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Punitive damages

MULTIPLYING THE VALUE OF YOUR CLIENT'S CASE THROUGH A LITTLE EXTRA EFFORT AND FOCUS

In our civil justice system, the successful end of most of our cases boils down to money. The replacement of an "eye-for-an-eye" justice with a system that values harm through monetary compensation necessarily means that our cases are about an exchange of money to compensate and make up for the harm done to our clients. Considering this fact, I've long been surprised at how little attention is often given to the pursuit of punitive damages – even though a successful punitive damage verdict can literally result in many multiples of the compensatory damages. This article provides an overview of how to present punitive damages at trial. Necessarily, this requires a dive into the pre-trial workup needed to ensure that your client's punitive damages claim is viable and preserved for trial.

Pre-trial nuts and bolts

Financial-condition evidence

A necessary predicate to a punitive damages verdict is evidence of the defendant's "ability to pay." (*Adams v. Murakami* (1991) 54 Cal.3d 105, 111.) There is widespread misconception that "ability to pay" is synonymous with "net worth" and that "net worth" is the only proper measure of "ability to pay." This is wrong, and it helps the defense. *Adams* held that the pertinent question is "ability to pay," and that "net worth" is not necessarily the required or best evidence of "ability to pay" in all cases. (*Id*. at 116 fn. 7.)

Does this mean "net worth" evidence is not important? No. In many cases, especially with larger corporate entities, evidence of "net worth" (or shareholder equity) is important. But, in other cases, like where the defendant is a viable ongoing entity (or person) yet with a present low or even negative net worth, other measures of "ability to pay" are more important.

Consider *Rufo v. Simpson* (2001) 86 Cal.App.4th 573, the O.J. Simpson civil wrongful-death case. There, the court held that "ability to pay" includes an analysis of the defendant's "prospects to gain more wealth in the future." (*Id*. at 624-625.)

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Another example is *Zaxis Wireless Comm., Inc. v. Motor Sound Corp.* (2001) 89 Cal.App.4th 577. There, while the defendant corporation had a negative "net worth," the appellate court found adequate evidence of "ability to pay" because it "had a credit line of $50 million of which $5.3 million was unexpected," which "indicates the lender made a determination that [the defendant] had the ability to pay amounts well in excess of the $300,000 punitive damages award." (*Id*. at 583; see also *Bankhead v. Arvinmeritor, Inc.* (2012) 205 Cal.App.4th 68 [$4.5 million punitive damage award affirmed despite negative net worth of $1.023 billion based, inter alia, on: defendant borrowing $245 million recently and having $343 million in cash on hand; defendant's last year profit was $12 million; defendant's CEO was paid $7.6 million and had a change of control severance agreement requiring payment of $25 million in case upon a change of control].)

These cases teach the importance of discovering information regarding the defendant's broader financial picture from both a retrospective and a prospective evaluation. The retrospective evaluation should include analyzing things like the defendant's attempts to obtain credit or loans. The underlying application documents are often a rich source of the defendant portraying its financial condition in the most favorable light to itself. And the prospective evaluation should include looking at things like future anticipated income stream as was done in *Rufo*.

Getting defendant's financial information

Informal efforts

So how do you get financial-condition evidence? Let's start with your informal efforts.

Publicly traded companies are required to file a form 10-K, also called an annual report, with the Securities and Exchange Commission (SEC). This can be obtained from the SEC's website – www.sec.gov/edgar – and is usually available on the company's own website. If the exact entity filing this report is your punitive damage defendant, then the information in the current report is probably all that you need. But there is a trap to fall into here if your defendant is not the exact entity that filed the 10-K, such as if the defendant is a subsidiary of the filing entity. Sometimes, the 10-K will separately list the financial reporting of each subsidiary, but much more frequently the subsidiary's finances are not separately broken out but collapsed into and embedded within the parent's consolidated financial reporting.

In this latter situation, the 10-K may not allow you to determine the "ability to pay" of the subsidiary. It is often necessary to have an economist, CPA or other financial expert review these documents to ensure there is a way to separate out the financial condition of the relevant subsidiary if the defendant against whom you are seeking punitive damages is the subsidiary.

As an aside, in any punitive damages case an economist, CPA or other financial expert should be designated to testify on "ability to pay" issues. Realize some authority suggests that the parent company's finances may be considered against the subsidiary (*Downey Savings & Loan Ass'n v. Ohio Casualty Ins. Co.* (1987) 189 Cal.App.3d 1072), but it is not recommended that you solely rely on this authority (in some cases, its reasoning will not apply).

