S121933

IN THE SUPREME COURT OF CALIFORNIA

LIONEL SIMON, dba LIBERTY PAPER COMPANY,
Plaintiff, Respondent, and Cross-Appellant,

vs.

SAN PAOLO U.S. HOLDING COMPANY, INC.,
Defendant, Appellant, and Cross-Respondent.

AFTER A DECISION BY THE COURT OF APPEAL
SECOND APPELLATE DISTRICT, DIVISION FOUR
CASE NO. B121917

APPLICATION TO FILE AMICI CURIAE BRIEF; AMICI CURIAE BRIEF OF THE CALIFORNIA CHAMBER OF COMMERCE, THE AMERICAN CHEMISTRY COUNCIL, THE NATIONAL ASSOCIATION OF MANUFACTURERS, UNOCAL CORP., AND AMERICAN INTERNATIONAL COMPANIES IN SUPPORT OF DEFENDANT

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APPLICATION TO FILE AMICI CURIAE BRIEF

Under rule 29.1(f) of the California Rules of Court, the California Chamber of Commerce, the American Chemistry Council, the National Association of Manufacturers, Unocal Corp., and American International Companies ask permission of the Chief Justice to file an amicus curiae brief in this case. The brief is combined with this application. (See Cal. Rules of Court, rule 29.1(f)(4).)

The California Chamber of Commerce is a voluntary, nonprofit California-wide business association with more than 14,000 members, both individual and corporate. Seventy-five percent of the Chamber's members employ 100 or fewer employees. The Chamber represents its members before the Legislature, local governing bodies, and the courts on a wide range of issues.

The National Association of Manufacturers (NAM) is the nation's largest multi-industry trade association representing large and small manufacturers in every industrial sector and all 50 states.

The American Chemistry Council (ACC) represents the leading companies engaged in the business of chemistry. ACC members apply the science of chemistry to make innovative products and services that make people's lives better, healthier, and safer. The business of chemistry is a $450 billion enterprise and a key element of the nation's economy. The business of chemistry in California alone directly employs over 79,000 workers, generating a payroll over $5.7 billion, representing 49 percent of the state's manufacturing workforce.

Unocal Corporation, the parent company of the Union Oil Company of California, is one of the world's leading independent oil and gas exploration, development, and production companies.

American International Companies are comprised of insurer-member companies of the American International Group, Inc. (AIG). Several of the American International Companies write commercial liability policies in California and nationwide.

This case raises an issue of vital interest to the amici because they and their members have faced and continue to face lawsuits seeking punitive damages. The Court of Appeal's opinion represents a dangerous and unwarranted departure from established punitive damages law, and directly threatens the interests of the amici in pending and potential future litigation.

Counsel for the amici have reviewed the briefs on the merits filed in this case, and counsel believe this court will benefit from additional briefing on the Court of Appeal's misapplication of the second and third "guideposts" for reviewing punitive damages, as set forth by the United States Supreme Court in *BMW of North America, Inc. v. Gore* (1996) 517 U.S. 559, 575 [116

S.Ct. 1589, 1599, 134 L.Ed.2d 809, 826] (*BMW*) and further refined in *State Farm Mutual Automobile Insurance Company v. Campbell* (2003) 538 U.S. 408, 419 [123 S.Ct. 1513, 1521, 144 L.Ed.2d 585, 602] (*Campbell*).

In the past, the business community has regarded California as a hostile environment, owing in part to the arbitrary imposition of excessive punitive verdicts. This case presents an opportunity for this Court to recognize and enforce the constitutional limitations on punitive damages mandated by the United States Supreme Court. In clarifying the courts' role in reviewing large punitive damage awards, the Court would confirm businesses' ability to operate in a predictable environment, with less fear of unwarranted punitive damage claims that drive up operating costs and hinder efforts to resolve disputes fairly without litigation. Accordingly, the California Chamber of Commerce, the National Association of Manufacturers, the American Chemistry Council, Unocal Corp., and American International Companies request that the court grant leave to file the attached amici curiae brief.

