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Supreme Court 2002 Term - The Property Cases: IOLTA, Qui Tam Actions, and Punitive Damages

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SUPREME COURT 2002 TERM – THE PROPERTY CASES: IOLTA, QUI TAM ACTIONS, AND PUNITIVE DAMAGES

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THE IOLTA TURNAROUND

I have been assigned three cases of note that broadly can be classified as being in the property area. The first case I am going to discuss is *Brown v. Legal Foundation of Washington*,[2] which involved one of several efforts of a Washington, D.C. public interest advocacy group to extinguish the IOLTA system, which is known as "IOLA" in New York.[3] IOLTA stands for Interest On Lawyers' Trust Accounts. Under IOLTA, the interest derived from certain lawyers' escrow accounts is paid by the escrow bank into an IOLTA fund, which then distributes the money to various

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[2] 538 U.S. 216 (2003).

[3] N.Y. Judiciary Law § 497 (McKinney 2003) provides in pertinent part: "An 'interest on lawyer account' or 'IOLA' is an unsegregated interest-bearing deposit account with a banking institution for the deposit by an attorney of qualified funds."

organizations that supply legal services to the poor.[4] Nationwide, these IOLTA bank funds distribute approximately $200 million a year to these organizations.[5]

Under the IOLTA rule established by court rule in the State of Washington, all clients' trust funds must be deposited in interest bearing accounts, but trust funds that in the sole judgment of the attorney are too small in amount or are to be held for too short a time to warrant deposit in an interest bearing account must be deposited in an IOLTA bank with the direction from the lawyer that the bank transfer any interest earned to the IOLTA fund distributing agency.[6] In the State of Washington, it is not only lawyers who must deposit the money under those circumstances into an IOLTA account.[7] Limited Practice Organizations (LPOs), which are non-lawyers, must also do that.[8] As you know, in the western and many other states, lawyers are not that deeply involved in real estate transactions; the brokers do it and they have escrow accounts. The two *Brown* plaintiffs had deposited money with an LPO. In one case, approximately $14,000 was deposited in an LPO IOLTA account which generated interest for two to three weeks; and in the other case, approximately $90,000 was placed in an LPO IOLTA account for two days, which produced $4.96 in interest.[9]

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[4] *Id.*
[5] *Brown,* 538 U.S. at 223.
[6] *Id.* at 223-24.
[7] *Id.* at 227.
[8] *Id.*
[9] *Id.* at 229.

The plaintiffs, assisted by the Washington Legal Foundation, brought an action to enjoin the IOLTA requirement, arguing (1) that the taking of the interest earned on the accounts violated the Fifth Amendment Just Compensation Clause,[10] and (2) that the rule that the lawyer or LPO must deposit small or limited time escrow funds in an IOLTA account amounted to an illegal taking of the beneficial use of the funds.[11] The district court granted summary judgment, dismissing the complaint.[12] A panel of the Ninth Circuit reversed,[13] but the full Ninth Circuit sitting en banc affirmed the district court and held there was no taking because, relying on *Penn Central Transportation Co. v. City of New York*,[14] the plaintiffs had suffered no actual loss nor any interference with investment backed expectations. Furthermore, even if there was a taking, the just compensation amounted to zero.[15]

While the *Brown* case was pending, *Phillips v. Legal Foundation of Washington*,[16] another IOLTA case, was decided by the Supreme Court. In *Phillips*, by a five-to-four vote, the

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[10] U.S. CONST. amend. V provides in pertinent part that "no person shall . . . be deprived of . . . property without due process of law; nor shall private property be taken for public use, without just compensation."

[11] *Brown*, 538 U.S. at 228-29.

[12] *Id.* at 230.

[13] Wash. Legal Found. v. Legal Found. of Wash., 236 F.3d 1097 (9th Cir. 2001) (panel), *aff'd*, 538 U.S. 216 (2003).

[14] 438 U.S. 104 (1978).

[15] Wash. Legal Found. v. Legal Found. of Wash., 271 F.3d 835, 861-62 (9th Cir. 2001) (en banc), *aff'd*, 538 U.S. 216 (2003).

