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A WIN FOR FEDERALISM: KENTUCKY COURT VACATES PUNITIVE DAMAGE AWARD

by

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The United States Supreme Court's recent decision in *State Farm Mutual Automobile Insurance Co. v. Campbell* strengthened constitutional limitations on punitive damage awards. Among other things, the Court held that only in the rarest cases can a punitive damage award exceed a 9:1 ratio to compensatory damages—and in cases where compensatory damages are substantial, even a 1:1 ratio “can reach the outermost limit of the due process guarantee.” 538 U.S. 408, 425 (2003).

The Court also recognized that the Constitution imposes *territorial* limitations on punitive damage awards. “A basic principle of federalism is that each State may make its own reasoned judgment about what conduct is permitted or proscribed within its borders, and each State alone can determine what measure of punishment, if any, to impose on a defendant who acts within its jurisdiction.” *Id.* at 422.

The Court's clarification of the ratio guidepost has received considerable attention, and many lower courts have reduced punitive damage awards in accordance with *State Farm's* mandate. But the Court's discussion of federalism—and its explicit recognition that States generally cannot reach beyond their borders to punish conduct occurring in other States—may prove equally significant in future punitive damage cases, as shown by a recent decision of the Kentucky Supreme Court.

Sand Hill Energy, Inc. v. Ford Motor Co. involved a wrongful death claim against Ford based on an alleged design defect in the transmission of a 1977 model-year pickup truck. The Kentucky Supreme Court upheld \$15 million of a \$20 million punitive damages jury award. *See* 83 S.W.3d 483 (Ky. 2002). Ford petitioned the United States Supreme Court for certiorari, and while its petition was pending, the Court issued its ruling in *State Farm*. The Court then granted Ford's petition and remanded the case to the Kentucky court for reconsideration in light of the new constitutional standards.

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On remand, the Kentucky Supreme Court held that the punitive damage award must be vacated in its entirety because the jury was allowed to consider evidence of Ford's out-of-state conduct. *See* 142 S.W.3d 153 (Ky. 2004).

The jury heard lengthy testimony about the number of vehicles Ford sold nationwide that contained the purportedly defective transmission. It also received evidence about reports of allegedly similar incidents that had occurred throughout the country, as well as the number of persons who had been killed in such incidents. In closing arguments, plaintiff's counsel told the jury that "we have to make them pay" and emphasized the number of supposedly defective transmissions that were "on the road" in all fifty States. The combined effect of this argument and evidence made it "clear that the jury was encouraged to punish Ford for its conduct throughout the country." *Id.* at 157.

Despite counsel's urging the jury to punish Ford on a nationwide basis, the trial court failed to instruct the jury on the constitutional prohibition against extraterritorial punishment. The Kentucky Supreme Court concluded that this omission violated *State Farm*, where the United States Supreme Court had "expressed particular concern over the evidence of State Farm's out-of-state/extraterritorial conduct" and had held that "[a] jury *must* be instructed . . . that it may not use evidence of out-of-state conduct to punish a defendant for action that was lawful in the jurisdiction where it occurred." *Id.* at 156 (quoting 538 U.S. at 422) (emphasis added).

Because the jury was not told of the territorial limitations on punitive damage awards, the court vacated the award and remanded for a redetermination of punitive damages. It recommended that the jury be instructed on remand that "you must not use out-of-state evidence to award the [plaintiff] punitive damages against Ford Motor Company for conduct that occurred outside Kentucky." *Id.* at 167.

The court also warned against admitting evidence of Ford's financial condition. *State Farm* "frowned upon" the admission of wealth evidence because it increases the risk that juries will use their verdicts to express biases against big businesses, particularly in cases where an out-of-state defendant lacks a strong local presence. Wealth evidence is also inappropriate as a matter of Kentucky law, which has long recognized that "[t]he tendency of this [evidence] would be to lead the jury to consider chiefly the pecuniary condition of the defendant, rather than the enormity or wantonness of the act for which punitive damages might be allowed." *Id.* (quotation omitted).

The *Sand Hill* case is important because it demonstrates that *State Farm* does not simply limit the permissible *amount* of punitive damage awards. It shows that *State Farm* also restricts, as a matter of federal constitutional law, the types of evidence and arguments that can provide a predicate for punishment. A State's power to impose punitive damages is limited to vindicating its interest in protecting its own consumers and its own economy. Punitive damages cannot be used to punish or regulate extraterritorial conduct that has no impact on the State's citizens. Nor can punitive damages be used as a way of "sending a message" across the country in order to implement the State's preferred policy choices nationwide. *State Farm* further recognizes that a defendant's wealth cannot be used to inflate a punitive damage award. Indeed, the admission of such evidence greatly increases the risk of juror bias, and makes possible the sort of improper "make them pay" arguments that occurred in *Sand Hill*.

By clarifying the types of evidence and arguments that can be considered in assessing punitive damages, *State Farm*—and the Kentucky Supreme Court's decision in *Sand Hill*—will help ensure that trial courts and juries respect these constitutional limits.