Dated: October 13, 2004

Respectfully submitted,
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AMICI CURIAE BRIEF

INTRODUCTION

The United States Supreme Court warned in *Campbell* that "'punitive damages pose an acute danger of arbitrary deprivation of property.'" (*Campbell*, *supra*, 538 U.S. at p. 417.) To combat this danger of arbitrariness, the Court prescribed an "[e]xacting appellate review" of punitive damages awards, to ensure that they are "'based on an application of law, rather than a decisionmaker's caprice.'" (*Id*. at p. 418.) The Supreme Court's prescription applies to all state courts reviewing punitive damages awards. (*Id.* at p. 416 ["While States possess discretion over the imposition of punitive damages, it is well established that there are procedural and substantive constitutional limitations on these awards"].)

The Court of Appeal here failed to carry out this mandate, and instead applied *Campbell* in a way that drains the Supreme Court's opinion of its capacity to rein in arbitrary punitive damages awards. The Court of Appeal affirmed a punitive award of $1.7 million where the jury had awarded only $5,000 in compensatory damages, and where the Legislature prescribed only a $2,500 fine for comparable misconduct. This brief focuses in particular on the court's misapplication of two of the three "guideposts" discussed in *Campbell*: the ratio guidepost and the comparable penalties guidepost.[1/] As we will show, the Court of Appeal's analysis not only violated the letter and spirit of *Campbell*, but it also intruded into the province of the Legislature,

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1/ Although this brief addresses only the second and third guideposts, amici agree with petitioner San Paolo U.S. Holding Company, Inc. that the Court of Appeal misapplied the first guidepost — degree of reprehensibility — as well. We understand that other amici are addressing the court's misapplication of the first guidepost, and we will not duplicate their arguments.

second-guessing policy determinations made by the Legislature on the recoverability of certain types of damages and the appropriate level of punishment for certain types of misconduct.

First, this brief addresses the ratio guidepost (also known as the "second guidepost"), which is designed to ensure that a punitive damages award is not out of proportion to a plaintiff's actual damages. Here, the punitive damages award is 340 times the amount of compensatory damages found by the jury. Under *Campbell*, such disproportionality is a clear indicator of excessiveness. But the Court of Appeal sidestepped this problem by comparing the punitive damages not to the damages as found by the jury, but to the court's own independent evaluation of harm arguably suffered by plaintiff Lionel Simon. Specifically, the court determined that San Paolo caused Simon to suffer $400,000 in lost profits, even though lost profits are, by statute, not an appropriate measure of damages where, as here, a defrauded purchaser of real property did not actually acquire the property. By incorporating non-recoverable elements of loss into its punitive analysis, the court deprived San Paolo of its constitutional right to fair notice. San Paolo had no notice that it would be subjected to punishment based on a measure of damages that the Legislature has expressly disallowed. The court also usurped the role of the Legislature by redefining the types of damages that are deemed to occur when a would-be purchaser is fraudulently prevented from acquiring real property.

Second, this brief discusses the comparable penalties guidepost (also known as the "third" guidepost), which is designed to ensure that a punitive award is not out of line with the statutory civil penalties for comparable misconduct. Here, the only comparable civil penalty identified by the Court of Appeal is a fine of $2,500, which is dwarfed by the $1.7 million punitive award. Under *Campbell*, this is another indicator of excessiveness, but the Court of Appeal again sidestepped *Campbell*. Instead of comparing the

punitive award to the applicable penalties for comparable misconduct, the court focused on statutes that allow treble damages in tort actions for different types of fraud, such as fraud against the elderly and the disabled, which are plainly more reprehensible than the type of conduct actually involved in this case (fraud in an arms-length real estate transaction).

The Court of Appeal's application of this guidepost, like its application of the ratio guidepost, not only ignores the Supreme Court's guidance in *Campbell* but fails to accord proper deference to the policy decisions of the Legislature. The very fact that the statute addressing the type of fraud at issue here does *not* authorize treble damages should have been a signal not to compare the punitive award to statutes authorizing treble damages for other types of fraud. Rather than deferring to the legislative determination that certain types of fraudulent conduct are more blameworthy than others, the court made its own independent determination that a business fraud is comparable, in terms of reprehensibility, to fraud directed towards vulnerable persons such as the elderly and the disabled.