[16] 524 U.S. 156 (1998).

traditional *Bush v. Gore* split,[17] the Supreme Court held that interest follows principal, that the interest generated by an IOLTA account is the private property of the owner of the principal and it remanded for trial or hearing of the remedial action to be taken. [18]

As a result, when *Brown* reached the Supreme Court, the Court, in *Phillips,* had already decided four years earlier that the IOLTA interest was the private property of the owner.[19] In *Phillips*, the five-to-four majority included Justice O'Connor.[20] In *Brown*, O'Connor joined the four *Phillips* dissenters and voted to save IOLTA.[21] The new majority ruled there was indeed a taking, but just compensation is measured not by what the taker has gained, but by what the owner has lost and, in an IOLTA situation, the owner has suffered no loss.[22]

How did they arrive at that conclusion? Writing for the majority, Justice Stevens first considered the Fifth Amendment provision that property may be taken for a "public use" provided that "just compensation" is paid. As to the public use requirement, there was no doubt that the IOLTA Foundation's distribution of the funds to what Justice Stevens described as "millions of America's needy" was a public use.[23] He rejected the plaintiffs' contention

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[17] Bush v. Gore, 531 U.S. 98 (2000) (illustrating the traditional five-to-four split between conservative Justices and liberal Justices, with the conservative Justices including Rehnquist, Scalia, Thomas, O'Connor, and Kennedy and liberal Justices including Stevens, Ginsburg, Breyer, and Souter).

[18] *Brown*, 538 U.S. at 235.

[19] *Phillips,* 524 U.S. at 160.

[20] *Id.* at 158.

[21] *Brown*, 538 U.S. at 220.

[22] *Id.* at 240.

[23] *Id.* at 232.

that taking their money to give to organizations whose activities they disagreed with was a violation of the First Amendment. An analogy Stevens used was that of a pacifist whose property is taken for the building of a munitions plant. There could be no valid objection as long as just compensation was paid.[24]

The Court then had to decide whether the compulsory transfer of the interest into an IOLTA Foundation amounted to a taking,[25] and if so, whether it was a regulatory taking, requiring a complex factual assessment of the purposes and economic effects of governmental action,[26] or whether it was a per se taking.[27] A regulatory taking involves the balance between the effect on the owner of the taking against the public purpose of the taking.[28] The Court concluded that the transfer of the interest from the IOLTA account to the Foundation that distributed the funds was a per se taking equivalent to when or where the government simply occupies property and pays for it.[29]

At that point, the Court addressed the issue of just compensation. Justice Stevens quoted Justice Holmes and *Boston*

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[24] *Id.*

[25] *Id.*

[26] *See, e.g., Penn Cent.*, 438 U.S. at 104.

[27] *Brown*, 538 U.S. at 233 (explaining that the majority of jurisprudence involving condemnations involves the straightforward application of *per se* rules similar to the situation in Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982), where the government appropriated part of a rooftop in order to provide cable TV access for apartment tenants).

[28] *Penn Cent.*, 438 U.S. at 127 (holding that a use restriction on real property may constitute a "taking" if not reasonably necessary to the effectuation of a substantial public purpose or if it has an unduly harsh impact upon the owner's use of the property).

[29] *Brown*, 538 U.S. at 233-34 (citing *Loretto*, 458 U.S. at 419).

Chamber of Commerce v. Boston[30] to the effect that the test is what has the owner lost, not what has the taker gained.[31] As to that formulation, Justice Stevens added that the Court starts its analysis with the fact that the lawyer who deposited the money into the IOLTA account expected that the amount deposited would earn less than the administrative expense (postage and clerical services) of making the deposit.[32] He followed with specific examples of small amounts that could be earned on short term escrow deposits. The interest on the $90,000 deposit was $4.96. On some larger deposits, it might be found that the interest exceeded the administrative costs. If so, the loss to the owner was due to the lawyer or LPO decision to deposit the money in the IOLTA account instead of a regular interest bearing account, and not to state action.[33] Therefore, the IOLTA deposit requirement did not violate the Just Compensation Clause because there was nothing to compensate for.[34]

Justice Scalia's dissent was rather scathing:

> The Court today concludes that the State of Washington may seize private property without paying compensation on the ground that the former owner suffered no net loss because the confiscated property was created by the omnipotence of a state regulatory program. In so holding, the Court

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[30] 217 U.S. 189 (1910) (holding that the correct measure of damages was based upon what the owner lost and not what the taker gained).

[31] *Brown*, 538 U.S. at 236.

