sanctions of double, treble or quadruple damages to deter and punish, the *Campbell* court repeated the statement in *Haslip* that a

punitive damages award of more than four times compensatory damages “might be close to the line of constitutional impropriety.”

- That the facts of a particular case could warrant a punitive damages award that either exceeded or fell below the norm, and that state courts must ensure that the measure of punitive damages is reasonable and proportionate to the amount of harm to the plaintiff and the general damages recovered. (109 Cal.App.4th at 1055.)

The Court of Appeal then endeavored to apply *Campbell* to the facts before it. It concluded that the 13-to-1 ratio between compensatory and punitive damages (which increased to 21-to-1 after the compensatory damages were remitted) was excessive. The Court then acknowledged that the jury had found that Argonaut’s conduct was fraudulent and reprehensible and deserved significant punitive damages. The Court went astray, however, in its effort to synthesize the principles it had discussed. The key paragraph in its decision states:

Campbell, [*BMW of North America, Inc. v. Gore* (1996) 517 U.S. 559, 116 S.Ct. 1589] and *Haslip* all suggest that in the usual case, i.e., a case in which the compensatory damages are neither exceptionally high nor low, and in which the defendant’s conduct is neither exceptionally extreme nor trivial, the outer constitutional limit on the amount of punitive damages is approximately four times the amount of compensatory damages. Taking into account the jury’s determination in this case, we conclude that the ratio should approximate that outer limit. (109 Cal.App.4th at 1057.)

As explained below, neither *Campbell*, nor the decisions in *Haslip* or *Gore*, support the four-to-one ratio adopted by the *Diamond Woodworks* court.

The Supreme Court Decisions in *Campbell*, *Haslip*, *Gore*, and *TXO* Do Not Support the Categorical Application of a Four-to-One Ratio, or Any Ratio

The Supreme Court’s pre-*Campbell* decisions concerning the outer limits of punitive damages did not plot a consistent arc, and *Campbell* did not bring absolute clarity to the field. But *Campbell* was clear in rejecting the type of bright-line ratio that the Court of Appeal adopted in *Diamond Woodworks*. The Supreme Court should be taken at its word when it says that “We decline again to impose a bright-line ratio which a punitive damages award cannot exceed.” (123 S.Ct. at 1524.) In fact, the next sentence in the *Campbell* decision says, “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.” (*Id.*)

While the four-to-one ratio adopted by the Court of Appeal is a “single-digit ratio,” there is no reason to believe that it is the ratio the Supreme Court had in mind when it made that statement. Rather, by “single-digit ratio,” the Court was referring to ratios below 10-to-1. *Gore* explains this, noting that, in *TXO Production Corp. v. Alliance*

Resources Corp. (1993) 509 U.S. 443, 113 S.Ct. 2711, the Court affirmed a punitive damages award that was 526 times the amount of compensatory damages, but when potential harm to the plaintiff was taken into account, "the relevant ratio was not more than 10 to 1." (*Gore*, 517 U.S. at 581.) If *Campbell* suggests any bright-line ratio, then, that ratio is 10-to-1, not four-to-one.

Campbell did not seek to distance the decision in *TXO*. To the contrary, it cites it with approval, explaining, "[W]e have consistently rejected the notion that the constitutional line is marked by a simple mathematical formula, even one that compares actual *and potential* damages to the punitive award." (*Campbell*, 123 S.Ct. at 1524, citing *TXO*, at 458, 113 S.Ct. 2711.) The ratio adopted by the Court of Appeal cannot be squared with these decisions.

The Court of Appeal relied on *Campbell's* allusion to the statement in *Haslip* that a punitive damage award greater than four times the amount of compensatory damages "might be close to the line of constitutional impropriety." (*Campbell*, 123 S.Ct. at 1524, citing *Haslip*, 499 U.S., at 23-24.) A closer examination of *Haslip* and the Supreme Court's cases decided after it shows that it neither adopted a four-to-one ratio, nor provides support for its use.

The award at issue in *Haslip* consisted of \$200,000 in compensatory damages and \$840,000 in punitive damages. Hence, the ratio of punitive to compensatory damages was slightly more than four-to-one. But the central issue before the Court in *Haslip* was not whether the punitive damages award was excessive. Rather, it was whether it was proper to impose punitive damages on an innocent employer based on *respondeat superior*. *Haslip* involved defalcations by an insurance agent, for which the insurer was held liable. The Court held that imposing liability upon the insurer for its agent's fraud under the doctrine of *respondeat superior* did not, based on the facts before the Court, violate due process. (499 U.S. at 15.)

The Court disposed of the insurer's due process challenge to the amount of the punitive damages award in a single paragraph, stating that since the four-to-one ratio in the case was more than 200 times the plaintiff's out-of-pocket expenses and much in excess of the fine that could have been imposed for insurance fraud, it "may be close to the line." But since it did not lack objective criteria, it did not cross the line into Constitutional impropriety. (499 U.S. at 23-24.)

In *Gore*, the Court characterized its statement in *Haslip* concerning a four-to-one ratio as "dicta," and explained that *TXO* "refined this analysis by confirming 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.' " (*Gore*, 517 U.S. at 581, quoting *TXO*, 509 U.S. at 460, emphasis in text.) *Gore* then noted that when the potential harm was factored into the ratio between compensatory and punitive damages, the ratio approved in *TXO* was 10-to-1. (517 U.S. at 581.)

Gore, like all the Supreme Court's punitive damages decisions, expressly declined to adopt a bright-line ratio between punitive and compensatory damages, stating, "We need not, and indeed we cannot, draw a mathematical bright line between the constitutionally acceptable and the constitutionally unacceptable . . ." (517 U.S. at 581.) Instead, the Court observed that in *Haslip*, the Court had noted that the 4-to-1 ratio "might" be "close" to the line, but was not improper, and that the approach in *Haslip* was refined in *TXO*, which approved an award amounting to a 10-to-1 ratio.

In sum, neither *Haslip*, *TXO*, *Gore*, or *Campbell* supports the adoption of a categorical four-to-one ratio. Rather, the most that can reasonably be deduced from *Campbell* and its predecessors is that punitive damages awards that exceed a 10-to-1 ratio "by a significant degree" will be constitutionally suspect. *Campbell* says that there are "no rigid benchmarks" that a punitive damages award may not surpass, and that "the precise award in any case, of course, must be based upon the facts and circumstances of the defendant's conduct and the harm to the plaintiff." (123 S.Ct. at 1524.) The High Court should be taken at its word.

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