Amici respectfully request that this Court reject the Court of Appeal's analysis and reverse the judgment.

LEGAL DISCUSSION

THE COURT OF APPEAL'S ANALYSIS DEFEATS THE PURPOSE OF THE *BMW/CAMPBELL* GUIDEPOSTS AND USURPS THE POLICYMAKING ROLE OF THE LEGISLATURE.

A. The Court of Appeal misapplied the ratio guidepost by measuring the punitive award against harm that the Legislature has declared to be noncompensable.

A critically important issue raised by this case is whether a reviewing court can, when comparing a punitive award to the value of the plaintiff's harm, include legally noncompensable injuries within the definition of "harm." In other words, can a court properly justify a high punitive award based on phantom elements of harm that the Legislature has precluded plaintiffs from recovering as compensatory damages? Amici think the answer to this question is no, but the Court of Appeal below disagreed.

The Court of Appeal held that, although the punitive award was 340 times greater than Simon's out-of-pocket damages, it was reasonable in comparison to Simon's claimed "loss" of $400,000 in hoped-for profits from a promised sale of real property. (*Simon v. San Paolo U. S. Holding Co., Inc.* (2003) 113 Cal.App.4th 1137, 1159-1166 (*Simon*).) The jury never found Simon suffered such a "loss." Nevertheless, the court found that this $400,000 in lost profits represented Simon's actual harm. The court's approach cannot be squared with the Legislature's measure of damages for cases such as this.

Civil Code section 3343 defines the compensable damages that are deemed to occur when the plaintiff is the victim of fraud in connection with a real estate transaction. (See Civ. Code, § 3343.) The statute defines the plaintiff's damages differently depending on whether the victim of the fraud actually ended up acquiring the property. (*Ibid*.) In cases like this one, where the defrauded purchaser did not ultimately acquire the property, the statute defines the plaintiff's damages to include out-of-pocket expenses, but not claimed lost profits. (*Ibid*.; see also *Kenly v. Ukegawa* (1993) 16 Cal.App.4th 49, 55 [explaining that section 3343 permits recovery of lost profits only when the plaintiff actually acquired the property in question].)

By punishing a defendant based on a measure of damages that has been rejected by the Legislature, the Court of Appeal introduced an element of unpredictability and arbitrariness into the appellate review of punitive damages that contravenes the United States Supreme Court's mandate that punitive damages not be imposed without fair notice. When the Supreme Court introduced the three-guidepost test in *BMW*, it explained that the purpose of the test was to ensure that defendants receive "fair notice not only of the conduct that will subject him to punishment, but also of the severity of the penalty that a State may impose." (*BMW*, *supra*, 517 U.S. at p. 574.) Fair notice is not provided when, as in this case, a reviewing court upholds the amount of a punitive award based on harm that is legally noncompensable under established law. No defendant has fair notice that it might be forced to pay damages based on a type of harm that is expressly excluded from the statutory definition of damages for the conduct at issue.

The Court of Appeal's contrary approach encroaches on the province of the Legislature. The Legislature made a deliberate policy decision when it drafted Civil Code section 3343 to allow lost profits *only* in cases where the defrauded purchaser actually acquires the property. (See Civ. Code, § 3343,

subd.(a)(4) [allowing recovery of "loss of profits" in cases "[w]here the defrauded party has been induced by reason of the fraud to purchase or otherwise acquire the property in question"].) By justifying Simon's punitive award based on evidence of alleged lost profits, the Court of Appeal effectively allowed Simon to recover damages based on a type of harm that the Legislature expressly excluded from its definition of damages for the type of conduct at issue. There is little difference between this approach and simply awarding Simon compensatory damages for lost profits. Either way, Simon's compensation is increased based on a measure of damages that the Legislature has disapproved. This Court should not endorse the Court of Appeal's end-run around the Legislature's policy determinations on the question of recoverable damages.