[32] *Id.* at 237.

[33] *Id.* at 237-38.

[34] *Id.* at 240.

> creates a novel exception to our oft-repeated rule that just compensation owed to former owners of the confiscated property is the fair market value of the property taken.[35]

Justice Scalia then went into a lengthy exposition of the cases supporting that proposition.[36] Much of the debate between Justice Stevens and Justice Scalia revolved around the meaning of *Webb's Fabulous Pharmacies v. Beckwith.*[37] In *Webb's*, a party had deposited $2 million with the clerk of the Florida court as an interpleader. The clerk deposited the money in an interest bearing account that produced $100,000, and when the time came to return the money, the clerk refused to pay the interest to the party. The Supreme Court heard the case and held that the circuit court's retention of the interest was an uncompensated taking of private property of the party.[38] To Justice Scalia, the parallel to the instant case was apparent.

Justice Stevens responded by arguing that the clerk was able to deduct a fee of $9,000 from the $100,000 amount held.[39] Justice Stevens' view was that the Webb's Pharmacies party was able to recover the net amount from the clerk, and in the instant case, when the administrative costs reduced the interest generated to nothing, there was no amount left to recover.[40]

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[35] *Id.* at 241 (Scalia, J., dissenting).
[36] *Brown*, 538 U.S. at 245.
[37] 449 U.S. 155 (1980).
[38] *Id.* at 164.
[39] *Brown*, 538 U.S. at 238 n.10.
[40] *Id.*

It is quite apparent that the attacks on the IOLTA program are now finished and defeated because the Supreme Court decided both the Fifth Amendment taking issue and the First Amendment issue relative to the plaintiffs' dissatisfaction with the use of their money.

QUI TAM – A NEW DANGER FOR MUNICIPALITIES

The next case is again "a tale of two cases," and this is a significant one, particularly for municipalities. The case is *Cook County, Illinois v. United States ex rel. Chandler*.[41] The list of the amicus briefs here is almost a page long; Boston, New York, San Francisco, many other cities, the National Association of Hospitals, the National Organization of Mayors, and other organizations. The issue was the Federal False Claims Act (FCA)[42] and its application to municipalities, school boards, and the like when they apply for federal funds.[43]

The FCA provides that "any person who knowingly presents, or causes to be presented, to an officer or employee of the United States Government . . . a false or fraudulent claim for payment . . . is liable . . . for civil penalty."[44] That person is liable

[41] 538 U.S. 119 (2003).
[42] 31 U.S.C. § 3729 (2003).
[43] *Chandler*, 538 U.S. at 124.
[44] 31 U.S.C. § 3729(a).

for treble damages and the costs of the action.[45] The term "any person" is very significant, as are the treble damages.

The Attorney General may sue under the FCA, but if the Attorney General does not sue, a private person may bring the suit in the name of the United States, which then has sixty days to bring the action on its own.[46] This is called "a qui tam action." If the claim succeeds, the private person can recover thirty percent of what is recovered in the lawsuit, plus attorney's fees and costs. If the Attorney General ultimately takes on the case, there is a sliding scale reward to the private person, who is called the relator.[47]

The fraud claim here involved $5 million that the National Institute of Drug Abuse had granted to Cook County, Illinois to study a treatment regimen for pregnant women who were addicted to drugs.[48] The study was run by Dr. Janet Chandler for about six months, but she was fired sixteen months into the study. Two years later, she brought this qui tam lawsuit alleging that the Cook County Hospital and the Institute had submitted false claims in order to get the grant that paid for the study.[49]

The single issue in the case was whether the term "any person" included municipal corporations.[50] Most municipal law practitioners would not think that to be a problem. The county moved to dismiss the complaint, but the district court read

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[45] *Id.*
[46] 31 U.S.C. § 3730(b)(2).
[47] *Id.*
[48] *Chandler*, 538 U.S. at 123.
[49] *Id.* at 124.
[50] *Id.* at 125.

