



April 24, 2008

CALIFORNIA SUPREME COURT REVERSES \$200 MILLION PUNITIVE DAMAGES AWARD *(City of Hope Nat'l Medical Center v. Genentech, Inc.)*

The Washington Legal Foundation (WLF) scored a major victory yesterday when the California Supreme Court unanimously reversed a court of appeal ruling that upheld an unprecedented \$200 million punitive damages award against Genentech, a biotech company. The company was involved in a contract dispute over royalties with City of Hope Medical Center which developed synthesized DNA material, and was found liable for contractual damages of \$300 million. While the Court upheld the contract damages award, it ruled that no punitive damages of any amount should have been assessed since there was no fiduciary relationship between the parties, a breach of which would have allowed the jury to consider imposing punitive damages.

In this case, the City of Hope Medical Center sued Genentech, Inc., over a dispute about the meaning of a 1976 contract provision as to what royalties should be paid to City of Hope over certain DNA products developed by Genentech and licensed to third-parties for sale. After a second lengthy trial (the first trial ending with a hung jury), the jury ruled against Genentech for breach of contract and awarded City of Hope \$300 million in compensatory damages and \$200 million in punitive damages.

In its brief, WLF decried the pernicious practice of "tortification" of contract law, which would adversely affect typical business and contract relations, leaving companies subject to astronomical punitive damages in contract cases. WLF devoted most of its brief arguing that excessive punitive damages inflict public harms such as higher costs and prices of goods and services, reduced professional services, disincentives to enter into intellectual property agreements, decreased product development, loss of jobs, gratuitous wealth transfers through windfall awards, and public disrespect for the lottery-like civil justice system.

WLF also argued that no punitive damages should have been assessed at all because California law prohibits the award of punitive damages in actions that "arise out of" a contract obligation. Accordingly, even if there were a fiduciary obligation, that obligation arose out of the contractual relationship between the parties, and hence, is not subject to punitive damages. Alternatively, WLF argued that the conduct of Genentech was not so reprehensible; rather, its interpretation of the contract was

objectively reasonable between two sophisticated business entities, and thus, under *State Farm v. Campbell*, punitive damages awards should not be imposed. Finally, WLF argued that if punitive damages could be imposed, the amount awarded here was grossly excessive. WLF argued that the amount not be based on the wealth of a publicly-held corporation, that it would unfairly punish innocent shareholders and workers, and that a much smaller award would still serve the purposes of punishment and deterrence.

Under California law and other jurisdictions, punitive damages are not allowed to be assessed in breach of contract cases; rather, they are reserved for certain intentional torts committed with malice or fraud. In its opinion, the Supreme Court ruled that the dispute was merely a contractual one between two sophisticated parties with counsel. The court held that a fiduciary duty is not created just because one party has greater expertise on the subject matter. Otherwise, as the Court analogized, a car mechanic could be improperly held to a higher fiduciary standard just because he possesses superior knowledge of mechanics over the owner of the vehicle.

"This is a great victory not only for Genentech, but for all companies that do business in California," said Paul Kamenar, WLF's Senior Executive Counsel. "In order to dispel any lingering doubts about the parties relationship with each other, language should be added to business contracts expressly disclaiming any fiduciary relationship," Kamenar added.

WLF has participated in many of the major punitive damages cases before the U.S. Supreme Court and lower federal and state courts over the last 20 years.

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For further information, contact WLF Senior Executive Counsel Paul Kamenar at 202-588-0302. WLF's brief filed in the case is posted on its website at www.wlf.org.