



By Brian J. McCormack

*“Punitive damages may be measured by the potential harm ‘likely to result’ from the defendant’s misconduct.”*

## Punitive damages based on potential harm

### Introduction

This article discusses the factual and legal bases for a punitive damage award based on the potential harm “likely to result” from the defendant’s misconduct.

A recent punitive damage award based on potential harm occurred in an Orange County trial where the jury returned a verdict of \$934,419,108. The verdict in *Beckman Coulter, Inc. v. Dovatron International, Inc., Flextronics International, Ltd., et al.*, the largest in Orange County history, was comprised of \$2,998,260 in compensatory damages and \$931,420,848 in punitive damages.

The jury’s award of punitive damages was based primarily on the “potential harm” to Beckman Coulter which was likely to occur from the defendants’ conduct. Beckman Coulter, based in Fullerton, California, is a world leader in the manufacture of clinical laboratory equipment. Defendant Dovatron, and its successor in interest, Flextronics, manufactured printed circuit boards used in two of Beckman Coulter’s laboratory instruments pursuant to a written contract. In the trial, plaintiff put on evidence that on two separate occasions, defendants threatened to cause an interruption in the manufacture of the critically needed printed circuit boards unless plaintiff acquiesced to defendants’ demands. In August 1998, defendants threatened to cease manufacturing the printed circuit boards unless plaintiff agreed to pay defendants a surcharge over and above the contract price. Again, in May 2000, defendants threatened to withhold critically needed parts unless Beckman Coulter purchased defendants’ entire inventory of component parts.

Plaintiff’s key witnesses, including corporate executives and an expert forensic accountant, presented testimony regarding the potential economic harm faced by Beckman Coulter as a result of defendants’ threats to cease manufacturing printed circuit boards. On the special jury verdict forms, the jury specifically and unanimously found that Beckman Coulter faced potential economic damages in the amount of \$340,744,000.

After trial, the case settled for approximately \$23,000,000.

The *Beckman Coulter* verdict raises the issue whether punitive damages may be

based only on the actual harm suffered by the plaintiff or whether punitive damages may properly be awarded based on the potential harm which the plaintiff faced.

In the *Beckman Coulter v. Flextronics* case, the jury was presented with jury instructions and verdict forms which instructed that an award of punitive

damages could be based upon actual *and/or* potential damages. Specifically, Jury Instruction No. 58, entitled "Punitive Damages - Actual and Potential Harm" stated as follows: "Should you decide to award punitive damages in this case, in determining the amount of the punitive damages, you may consider not only the amount of actual harm caused by defendants, but also the amount of potential harm which could have occurred from defendant's conduct. It is appropriate to consider the magnitude of the potential harm that defendant's conduct could have caused."

This instruction was based upon, and is consistent with, several United States Supreme Court and Federal and California appellate decisions discussed below.

#### **General standard for punitive damages**

The United States Supreme Court has established three "guideposts" to consider in reviewing punitive damage awards. Initially announced in *BMW of North America, Inc. v. Gore* (1996) 517 U.S. 559 [116 S.Ct. 1589], and reaffirmed in *State Farm Mutual Auto Insurance Company v. Campbell* (2003) 538 U.S. 408 [123 S.Ct. 1513], the three "guideposts" are: (1) the degree of reprehensibility of the defendant's misconduct; (2) the disparity between the actual *and/or* potential harm suffered by the plaintiff and of 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.

The California Supreme Court has articulated three similar factors: (1) "The particular nature of the defendant's acts in light of the whole record," (2) "the amount of compensatory damages awarded," and (3) "the wealth of the particular defendant." *Neal v. Farmers Ins. Exchange* (1978) 21 Cal.3d 910 [148 Cal.Rptr. 389].

Both the federal and state formulations require the reviewing court to consider all guideposts together, not in isolation. *State Farm Mutual Auto Insurance Company v. Campbell, supra*, 538 U.S. 408; *Neal v. Farmers Ins. Exchange, supra*, 21 Cal.3d at 928. All guideposts must be considered to determine if the award furthers the "legitimate interest in punishing unlawful conduct and deterring its repetition." *BMW of North America, Inc. v. Gore, supra*, 517 U.S. at 568.