"person" to include municipal corporations.[51] The Seventh Circuit dismissed the interlocutory appeal.[52]

In the meantime, the Supreme Court decided *Vermont Agency of Natural Resources v. United States ex rel. Stevens*.[53] In *Vermont Agency*, the issue was whether "any persons" included the state.[54] The Supreme Court held that the state did not come within the term "any persons," and as a result was not subject to qui tam actions.[55] The Supreme Court described the treble damages provision of the FCA (which was added in 1986) as punitive and not remedial. States, like local governments, are not subject to punitive damages. Therefore, the state could not be subjected to a qui tam lawsuit because it could not be subjected to treble damages.[56]

The Federal False Claims Act was originally enacted in 1863 to deal with fraudulent claims made by Civil War contractors.[57] Six years later, in 1869, the Supreme Court held that the Act applied to municipalities.[58] As long ago as 1826, the Supreme Court held the word "person" included "persons politic

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[51] United States *ex rel.* Chandler v. Hektoen Inst. for Med. Research, 35 F. Supp. 2d 1078 (N.D. Ill. 1999), *aff'd* Cook County v. United States *ex rel.* Chandler, 538 U.S. 119 (2003).

[52] United States *ex rel.* Chandler v. Cook County, 277 F.3d 969 (7th Cir. 2002).

[53] 529 U.S. 765 (2000).

[54] *Id.* at 768.

[55] *Id.* at 787-88.

[56] *Id.*

[57] *See* Anna Mae Walsh Burke, Article, *Qui Tam: Blowing the Whistle for Uncle Sam*, 21 NOVA L. REV. 869, 871 (1997).

[58] Cowles v. Mercer County, 74 U.S. 118 (1869).

and incorporate," as well as natural persons.[59] If that issue is so long settled, why is there an issue now? What were all of these amicus briefs about? Cook County first argued that even in early law, whether the word "person" included a body politic depended upon the general reason and design of the statute.[60] As to the Act, the County relied on the original wording of the statute that referred to "any person not in the military or naval forces," as well as other similar language.[61] Furthermore, argued the County, the act was aimed at private contractors, and local governments were not players in those years.[62]

Justice Souter wrote for a unanimous court and cited to an earlier case, *United States v. Neifert-White Co.*[63] for the proposition that in the Federal False Claims Act, Congress wrote expansively to reach all types of fraud, without qualification.[64] In sum, neither history nor text pointed to the exclusion of municipalities from the class of persons covered by the FCA in 1863.[65] However, the FCA was amended in 1986, and that amendment became another focus of Cook County's argument that "person" does not include municipalities.[66] When Congress amended the FCA in 1986, it

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[59] United States v. Amedy, 24 U.S. 392 (1826).
[60] *Chandler*, 538 U.S. at 125-26.
[61] *Id.* at 127.
[62] *Id.* at 128.
[63] 390 U.S. 228 (1968).
[64] *Chandler*, 538 U.S. at 129.
[65] *Id.* at 129-30.
[66] *Id.*

raised the civil penalty from $2,000 to $5,000 or $10,000 and raised the ceiling on damages from double to treble.[67]

In *Vermont Agency*, when the Supreme Court held "person" under the FCA did not include states, it primarily relied on what it described as the long standing interpretive presumption that "person" does not include sovereign states.[68] Nevertheless, to buttress its holding that "person" did not include states, the *Vermont Agency* Court declared that the increase in the amount of the fines and damages in the 1986 amendment amounted to a change from a remedial provision to a punitive one which "would be inconsistent with qui tam liability in light of the presumption against imposition of punitive damages on governmental entities."[69] That was another reason why the FCA could not apply to the states.[70]

Cook County argued that if that was true, the 1986 increase to treble damages turned the FCA into a punitive statute that also could not apply to governmental entities like municipalities.[71] This argument gave Justice Souter much difficulty. Despite the rather clear language in *Vermont Agency*, Justice Souter declared that treble damages have a remedial purpose as well as a punitive one.[72] The government had to be compensated for costs and delays

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[67] *Id.*
[68] *Vermont Agency,* 529 U.S. at 787.
[69] *Id.* at 784-85.
[70] *Id.*
[71] *Chandler,* 538 U.S. at 130.
[72] *Id.*

caused by detection and investigation of fraudulent claims.[73] In a qui tam case, thirty percent is diverted and there is no pre-judgment interest.[74] "The treble damage feature thus leaves the remaining double damages to provide elements of make whole recovery beyond mere recoupment of the fraud." Furthermore, it is only local taxpayers who have enjoyed the indirect benefit of fraud who will have to pay the treble damages.[75]

Justice Souter also rejected the argument that punitive damages are inconsistent with municipal liability by invoking what he called the cardinal rule that repeals by implication are disfavored.[76] Therefore, the increase to treble damages in 1986 could not repeal by implication the rule that "persons" include municipalities.[77] The increase was intended to make the FCA a more useful tool against fraud in modern times. Therefore, the denial of Cook County's dismissal motion was upheld.[78]

The federal government has collected more than $10 billion since 1986,[79] so this is a very important case for municipalities.