Although the Court of Appeal's analysis was limited to a particular type of noncompensable harm, the court's erroneous reasoning could be easily extended to any area in which, as a matter of public policy, certain types of harm are noncompensable. (See, e.g., Code Civ. Proc., § 1021 [attorney fees generally noncompensable even though incurred as a result of another's wrongdoing]; *Molien v. Kaiser Foundation Hospitals* (1980) 27 Cal.3d 916 [certain emotional distress resulting from bystander observation of a distressing event noncompensable]; *Ortega v. Pajaro Valley Unified School Dist*. (1998) 64 Cal.App.4th 1023, 1060 [distress from enduring the stresses of litigation noncompensable].)

Similarly, the court's analysis could improperly approve an otherwise excessive punitive award based on the reviewing court's determination that the compensatory award does not represent the full extent of the plaintiff's harm because the supposed harm is, by statute, recoverable only to a limited extent. (See, e.g., Veh. Code, §§ 17150, 17151, 17152 [statutory cap on vehicle owners' liability]; Civ. Code, § 3333.2 [statutory cap on noneconomic

awards in medical malpractice actions].) To prevent a widespread erosion of the established limitations on damages, this Court should preclude lower courts from considering noncompensable harm during excessiveness review of punitive awards.

In this particular case, the Court of Appeal not only invaded the province of the Legislature, but it arrogated the role of the jury as well. The jury in this case apparently was never told they could not award lost profits damages. Simon asked the jury in the first trial to award such damages, and the trial court instructed them that they could do so, but they declined. (See San Paolo's Opening Brief on the Merits (OBOM) at p. 21.) Thus, the Court of Appeal usurped the jury's role by assuming the existence of damages that the jury did not believe existed.[2/]

To justify the Court of Appeal's reliance on noncompensable harm, Simon relies heavily on this Court's opinion in *Neal v. Farmers Ins. Exchange* (1978) 21 Cal.3d 910. (See Simon's Answer Brief on the Merits (ABOM), pp. 30-31.) Punitive damages law has evolved considerably since *Neal* was decided, both as a matter of state law and federal due process. *Neal* pre-dates the entire line of United States Supreme Court authority focusing on the importance of fair notice and requiring the elimination of arbitrariness from

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2/ The Court of Appeal's ruling is part of a larger post-*Campbell* trend in which courts have substituted their own factual findings for those of the jury. At least two districts of the Court of Appeal, including the Court of Appeal here, have purported to cure instructional errors arising out of *Campbell* by reducing punitive damages awards rather than ordering a new trial. (See *Romo v. Ford Motor Co.* (2003) 113 Cal.App.4th 738, 763; *Boeken v. Philip Morris USA Inc.* (Sept. 21, 2004, B152959) ___ Cal.App.4th ___ [19 Cal.Rptr.3d 101].) These decisions conflict with this Court's holding in *Schelbauer v. Butler Manufacturing Co.* (1984) 35 Cal.3d 442, 454 that the use of remittitur is "confined to cases in which an excessive damage award [is] the *only* error in the jury's verdict" (original emphasis).)

punitive damages jurisprudence. It is time for this Court to revisit *Neal* and clarify that, in the aftermath of *BMW* and *Campbell*, as a constitutional matter punitive damages cannot be upheld when they are disproportionate to the plaintiff's compensatory damages, and must be reasonable in comparison to damages that are legally compensable.

Simon also relies on the United States Supreme Court's statements that punitive damages can be justified by the "potential harm" to the plaintiff. In Simon's view, the Court's statements about "potential harm" call for a ratio analysis that goes beyond a simple comparison of punitive damages to compensatory damages. (See ABOM, pp. 36-38.)

Simon's reliance on the concept of "potential harm" is misplaced. There is an important distinction between potential compensable harm, as discussed by the United States Supreme Court, and noncompensable harm, which is at issue here.