#### *Reprehensibility of defendant's conduct*

"The most important indicium of the reasonableness of a punitive damages award is the degree of reprehensibility of the defendant's conduct." *State Farm Mutual Auto Insurance Company v. Campbell, supra*, 538 U.S. 408, quoting *BMW of North America, Inc. v. Gore, supra*, 517 U.S. at 575.

The United States Supreme Court in *State Farm v. Campbell* instructed reviewing courts to apply the following factors in consideration of the degree of reprehensibility of a defendant's conduct: (1) whether the harm caused by the defendant's conduct was physical as opposed to economic; (2) whether the defendant's tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others; (3) whether the target of the conduct was financially vulnerable; (4) whether the defendant's conduct involved repeated actions or was an isolated incident; and (5) whether the harm was the result of intentional malice, trickery or deceit or mere accident. *State Farm Mutual Auto Insurance Company v. Campbell, supra*, 538 U.S. 408.

#### *Ratio of punitive damages to actual or potential harm*

The holding in *State Farm v. Campbell* requires the court to compare "the disparity between the actual or potential harm suffered by the plaintiff and the punitive damage award." *State Farm Mutual Auto Insurance Company v. Campbell, supra*, 538 U.S. 408. *State Farm v. Campbell* defined the relevant Constitutional ratio as comparing "harm or potential harm, to the plaintiff and the punitive damages award," by stating that "we 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." *Id.*, citing *TXO* at 458 (emphasis added).

The Supreme Court has repeatedly declined "to impose a bright-line ratio which a punitive damages award cannot exceed." *Id.* at 1524. However, the court has also repeatedly noted that "traditional" multipliers for wrongful conduct have been in the range of double, treble or quadruple the compensatory damages and that a ratio of more than four to one might be "close to the line of constitutional impropriety." *Id.*, citing *Haslip*, 499 U.S. at 23-24. "Nonetheless, because there are no rigid benchmarks that a

punitive damages award may not surpass, ratios greater than those we have previously upheld may comport with due process where a particularly egregious act has resulted in only a small amount of economic damages." *Id.*, quoting *BMW*, 517 U.S. at 582. "A higher ratio may also be justified in cases in which the injury is hard to detect or the monetary value of the non-economic harm might have been difficult to determine." *Id.*

"Single digit multipliers are more likely to comport with due process, while still achieving the state's goal of deterrence and retribution." *State Farm, supra*, 123 S.Ct. at 1524. "The precise award in any case, of course, must be based upon facts and circumstances of the defendant's conduct and the harm to the plaintiff." *Id.*

Thus, applying the holding in *State Farm*, courts have consistently upheld punitive damage awards with a single digit multiplier. For example, the court in *In re: Exxon Valdez*, 296 F.Supp.2d 1071 (D. Alaska 2004) approved a ratio of 8.77 to 1. In addition, the court in *Zhang v. American Gem Seafoods, Inc.*, 330 F.3d 1020 (9th Cir. 2003) approved a 7 to 1 ratio. The *Zhang* court stated that it was "aware of no Supreme Court or Ninth Circuit case disapproving of a single digit ratio between punitive and compensatory damages . . ." *Zhang*, 339 F.3d at 1044.

"Potential harm" to plaintiff is an authorized basis for punitive damages under United States Supreme Court decisions before *State Farm* and under lower court decisions before and after *State Farm*.

#### **Earlier Supreme Court decisions on "potential harm"**

Three United States Supreme Court decisions before *State Farm v. Campbell* acknowledged that punitive damages may be measured by the potential harm "likely to result" from the defendant's misconduct.

In *Pacific Mutual Life Insurance Company v. Haslip* (1991) 499 U.S. 1 [111 S.Ct. 1032], the factor of "harm likely to result" from a defendant's misconduct was cited as a relevant factor for punitive damages. *Haslip* affirmed an award of punitive damages because the Alabama Supreme Court required "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 occurred . . ." *Id.* at 1045.