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[73] *Id.*
[74] *Id.* at 131.
[75] *Id.* at 132.
[76] *Chandler*, 538 U.S. at 132.
[77] *Id.*
[78] *Id.* at 134.
[79] *See* Burke, *supra* note 57, at 871.

THE CONTINOUS EROSION OF PUNITIVE DAMAGES

Finally, we reach the latest Supreme Court missive on punitive damages, *State Farm Mutual Automobile Insurance Co. v. Campbell.*[80] *Campbell* is the last of a trio of Supreme Court cases that have injected the Fourteenth Amendment into punitive damage jurisprudence and have constitutionalized the area. What the Court is doing to common law punitive damages is similar to how it constitutionalized defamation some forty years ago in *New York Times v. Sullivan.*[81]

Punitive damages, sometimes called "exemplary damages," are mentioned as far back as Blackstone's Commentaries.[82] State juries were hearing punitive damage cases in 1868 when the Due Process Clause entered the Constitution as part of the Fourteenth Amendment.[83] In more recent years, attempts were made to get the Supreme Court to deal with punitive damages as a constitutional issue, but the efforts were continuously rejected. I remember Justice Scalia being at this law school at a luncheon we had for him.[84] He spoke about the lawyers who come in on these punitive

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[80] 538 U.S. 408 (2003).

[81] 376 U.S. 254 (1964) (holding that in a libel action brought by a public official against critics of his official conduct, there are safeguards for freedom of speech and press that are required by the First and Fourteenth Amendments).

[82] 3 BLACKSTONE, WILLIAM, COMMENTARIES OF THE LAWS OF ENGLAND 220 (The University of Chicago Press 1979) (1768).

[83] *See generally* Kinsey v. Wallace, 36 Cal. 462 (1868) (discussing the jurors' discretion when awarding punitive damages).

[84] Associate Supreme Court Justice Antonin Scalia was Touro Law Center's 1995 Distinguished Jurist in Residence on October 18 and 19, 1995. Justice

damages cases in a most derogatory tone. You can feel the wealth in the room, he said, although those may not be his exact words. I remember him saying something about expensive suits, but I remember distinctly that he mentioned tasseled shoes. If you go to the Supreme Court, I suggest you do not go with tasseled shoes.

It was not really until the 1980s that the Due Process Clause began to receive serious attention in punitive damage cases in the Supreme Court. In the 1989 case, *Browning-Ferris Industries v. Kelco Disposal*,[85] the Court rejected an attack on punitive damages as being violative of the excessive fines provision of the Eighth Amendment.[86] The Due Process Clause was not specifically raised in that case, so the Court commented that the issue must await another day.[87]

That day came in 1991 in *Pacific Mutual Life Insurance Co. v. Haslip*.[88] *Haslip* involved an insurance agent who pocketed the insured's premiums. The policy lapsed, leaving the plaintiff without health insurance when she needed it.[89] Plaintiff's award of $800,000 in punitive damages was attacked on Fourteenth Amendment due process grounds as excessive.[90] Although the punitive damage award was upheld by the Supreme Court,[91]

Scalia attended classes and met with students, student groups, faculty members and invited guests during his two day stay at the Law Center.

[85] 492 U.S. 257 (1989).

[86] *Id.* at 262. U.S. Const. amend. XIII, states in pertinent part: "Excessive bail shall not be required, nor excessive fines imposed . . . ."

[87] *Browning-Ferris*, 492 U.S. at 259 n.1.

[88] 499 U.S. 1 (1991).

[89] *Id.* at 5.

[90] *Id.* at 7.

[91] *Id.* at 19.