If the defendant is a non-profit, get their IRS form 990 tax filings, which can be obtained from websites such as www.guidestar.com. But realize that the tax-filing documents often understate the actual financial condition. For example, if the entity holds a lot of real estate, tax documents usually understate the value of real estate both through not having current appraisals and through the fiction of real estate depreciation, which devalues on paper what is often an appreciating asset. The tax documents may also not show the debt on the property. Again, a financial expert needs to help dig into these issues to properly understand the entity's "ability to pay."

If your informal efforts produce what you need, provide what you have found to the defense lawyer and try to obtain stipulations that the information you discovered from public sources may be used at trial. Often, they will agree. If not, and there is time, try to obtain certified copies of the documents from the SEC or the IRS (in case of the 990s).

Formal efforts

If these informal efforts are not sufficiently fruitful, or if the defendant is a privately held company, then you will need to resort to formal measures. There are two different ways to do this before trial: (1) a pre-trial motion for financial condition discovery under Civil Code section 3295(c); and (2) a notice to appear and produce at trial under Code of Civil Procedure section 1987.

I have a bias against filing a pre-trial motion for financial discovery unless this is the only viable option. It is a lot easier to make a prima facie entitlement to punitive damages at trial when the judge sees the evidence unfolding than when it is on paper. I worry that a denial of this type of motion impacts the judge's view of the strength of the punitive damage claim and also the defendant's view of settlement.

But there is a wrinkle with relying solely on a section 1987 demand if the defendant is an out-of-state defendant. An older decision held that a section 1987 demand cannot compel production of out-of-state records at trial. (*Amoco Chemical Co. v. Certain Underwriters at Lloyd's of London* (1995) 34 Cal.App.4th 554.) I believe this decision is wrong, but it remains on the books. The core rationale was that, under Code of Civil Procedure section 1989, neither a subpoena nor a 1987 demand may compel an out-of-state witness to appear in a California trial. (*Amoco Chemical*, *supra*, 34 Cal.App.4th at 559-560.) But this rationale ignores Code of Civil Procedure section 1987.3, which states that "[w]hen a subpoena duces tecum is served upon a custodian … and his personal attendance is not required by the terms of the subpoena, section 1989 shall not apply." Section 1987.3 expressly

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permits production of records across state lines notwithstanding section 1989 so long as the subpoena or notice to appear does not require production of a witness.

Still, with this uncertainty, it is best to approach defense counsel well before trial and work through an agreement and stipulation for production of the relevant financial condition information. Often, at that stage, stipulations can be reached to deal with these issues at trial upon a finding of malice, fraud or oppression.

Finally, while this should never be relied on as the primary method, case law does permit a court to order production of financial condition information at trial upon a finding of malice, fraud or oppression even if the plaintiff did not seek this information through subpoena, notice to produce or otherwise pre-trial. (*Mike Davidov Co. v. Issod* (2000) 78 Cal.App.4th 597, 608-609.) While this is critical authority to know in case of emergencies, it is discretionary with the trial judge, so relying on this hit-or-miss remedy is dangerous.

Federal court rules

A last cautionary tale. In federal court, the rules are different; section 3295(c)'s prohibitions on financial condition discovery do not apply. This means you must conduct pre-trial discovery of financial condition and force the defendant to try to block this through a protective order or otherwise. At that point, I will typically reach stipulations with the defense that we will bifurcate punitive damages as done in state court, that they will produce the financial condition information at trial upon the required finding, and that the plaintiff's failure to list this evidence on the final pre-trial filings is not a bar to admitting this information in phase two. This stipulation is then submitted as an order signed off by the district court. If the defense resists this stipulation, then you move forward with discovery on these issues.

Corporate liability: officer, director or managing agent involvement in the malice, fraud or oppression

To obtain punitive damages against the corporate employer, there must be evidence that a corporate officer, director or managing agent engaged in, authorized or ratified the fraudulent, oppressive or malicious conduct. (Civ. Code, § 3295, subd. (b).)

A full review of the law on establishing one is an officer, director or managing agent is beyond the scope of this article. However, a lot of great new case law has developed endorsing the idea that the absence of formal policies constraining an employee's conduct can itself be used to establish ad hoc discretionary policy-making authority rendering even a lower-level employee a corporate managing agent.

Perhaps the best is *King v. U.S. Bank, N.A.* (2020) 53 Cal.App.5th 675. There, the court held that a relatively low-level human-resources investigator was a managing agent given the broad discretionary authority conveyed to the investigator to determine how to conduct a workplace-misconduct investigation. (*Id*. at 713-715.)

The employer's policies promised a prompt and thorough investigation of workplace concerns, but the employer "did not have any rules, policies, procedures, practices, or criteria in place for investigators to follow in performing such investigations." (*Id*. at 713.) Instead, "[t]he investigators, like McGovern, were given the discretion and judgment to determine what to do and how to do it, with appropriate support from their managers. It was up to the investigators, however, to determine if/when to consult with their managers on a case-by-case basis." (*Ibid*.)