In *TXO Production Corp. v. Alliance Resource Corp.* (1993) 509 U.S. 443 [113 S.Ct. 2711, 2721], the Supreme Court affirmed a \$10 million punitive damage award that could be justified only on the basis of "harm likely to occur from the defendant's conduct." *TXO, supra*. Though compensatory damages were just \$19,000, the court in *TXO* cited defendant's threatened potential harm as justifying a \$10 million punitive damage award. The prevailing party, Alliance, claimed that TXO, a joint venture in the oil and gas development, committed slander of title. Evidence supporting the judgment showed that TXO sought to acquire valuable oil and gas rights from Alliance. The value of the income stream expected from the tract ranged from \$22.5 million to \$37.5 million, depending on the number of oil wells. *Id.* at 2715, fn. 10. In an effort to diminish Alliance's rights, TXO acted in bad faith

by (1) recording a quit claim deed from grantors who held only coal mining rights, (2) attempting to induce a man in the chain of title for coal mining rights to falsely swear that he had acquired oil and gas rights, and (3) "knowingly and intentionally" bringing "a frivolous declaratory judgment action" to clear a "purported cloud on title." *Id.* at 2716.

In TXO's declaratory relief action, the court entered judgment for Alliance. A jury then determined Alliance's counterclaim for slander of title, awarding \$19,000 in compensatory damages (the expense of defending declaratory judgment action) and \$10 million in punitive damages. The Supreme Court affirmed this award, even though it was 526 times the compensatory damages. *TXO*, 113 S.Ct. at 2721.

The court in *TXO* recognized that the potential harm caused by a defendant's misconduct is a relevant consideration for

punitive damages, as in this example: "For instance, a man wildly fires a gun into a crowd. By sheer chance, no one is injured and the only damage is to a \$10 pair of glasses. A jury reasonably could find only \$10 in compensatory damages, but thousands of dollars in punitive damages to teach a duty of care. We would allow a jury to impose substantial punitive damages in order to discourage future bad acts." *TXO*, 113 S.Ct. at 2721.

Hence, *TXO* ruled that one measure of punitive damages is the "reasonable relationship" of the punitive award to "the harm that is likely to occur from the defendant's conduct." "Punitive damages should bear a reasonable relationship to the harm that is likely to occur from the defendant's conduct as well as to the harm that actually has occurred. If the defendant's actions caused or would likely cause in a similar situation only slight harm, the damages should be relatively small. If the harm is grievous, the damages should be much greater." *TXO*, 113 S.Ct. at 2721 (emphasis added).

*TXO* specifically cited "potential harm" as a basis for punitive damages: "Thus, both State Supreme Courts and this court have eschewed an approach that concentrates entirely on the relationship between actual and its potential damages. 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." *TXO*, 113 S.Ct. at 2721-2722 (emphasis added).

Accordingly, *TXO* ruled that the question of the appropriateness of a particular damage award is answered by comparing the punitive award with "the potential loss" to plaintiff from the defendant's misconduct. "While petitioner stresses the shocking disparity between the punitive award and the compensatory award, that shock dissipates when one considers the potential loss to respondent, in terms of reduced or eliminated royalty payments, had petitioner succeeded in eliciting scheme. Thus, even if the actual value of the "potential harm" to respondents is not between \$5 million and \$8.3 million, but is closer to \$4 million, or \$2 million, or even \$1 million,

the disparity between the punitive award and the potential harm does not, in our view, "jar one's Constitutional sensibilities." *TXO*, 113 S.Ct. at 2722.

In *BMW of North America v. Gore* (1996) 517 U.S. 559 [116 S.Ct. 1589], the United States Supreme Court stated that *TXO* confirmed 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." *Id.* at 1602 (emphasis added). Further, *BMW* acknowledged that *TXO* "relied on the difference between [the punitive damages award of \$10 million] and the harm to the victim that would have ensued if the tortious plan had succeeded. That difference suggested that the relevant ratio was not more than 10:1." *Id.* at 1589 (emphasis added).

#### Lower court decisions on potential harm

State and federal courts approve punitive damages by relying upon the ratio to potential harm. For example, in *Trinity Evangelical Lutheran Church v. Tower Insurance Company* (Wis. 2003) 661 N.W.2d 789, a punitive damages award of \$3.5 million was deemed not excessive in relation to the potential harm of \$490,000 (7:1 ratio). The insurer had intentionally refused to provide coverage that the insured had purchased and later needed for an accident involving a non-owned auto. In affirming the \$3.5 million punitive damage award, the court considered "the potential damage that might have been caused by the acts" in the amount of \$490,000 creating a 7:1 ratio between the punitive damage award and the potential harm. *Id.* at 800-803 (emphasis added).