Justice O'Connor dissented and paraphrased the *Haslip* jury charge as follows: "Think about how much you hate what the defendants did and teach them a lesson."[92] She then dealt with 200 years of history and concluded that things are much different now, and due process requires constraint of jurors.[93]

The case that pushed the Fourteenth Amendment into punitive damage law is *BMW v. Gore*,[94] which was decided in 1996. BMW sold a new car to Dr. Gore and did not tell him that it had been slightly damaged and repainted.[95] When Dr. Gore went to have the car "snazzied" up, to use his term, the finisher told him that his car had previously been repainted.[96] Dr. Gore brought a lawsuit in Alabama against BMW.[97] It turned out that BMW had delivered 1,000 new cars nationwide without disclosing they had been repainted.[98] The reduction in value of Dr. Gore's car due to the fact that it was a repainted car was $4,000. On the punitive damages issue, the jury multiplied that $4,000 by the 1,000 cars that BMW had repainted and came up with $4 million of punitive damages and $4,000 in compensatory damages. The Supreme Court of Alabama reduced the punitive damages to $2 million dollars.[99]

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[92] *Id.* at 49 (O'Connor, J., dissenting).
[93] *Pacific Mutual*, 499 U.S. at 62.
[94] 517 U.S. 559 (1996).
[95] *Id.* at 563.
[96] *Id.*
[97] *Id.*
[98] *Id.*
[99] BMW of North America, Inc. v. Gore, 646 So.2d 619, 629 (Ala. 1994).

When the case reached the United States Supreme Court, Justice Stevens, writing for a five-to-four majority, held that grossly excessive punitive damages violate both procedural and substantive due process guaranteed by the Fourteenth Amendment.[100] A grossly excessive award of punitive damages constitutes a violation of substantive due process. Elementary considerations in the Constitution and constitutional jurisprudence also require fair notice procedurally, not only that the conduct will incur punishment, but also as to the severity of the punishment.[101] BMW was entitled to notice that repainting the car might result in a $4 million verdict against it.[102]

The *BMW* Court specified a three guidepost standard for judging the constitutionality of punitive damage awards. This is the law today and we will see how it has been expanded. One, what is the degree of reprehensibility involved in the misconduct? How bad was it? Number two, what is the disparity between the harm incurred and the punitive damage verdict — the ratio between compensatory and punitive damages? Three, what is the difference between the punitive damage award and civil penalties that could be imposed under the law?[103] In Alabama under the Deceptive Practices Act,[104] the civil penalty for what BMW did was $2,000.[105] Now, those are the three standards, and they

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[100] *BMW*, 517 U.S. at 574-75.
[101] *Id.*
[102] *Id.*
[103] *Id.*
[104] ALA. CODE § 8-19 (1993).
[105] *Id.* § 8-19-11(b).

continue to be the standards. If you are practicing in that area of the law, just be aware of it.

In *BMW*, Justice Thomas joined Justice Scalia in one dissent, and Chief Justice Rehnquist joined Justice Ginsburg in another. Justice Scalia's point of view, and I think Justice Ginsburg's as well, was basically, what are we doing here? State courts have been deciding reasonableness issues as long as anyone can remember, and why is this now a federal issue?[106] Justice Scalia concluded by writing, "by today's logic, *every* dispute as to evidentiary sufficiency in a state court poses a question of constitutional moment, subject to review in this Court. That is a stupefying position."[107] Justice Ginsburg wrote, "I would therefore leave the state court's judgment undisturbed, and resist unnecessary intrusion into an area dominantly of state concern."[108]

Five years later, in 2001, *Cooper Industries v. Leatherman Tool Group*[109] arrived at the Supreme Court. Leatherman invented a Swiss army knife that included a plier. Cooper Industries published a picture essentially of the Leatherman Swiss army knife and represented the knife as its own product.[110] A lawsuit followed. The jury returned a verdict of $50,000 compensatory and $4 million punitive damages.[111] The Supreme Court, in an opinion written by Justice Stevens, (this time for an eight-to-one

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[106] *BMW*, 578 U.S. at 607 (Scalia, J., dissenting).
[107] *Id.* at 607.
[108] *BMW*, 578 U.S. at 607 (Ginsburg, J., dissenting).
[109] 532 U.S. 424 (2001).
[110] *Id.* at 427-28.
[111] *Id.* at 429.