"Potential harm," as that term is used by the United States Supreme Court, is harm that would have occurred from a defendant's plan to commit a tort, but never materialized because the plan was thwarted before it could be carried out. The United States Supreme Court first introduced the concept of "potential harm" in *TXO Production Corp. v. Alliance Resources Corp.* (1993) 509 U.S. 443, 460 [113 S.Ct. 2711, 2721, 125 L.Ed.2d 366, 381] (*TXO*). In that case, the Court said it was 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* . . ." (*Ibid*., emphasis added; see also *id*. at p. 462 ["While petitioner stresses the shocking disparity between the punitive award and the compensatory award, that shock dissipates when one considers the potential loss to respondents, in terms of reduced or eliminated royalties payments*, had petitioner succeeded in its illicit scheme*" (emphasis added)].)

The one published California decision that discusses the potential damages element of *TXO* has similarly characterized that case as holding potential harm may be considered "where a scheme worthy of punitive damages does *not* fully succeed." (*Sierra Club Foundation v. Graham* (1999) 72 Cal.App.4th 1135, 1162, fn. 15, emphasis added.)

The rationale for considering potential damages is that, when the tortious conduct does not cause the intended or probable result (e.g., in fraud cases, the scheme does not succeed), a punitive award that bears a reasonable relationship only to the result that actually occurred may not be adequate to punish and deter. For instance, *TXO* referred to a hypothetical posited in a West Virginia Supreme Court case, *Garnes v. Fleming Landfill, Inc.* (1991) 186 W.Va. 656, 661 [413 S.E.2d 897, 902] in which the court suggested a man might wildly fire a gun into a crowd of people, but fortuitously cause damage only to a $10 pair of glasses. In such a situation, *TXO* agreed it would be appropriate to measure the punitive award by the harm that the shooter likely would have caused if not for good fortune. (*TXO, supra,* 509 U.S. at p. 460.) The *Garnes* case itself referred to potential harm as "a very narrow exception" to a general rule of considering the relationship between punitive damages and the plaintiff's actual harm. (*Garnes*, *supra*, 413 S.E.2d at p. 908, fn. 7.)

Potential harm is not an issue in this case. This is not a case in which the defendant had a tortious plan that was foiled before it was completed. To the contrary, the Court of Appeal's discussion of the facts indicates that San Paolo fully succeeded in its plan to fraudulently back out of its agreement with Simon. Thus, there is no reason to speculate about what harm would have occurred if the plan had succeeded. The plan did succeed, and therefore the only relevant harm is the damage that actually resulted.

Nor does the Supreme Court's discussion of potential harm amount to an endorsement of a free-form ratio analysis in which a reviewing court can

compare punitive damages to legally noncompensable harm. In a true potential harm situation, punishing the defendant based on intended or probable potential harm does not violate due process because the defendant had fair notice of the compensable harm that was likely to occur if the defendant's plan was successful. The same reasoning does not apply to noncompensable harm: as discussed above, no defendant can be said to have fair notice that it will be forced to pay damages based on amounts that, by statute, do *not* reflect the measure of the plaintiff's actual harm.

For the foregoing reasons, this Court should reject the Court of Appeal's reliance on noncompensable harm in applying the ratio guidepost.

B. The Court of Appeal misapplied the comparable penalties guidepost by comparing the punitive award to penalties for conduct that was not present in this case.

In affirming the $1.7 million punitive award, the Court of Appeal misapplied the third *BMW* guidepost, which requires reviewing courts to consider the magnitude of "'civil penalties authorized or imposed in comparable cases.'" (*Campbell*, *supra*, 538 U.S. at p. 428.) The third guidepost is designed not only to ensure that defendants have fair notice of the amount of a penalty that might be imposed on their conduct (*BMW*, *supra*, 517 U.S. at p. 582), but also to ensure that reviewing courts defer to legislative judgments about the appropriate level of punishment (*id.* at p. 583). Accordingly, when legislatures enact statutes establishing penalties for different types of misconduct, reviewing courts should accord "substantial deference to [those] legislative judgments." (*Ibid*.)