Other decisions also use "potential harm" as a benchmark for approving punitive damages: *Bains LLC v. Arco Products Company* (W.D.Wa. 2002) 290 F.Supp.2d 1193, 1201 (\$5 million punitive damage award approved where actual damages were \$1 but potential harm was \$550,000); *Southern Union Company v. Southwest Gas Corp.* (D.Ar. 2003) 281 F.Supp.2d 1090, 1098, 1104 (threatened "potential" "lost profits" "could be factored into the jury's decision to punish defendant," citing *TXO*; also defendant proffered of fabricated evidence showed that defendant, if "not deterred by an appropriate award of punitive damages" "would continue to engage in further reprehensible

acts . . . ."); *In Re: New Orleans Train Car Leakage Fire Litigation* (La.App. 2001) 795 So.2d 364, 386 (Railroad's reckless misconduct caused fire; punitive damages of \$850 million not excessive where potential harm could have exceeded \$850 million).

In *Simon v. San Paolo U.S. Holding Company, Inc.* (2003) 113 Cal.App.4th 1137 [7 Cal.Rptr.3d 367], decided on December 2, 2003, the California Court of Appeal affirmed an award of \$1.7 million in punitive damages where the compensatory damages awarded to the plaintiff were only \$5,000 (a 340:1 ratio of punitive damages to compensatory damages). On March 24, 2004, the Supreme Court granted review of *Simon*, rendering the decision no longer citable. (Cal. Rules of Court, Rule 976, subd. (d).)

Plaintiff Simon sought specific performance of an alleged contract to purchase real property, located at 816 Figueroa Street, Los Angeles. Plaintiff also sought damages for a breach of the contract, as well as damages for fraud, consisting of a false promise to sell the property to plaintiff under certain terms and conditions.

By special verdict rendered in August 1997, the jury found in favor of Simon on the fraud cause of action, awarding him \$5,000 in compensatory damages and \$2.5 million in punitive damages. The trial court subsequently granted defendant's motion for a new trial. A second jury assessed punitive damages in the amount of \$1.7 million in April 1998, and judgment was entered against the defendant in the amount of \$1,705,000.

The California Court of Appeal affirmed the jury verdict. However, the United States Supreme Court ultimately remanded the case for further consideration in light of the Court's holding in *State Farm v. Campbell*.

In affirming the \$1.7 million punitive damage award, the *Simon* court cited *Haslip* and *TXO* for the premise that "the Supreme Court did not prohibit consideration of harm to the plaintiff that is not reflected in the compensatory damage award. Indeed, the court has approved a similar factor, holding that it is appropriate to consider not only the harm that actually has occurred, but also *all the harm that is likely to result from the defendant's conduct.*" *Simon*, 113 Cal.App.4th at 1164 (emphasis added).

Further, citing the holding in *State Farm*, the *Simon* court stated that "we do not construe State Farm's suggested ratios as limiting the reviewing court to a comparison of punitive damages to an award of

out of pocket expenses that does not reflect the full effect of the defendant's conduct upon the plaintiff, particularly where the resulting punitive damage award would not result in an amount that would further the

California public policy of punishing the defendant and making an example, in order to discourage him and others from perpetrating fraud in the future." *Ibid.*

Consistent with the *Simon* court's view of the Supreme Court's holding in *State Farm*, the *Simon* court considered not only the \$5,000 in compensatory damages, but also considered the loss of the benefit of the bargain to plaintiff Simon, which Simon was not entitled to recover under Civil Code § 3343, because it limited Simon's recovery to his out of pocket expenses of \$5,000. The evidence showed that Simon had agreed to purchase the building for \$1,100,000. Simon's expert appraised the building's value at \$1,500,000. Accordingly, the *Simon* court reasoned that Simon had suffered benefit of the bargain damages in the amount of the \$400,000, the difference between the appraised value and the price at which defendant promised to sell the building to Simon.

In *In re the Exxon Valdez* (D. Alaska 2004) 296 F.Supp.2d 1071, the United States District Court for the District of Alaska awarded \$4.5 billion in punitive damages. The Exxon Valdez court considered the holdings in *TXO*, *BMW* and *State Farm*, and specifically stated that *it is appropriate to consider "potential harm" in determining an appropriate punitive damage award.*

On March 24, 1989, Joseph Hazelwood, a relapsed alcoholic who, more

probably than not, had consumed sufficient alcohol to incapacitate a non-alcoholic, grounded the Exxon Valdez in Prince William Sound, releasing approximately 11 million gallons of crude oil and causing irreparable damage to the waters in Prince William Sound and the surrounding coastline. Commercial fisheries throughout the area were totally disrupted, with entire fisheries being closed for the 1989 season.