Court), noted that excessive punitive damages are analogous to excessive fines under the Eighth Amendment, and the Due Process Clause of the Fourteenth Amendment makes the Eighth Amendment applicable to the States.[112] Compensatory damages, according to Justice Stevens, derive from the factual finding by the jury, while punitive damages are expressions of moral condemnation.[113]

That was the heart of it. Punitive damages are private fines levied by civil juries to punish reprehensible conduct. Legislatively enacted criminal and civil sanctions have standards and limits; the defendant has due process notice of what he or she is facing. There are no standards on punitive damage awards which amount to fines subject to no fixed limits.[114]

The *Cooper Industries* Court then reiterated the three guideposts from *BMW v. Gore* and made a few significant observations.[115] Reprehensibility is primarily for the trial court to determine. Ratio between compensatory and punitive damages is for the trial court, as well as the appellate court to consider.[116] However, the comparison between the civil fines and the punitive damages was for the appellate courts, and punitive damage awards should be reviewed de novo.[117] In de novo review, no deference to the trial court or jury is required as there is in abuse of discretion

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[112] *Id.* at 433-35.
[113] *Id.* at 432.
[114] *Cooper Indus.*, 532 U.S. at 434.
[115] *Id.* at 434-35.
[116] *Id.* at 431.
[117] *Id.*

review. As to this requirement, the tort reform organizations welcomed the decision and declared that juries will no longer decide punitive damage awards, judges will. To Justice Ginsburg, de novo review in this situation really destroyed the Seventh Amendment guaranty of jury trial in punitive damage cases.[118]

There was one exchange between Justice Stevens and Ginsburg (the lone dissenter) that was particularly interesting. Stevens wrote for the majority, "unlike the measure of actual damages suffered, which presents a question of historical or predictable fact, the level of punitive damages is not really a 'fact' tried by the jury."[119] Justice Ginsburg replied, "[O]ne million dollars worth of pain and suffering does not exist as a fact in this world any more or less than one million dollars worth of moral outrage. Both derive their meaning from a set of underlying facts as determined by a jury."[120] The Seventh Amendment provides that: "No fact tried by a jury shall be otherwise re-examined in any court of the United States than according to the rules of the common law."[121] Ginsburg concluded that if the level of punitive damages is not a fact for the jury to consider, the Seventh Amendment guaranty of trial by jury is gone.[122]

Now we return to *State Farm Mutual Automobile Insurance Co. v. Campbell.* Campbell was driving with his wife and decided to pass six vans on a two-lane highway in Utah. As he was

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[118] *Id.* at 446-48 (Ginsburg, J., dissenting).
[119] *Cooper Indus.*, 532 U.S. at 437.
[120] *Id.* at 446.
[121] *Id.* at 445.
[122] *Id.* at 447.

passing, a car was coming the other way. The other car had to swerve, went off the road, and hit another car. One person was killed, another was permanently disabled, and the Campbells were unscathed.[123] The Campbell's insurance policy was for $50,000. State Farm refused to settle and went to trial. State Farm also told the Cambells that their assets were safe and that they would not need their own attorney. The jury returned a $185,849 verdict in the case, and State Farm paid it.[124]

After State Farm paid the judgment, the Campbells brought an action against State Farm claiming intentional infliction of mental distress, bad faith, and fraud.[125] At trial, the Campbells presented all of the facts concerning State Farm's conduct around the country for the past twenty years, which, among other things, included evidence of a national scheme by State Farm to defraud consumers.[126] There was also expert testimony of fraudulent conduct by State Farm. The jury awarded the Campbells $2.6 million worth of compensatory and $145 million in punitive damages.[127] The trial court reduced the award to $1 million and $25 million,[128] but the Utah Supreme Court applied the three guideposts and increased it back up to $145 million.[129]

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[123] *Campbell*, 538 U.S. at 413.
[124] *Id.*
[125] *Id.* at 414.
[126] *Id.* at 415.
[127] *Id.*
[128] Campell v. State Farm Mut. Auto. Ins. Co., 65 P.3d 1134, 1141 (2000).
[129] *Id.* at 1155.