This concept, which was not part of the traditional post-verdict review of punitive damages prior to *BMW*, was one of the most significant and

ground-breaking aspects of the *BMW* opinion. (See Sykes, *Marking a Road to Nowhere? Supreme Court Sets Punitive Damages Guideposts in BMW v. Gore* (1997) 75 N.C. L.Rev. 1084, 1112 [stating that the third guidepost, unlike the others "adds a new tool to the toolchests of lower courts"].) The third guidepost gave reviewing courts a concrete benchmark for evaluating punitive damage awards. Instead of justifying punitive damage awards by reference to large awards in prior cases — the very problem the Supreme Court was seeking to rectify when it delineated its three guideposts — reviewing courts were required after *BMW* to determine fair notice by reference to the enactments of the Legislature.

The Court of Appeal turned back the clock by denying deference to legislative judgments about the relative punishment levels for different types of misconduct. The court second-guessed the Legislature's determinations and made its own independent evaluation of what the appropriate level of punishment should be for the conduct at issue. (*Simon*, *supra*, 113 Cal.App.4th at p. 1147.)

The Court of Appeal recognized that the catch-all civil penalty for various types of fraudulent and unfair conduct is the $2,500 fine provided by Business and Professions Code section 17206. (*Simon*, *supra*, 113 Cal.App.4th at p. 1147.) But the court chose to disregard this penalty, because it could apply to conduct that is unfair, but not necessarily fraudulent. (*Ibid*.) Instead of comparing the punitive damages to the only penalty conceivably applicable to this case, the court looked at other penalty statutes that address specific types of fraudulent conduct not at issue in this case: fraud against the elderly and disabled persons, and fraudulent eviction of tenants from rent-controlled residential units. (*Ibid*.) These statutes provide for treble damages (i.e., a 2-to-1 ratio). Extrapolating from these statutes, the court upheld a quintuple damages award — a punitive award that is 4.2 times greater than the

plaintiff's harm, including noncompensable harm, as discussed in the previous section.

Nothing in United States Supreme Court jurisprudence contemplates that a court will compare a punitive award to the damages authorized for other types of conduct, especially not when *there is a statute that specifically defines the allowable damages for the precise conduct at issue.* A person defrauded in connection with the purchase of real property, who does not acquire the property, may recover out-of-pocket damages. (See Civ. Code, § 3343.) The statute does not authorize recovery of lost profits, nor does it provide for double or treble damages. (*Ibid.*) It would seem self-evident that, for purposes of deferring to "legislative judgment" about the appropriate penalties for the conduct at issue, it makes more sense to look at the statute that expressly applies to the precise conduct at issue, rather than some other statutes for other types of conduct.

Indeed, comparing the damages statutes for different types of fraud leads to the *opposite* conclusion from the one reached by the Court of Appeal. The fact that the Legislature has authorized treble damages for certain types of frauds, and not for the type of fraud at issue here, leads to the conclusion that the Legislature views the type of fraud at issue here to be less worthy of punishment than the types of frauds covered by the other statutes.

Rather than deferring to the Legislature's determinations that double and triple damages are not available for the conduct in this case, and rather than deferring to the Legislature's view that $2,500 is the appropriate penalty for garden-variety civil fraud, the Court of Appeal second-guessed the Legislature and made its own determination that business fraud in connection with a real estate transaction should be treated as seriously as fraud against the elderly or the disabled, or the fraudulent eviction of a tenant from a rent-controlled apartment. Indeed, the court actually treated the fraud in this case

more seriously, since the court upheld a multiplier greater than the multiplier authorized for those types of frauds.

The Court of Appeal's analysis not only violates the letter of the Supreme Court's requirements, but it also undermines their purpose. Instead of ensuring that punitive damages are not imposed without fair notice, the Court of Appeal's approach would dictate that punitive damages may be imposed based on statutes that no reasonable defendant would anticipate being subjected to. Amici respectfully request that this Court expressly reject the Court of Appeal's misapplication of the third guidepost.

CONCLUSION

For the reasons set forth above, this Court should reverse the decision of the Court of Appeal and reduce the punitive award to an amount that is not excessive under the due process guidelines set forth by the United States Supreme Court.

Respectfully submitted,

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CERTIFICATE OF WORD COUNT

(Cal. Rules of Court, rule 29(c)(1).)

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Dated: October 13, 2004

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Curt Cutting