The *King* court reasoned: "Given the breadth of the discretion delegated to [a low-level human resources generalist] in determining how to fairly and thoroughly investigate suspected acts of dishonesty or unethical misconduct (i.e., corporate policy) and what constitutes a fair and thorough investigation – the results of which would determine (and in this case did determine) whether an employee would be disciplined or terminated – the jury could have reasonably inferred she had the authority and discretion to interpret and apply the investigative policies for U.S. Bank's commercial banking division as she saw fit, such that her decisions ultimately determined corporate policy." (*Id*. at 713-714.)

Similarly, in *Colucci v. T-Mobile USA, Inc.* (2020) 48 Cal.App.5th 442, the court affirmed the jury's finding that a retail district manager was a managing agent because the district manager was "responsible for managing nine retail stores and 100 employees"; "had independent, final authority to hire and fire employees within his district"; "alone decided to fire Colucci"; "had substantial discretionary authority over daily store operations, which led to the ad hoc formulation of policy" such as deciding "whether and where to transfer employees; whether to institute disciplinary measures; and whether and how to investigate employees' reported concerns" which "decision affected company policy over a significant aspect of T-Mobile's business." (*Id*. at 452.)

Colucci also expressly held that one can be a managing agent even if the person plays no "role in setting official corporate policies – e.g., those contained in an employee handbook...." (*Id*. at 453.) Rather, "formulat[ing] operational policies through [one's] discretionary decisions" can be enough. (*Id*. at 454; see also *Tilkey v. Allstate Ins. Co.* (2020) 56 Cal.App.5th 521, 554 ["a managing agent does not need to be a corporate policymaker and can formulate operational policies through discretionary decisions"].)

Trial

Punitive damages need to be front and center in your trial presentation. Too often, they are treated as an afterthought which is a recipe for not getting the jury to render a punitive damages verdict. I want to work punitive damages into every phase of the trial in one way or another, conditioning the jury to the importance that they play in the jury's decision and what an amazing and awesome power it is for a jury to impose punitive damages.

Voir Dire

Always introduce punitive damages as a concept in voir dire. I want the jury

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thinking about punitive damages from day one, and I try to frame punitive damages as "the most important part of the case" and the "most awesome power" our system gives to juries in our civil justice system. I tell the jurors that most of the issues the jury will decide in the case relate only to the plaintiff and the defendant. But punitive damages are different. They are the "one time in a case like this the law says the jury is supposed to think beyond the walls of the courtroom to try to change bad behavior and prevent it from happening from this defendant and others."

I will typically cover non-economic damages in voir dire before punitive damages. Then, after concluding non-economics, I ask similar questions about punitive damages. This is where I talk about them as the "most awesome power" and "most important part of the case." Sometimes, especially if the jury pool leans conservative, I might ask how the jurors feel about punishment generally, including through a reference to punishment in the criminal system – "Does anyone here feel that if a person commits a crime – say, robs a store – they should not be punished for doing that?"

Of course, everyone says they should. I will then try to explain that in some civil cases where the conduct is very bad, punishment is part of the case. I will then ask jurors about their attitudes of punishment damages – punishing through money. Often, jurors who lean more conservative tend to be more receptive to punishment damages than compensatory damages. So, focusing on the punishment part of the case plays well to more conservative jurors. We are effectively civil prosecutors in punitive damage cases and we should try to make this clear to our jurors.

Opening statement

In opening statement, I want to do two things to keep the jury focused on punitive damages. First, the substantive point – drive home how the defendant knew the rules and consciously chose to break them. Whatever shows conscious disregard of known rights or fraudulent conduct needs to be walked through.

The point is to show the violation was not a mistake; it was a conscious choice or intentional decision. A corporate defendant likely has policies and/or training on the relevant rules. They knew the rules, they just chose to break them. If there's a cover-up (such as pretextual termination in an employment case), walk through this evidence because it fits into a fraud rationale for punitive damages.

Second, the framing point – I will often end my opening statement by bringing back the words I used in jury selection (e.g., "most awesome power," etc.) and remind them that the "most important part of the case" is their punitive damage verdict, which will "complete their jobs as jurors."

Witness examinations

During witness examinations, I will walk through the substantive evidence showing that the company and its actors knew the rules and chose not to follow them and/or the acts of misleading conduct that can be used to argue fraud. I will also ask witnesses about punishment. For example, when questioning a human-resources witness in an employment case, I may ask: "The Company's policies provide for punishment if an employee breaks the rules, right?" Or, "The company recognizes that punishment is an important part of getting behavior to change, right?" After a series of questions like this, I may then ask: "And if the company itself breaks the rules, would you agree it would also be fair for the jury to punish it?" Sometimes questions like that don't get answered, but they frame the issue and keep the focus on the importance of punishment to change behavior.