The United States Supreme Court heard the case and overturned the Utah Supreme Court.[130] The Court voiced some additional concerns that are very significant to those of you who are trying either side of a punitive damage case. First, the Court held that in dealing with reprehensibility, the state has no legitimate interest in imposing punitive damages for unlawful acts in other states.[131] What had been confronted here was testimony regarding State Farm's conduct around the country.[132] The Court held that the jurors must be instructed that they may not use that out-of-state conduct to punish the defendant for action that was lawful in the instant jurisdiction.[133] That is a basic switch, and it certainly affected the *Campbell* case, but it restricts the evidence to acts within the state. Lawful conduct outside of the state may be probative when it relates to the deliberateness of the conduct in the state, but it must have a nexus to the specific harm suffered by the plaintiff.[134] That is a very important restraint.

The Court next looked at the second factor, the ratio between compensatory and punitive damages.[135] Justice Kennedy,

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[130] *Campbell*, 538 U.S. at 429.

[131] *Id.* at 421.

[132] *Id.* at 420. The Campbells demonstrated through the testimony of State Farm employees who had worked outside of Utah and through expert testimony that this "pattern of claims adjustment under the PP&R program was not a local anomaly, but was a consistent, nationwide feature of State Farm's business operations, orchestrated from the highest levels of corporate management." *Id.*

[133] *Id.* at 422.

[134] *Id.* (citing *Gore*, 517 U.S. at 572-73) ("a State 'does not have the power . . . to punish [a defendant] for conduct that was lawful where it occurred and that had no impact on [the State] or its residents.'").

[135] *Campbell*, 538 U.S. at 424 ("Turning to the second *Gore* guidepost, we have been reluctant to identify concrete constitutional limits on the ratio

writing for the Court declared, "few awards exceeding a single digit ratio between punitive and compensatory damages to a significant degree will satisfy due process. In *Haslip* . . . we concluded that an award of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety."[136] When compensatory damages are high, a ratio of one-to-one, they may reach the outermost limits of constitutionality.[137] Now, that is a very significant change. The Court stated that these limitations are not rigid benchmarks, so a greater ratio might comport with due process where the economic damages were small but the conduct was particularly egregious.[138] Finally, the wealth of the defendant cannot justify an otherwise unconstitutional punitive damages award.[139] The single digit four-to-one and one-to-one language came close to legislating punitive damage caps.

The third guidepost, appellate comparison between civil penalties and the punitive damage award, drew very little comment. The Court explained that criminal penalties could only be considered in connection with how serious the state viewed the wrongful conduct and should not be used to determine the dollar

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between harm, or potential harm, to the plaintiff and the punitive damages award.").

[136] *Id.* at 425.

[137] *Id.*

[138] *Id.*

[139] *Id.* at 427.

amount of the award.[140] The judgment was reversed and the case was remanded.[141]

Again, Justices Scalia, Thomas, and Ginsburg dissented, arguing that the Due Process Clause does not constrain the size of punitive damage awards.[142] Justice Ginsburg noted that just ten years before, a 526-to-1 ratio was approved by the Court, as well as a 200-to-1 ratio.[143] She followed with a lengthy discourse on the dreadful things (destruction of documents, falsification of documents, character assassination, etc.) that State Farm did over the years.[144] She finished as follows:

> I remain of the view that this Court has no warrant to reform state law governing awards of punitive damages. Even if I were prepared to accept the flexible guidelines prescribed by *Gore*, I would not join the conversion of those guides into instructions that begin to resemble marching orders . . . . I would leave the judgment of the Utah Supreme Court undisturbed.[145]

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[140] *Campbell*, 538 U.S. at 428.

[141] *Id.* at 429.

[142] *Id.* (Scalia, J., dissenting).

[143] *Id.* at 430 (Ginsburg, J., dissenting). *See, e.g.*, Pac. Mut. Life Ins. Co. v. Haslip, 499 U.S. at 18 (upholding a punitive damages award "more than 4 times the amount of compensatory damages, . . . more than 200 times [the plaintiff's] out-of-pocket expenses," and "much in excess of the fine that could be imposed."). *See also* TXO Prod. Corp. v. Alliance Res. Corp., 509 U.S. 443, 453 (1993) (affirming a state-court award "526 times greater than the actual damages awarded by the jury.").

[144] *Id.* at 431.

[145] *Campbell*, 538 U.S. at 439.

She concluded that the constraints have now been pushed effectively probably toward four-to-one, and even one-to-one.[146]

I think the next issue that probably will be dealt with by the Supreme Court will be the matter of wealth. In my view, punitive damages as we have known them are going, going, and soon gone.

[146] *Id.*

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