The jury ultimately awarded \$5 billion in punitive damages against Exxon. Exxon moved for a remittitur of the punitive damages. The motion was denied. Exxon appealed as to the amount of the punitive damages. The Ninth Circuit Court of Appeal found that the \$5 billion punitive damage award was too high and remanded the case to the District Court, which reduced the punitive damage award to \$4 billion.

In August 2003, the Ninth Circuit Court of Appeals vacated the \$4 billion punitive damage judgment and again remanded the case to the District Court to reconsider the punitive damage award in light of *State Farm v. Campbell*.

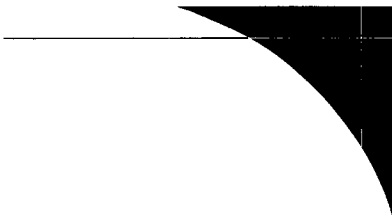
In assessing the reasonableness of the jury's \$5 billion punitive damage award, the Exxon Valdez court repeatedly quoted language from *Haslip*, *TXO*, and *State Farm*, which allow the trier of fact to consider the *potential harm* that may have

resulted from the defendant's conduct. In addition, the Exxon Valdez jury was presented with a jury instruction which read in pertinent part: "In determining the amount of punitive damages to award, if any, you may consider among other factors: . . . (b) *the magnitude of the harm likely to result from the defendant's conduct*, as well as the magnitude of the harm that has actually occurred." *Id.* at 1081, fn. 31 (emphasis added).

Citing *TXO*, the Exxon Valdez court stated "*it is appropriate to consider the magnitude of the potential harm that the defendant's conduct would have caused to an intended victim if the wrongful plan had succeeded.*" *Id.* at 1098.

The Exxon Valdez court stated that "while neither *BMW* or *State Farm* involved potential harm, both cases acknowledged that *potential harm is part of the ratio analysis.* Clearly this court is not restricted to the jury's compensatory award in evaluating the ratio guidepost." *Id.* at 1098.

Ultimately, the Exxon Valdez court found that the "potential harm" stemming from the Exxon Valdez accident was simply not possible to quantify. However, the court specifically stated that after *State Farm*, a consideration of potential harm is still appropriate: "Thus, the court finds that the actual harm Exxon's conduct caused plaintiffs was \$513,147,740. The punitive damages award was \$5 billion,



which leads to a ratio of 9.74 to 1. This ratio, of course, does not include any consideration of potential harm, *a consideration that is still appropriate after State Farm.*" *Id.* at 1102 (emphasis added).

Due to the difficulty in quantifying the potential harm, the *Exxon Valdez* court justified a higher ratio of punitive damages to actual damages as follows: "Because there is no way to quantify the non-economic, potential, and yet to be litigated economic harms discussed above, the appropriate approach is to accommodate the unknowns by allowing a higher ratio to pass constitutional muster. This is in keeping with the Supreme Court precedent. In *BMW*, the court observed that 'a higher ratio may . . . be justified in cases in which the injury is hard to detect or the monetary value of non-economic harm might have been difficult to determine.'" *Id.* at 1104, citing *BMW*, 517 U.S. at 582.

After considering all relevant factors, the *Exxon Valdez* court determined that the jury's award of \$5 billion in punitive damages was not grossly excessive. However, because the court was specifically instructed by the court of appeal to reduce the \$5 billion punitive damage award, the court compromised by reducing the punitive damage award to \$4.5 billion.

#### **Conclusion**

Based on the authorities cited above, including *Haslip*, *TXO*, *BMW*, *State Farm*, *Simon* (review granted) and, most recently, *Exxon Valdez*, it is clear that it is appropriate to consider the magnitude of the potential harm faced by a plaintiff when determining an appropriate punitive damage award. As of today's date, not a single Supreme Court, Federal or State decision states that potential harm may *not* be used as the basis for determining the amount of punitive damages.

In an appropriate case, as in *Beckman v. Flextronics*, it is proper to consider the potential harm faced by the plaintiff in determining the amount of punitive damages to award. This consideration is appropriate and necessary to further the California public policy of punishing a defendant and making an example of it, in order to discourage the defendant and others from perpetrating such conduct in the future.

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