Phase-one closing

In the phase-one closing, repeat the same themes and frames around your punitive damage claim that you have advanced throughout the trial. Early in the closing, I typically have a section that I conceptualize as the time to elevate the case and empower the jury. By that, I mean I will focus on the things about the case that make the case societally important – not just important for the plaintiff.

This is allowed in a punitive damage case because the jury must ultimately look at whether the conduct is worthy of punishment and deterrence. Here, I will focus on why the issues in the trial matter at a broader societal level, how the defendant corporation still does not get it based on the evidence at trial and, thus, why a punishment verdict is needed to get the defendant to see its wrong and change its behavior in the future.

If the trial showed the defendant refused to accept responsibility when it should have, this point will be made and then I will conclude by pointing out that only the jury can make the defendant get the message and that message is delivered through a punishment verdict.

These are conceptual points I make repeatedly and rhetorically from the beginning of the closing through the liability discussion. Once I am done with the liability discussion (including, typically, the verdict form questions), I will then review the specific instructions on malice, fraud or oppression and managing agents.

Don't skip this part. The jury needs to see the law on punitive damages and how it ties into the verdict form question. Once this is done, I revert back to the thematic arguments focusing on the fact that even after all these weeks of trial, the defendant apparently still does not get the message and only this jury has the power to make them get the message, and this is done not through a compensation verdict but only through a punishment verdict.

A last point. For post-verdict and appeal protection, remind the jury in phase-one closing not to punish in their compensatory verdict. Compensation must be separate from punishment and this is the compensation phase. To be able to deliver a punishment verdict right now they must say "yes" to the punishment question. I then tell the jury that "to complete your verdict, and do the most

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important thing you can do as jurors, there will be a brief second phase typically lasting a half day or so during which you will hear about the company's financial condition and then hear brief closing arguments." I don't like surprising jurors and in trials where the jury did not realize there would be a phase two, I have seen anger on their faces.

Another practice tip: Before or certainly no later than right after phase-one closings, if you have served a 1987 demand for financial condition information or have an agreement from the defense to provide it, ask the court to order its production immediately upon a malice, fraud or oppression finding. Courts want to issue this order because they do not want a delay between phase one and two. With such an order, if the defendant does not comply as ordered, the trial court can find a waiver of the right to have financial condition evidence considered. (*Mike Davidov Co.*, *supra*, 78 Cal.App.4th at 608-609.)

Phase two of the trial

Most frequently, phase two involves either a stipulation of the relevant financial condition numbers or brief testimony from an economist, CPA or a financial person from the company. Then it's off to closings.

Phase two closing is not the time to rehash all the evidence. It is not the time to scream and rant at the jury. This is the time to calmly reason with the jury about why punishment must be felt and to show the jury why a large number is needed for this defendant to feel it. I also believe in giving the jury hope in phase two. That is, the hope that through a serious enough punitive damages verdict, the jury can make this defendant take notice and change.

I often talk about how the company is not an intrinsically bad company. I may show their "core values" to make the point that they once recognized the right way to function. But this case shows that the company has lost its way and the punitive damages verdict this jury renders can become part of the corporate folklore of this company. That way, next time, this company will think twice about breaking the law.

Focus on the two purposes – punishment and deterrence, making clear that deterrence includes this defendant and others. Then review the punishment jury instructions showing your case meets all or most of the reprehensibility sub-factors. It is critical to talk about the fact that punishment is ineffective if it is not felt.

I often use a true story about getting sent to the cloak room in kindergarten when I misbehaved. The cloak room happened to be where the toys were stored. That punishment was not felt. I kept misbehaving. We are not here to bankrupt, but we are here to make it hurt some. If punishment does not hurt, it does not work.

Turning to the financial condition, especially when dealing with large corporate defendants, illustrate why given the vast resources of the company, only a large number will get their attention. Do this by comparing your ask with various measures of the defendant's financial condition – e.g., as a percentage of "net worth," as a percentage of annual revenues, as a percentage of daily revenues, etc. The more different comparisons the better. And remember to tell them they can do more, or they can do less. This way, your ask sets the floor, not the ceiling.

Don't take punitives for granted

Don't take punitive damages for granted, and don't let them disappear into the background of your case. The most important point about punitive damages is your mindset – treat them as an equally important part of the rest of the case and you will increase your chances of that jury delivering a punitive damages verdict.

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