Net worth punitive damages issue
By Dave Holmes

A little over a year ago, in *State Farm Mutual Automobile Insurance Co. v. Campbell*, 538 U.S. 408 (2003), the United States Supreme Court reversed an award of $145 million in punitive damages entered against State Farm where the compensatory damages award was $1 million. The Court held that the punitive damages award was neither reasonable nor proportionate to the wrong committed, and it was thus an irrational, arbitrary, and unconstitutional deprivation of the property of the insurer. The Court reviewed several guideposts for a trial court to consider in determining whether a punitive damage award is reasonable. These were reviewed in detail in our Spring 2003 newsletter.

One issue that the *State Farm* Court touched on was whether a defendant’s net worth is a legitimate factor to be considered by a jury considering an amount to award in punitive damages. The Court held that reference to the assets of State Farm had little to do with the actual harm sustained by the Campbell’s. The Court stated: “The wealth of a defendant cannot justify an otherwise unconstitutional punitive damages award.” The Court then noted, however, that while “[w]ealth provides an open-ended basis for inflating awards when the defendant is wealthy that does not make its use unlawful or inappropriate; it simply means that this factor cannot make up for the failure of other factors, such as reprehensibility, to constrain significantly an award that purports to punish a defendant’s conduct.”

Since *State Farm* was decided on April 7, 2003, few courts have considered the issue of when net worth can appropriately be considered in a punitive damages claim. One court from the Seventh Circuit Court of Appeals in Chicago recently held that a defendant’s wealth is not a sufficient basis for awarding punitive damages. *Mathias v. Accor Economy Lodging, Inc.*, 347 F.3d 672 (7th Cir. 2003). In *Mathias*, the court held that if wealth was a sufficient basis for awarding punitive damages, this would be discriminatory and would violate the rule of law by making punishment depend on status rather than conduct. The court found, however, that wealth was relevant to the case because it was an indication of the resources that enabled the defendant to mount an extremely aggressive defense which would make it more difficult for plaintiffs to find a lawyer to handle their case that involved only modest stakes.

Another issue that arises in the net worth context is how net worth should be computed. The court in *Mathias* noted that net worth is not the correct measure of a corporation’s resources. It found that net worth was simply an accounting artifact that reflects the allocation of ownership between equity and debt claimants, noting that a firm financed largely by equity investors has a large net worth while the identical firm financed largely by debt may have only a small net worth because it would be treated as a liability.

Whether net worth is determined by stock value or book value may have a significant impact on the net worth figure. The stock value may be significantly greater than the book value. Courts have considered whether net worth should be determined by stock value or book value in the context of claims brought under the Fair Debt Collection Practices Act. That Act provides that “in the case of a class action the total recovery shall not exceed the lessor of $500,000 or one percentum of net worth of the debt collector.” The Fair Debt Collection Practices Act does not define net worth. In attempting to determine the ordinary and plain meaning of net worth, the court in *Sanders v. Jackson*, 209 F.3d 998 (7th Cir. 2000), concluded that net worth means assets minus liabilities. Therefore, the court held that book value rather than stock market value is the appropriate measure of determining net worth.

Whether net worth will be admissible to prove an amount of punitive damages will depend upon the facts of the case. Defendants should argue that net worth is not relevant, but if it is going to be admitted, net worth should be determined by book value rather than market value.

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