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Punitive Damages and California Employment Law

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California law authorizes punitive damages to punish and discourage “oppression, fraud, or malice.” Courts have explained that punitive damages are “an expression of moral condemnation” for conduct done with “willful and conscious disregard of the rights or safety of others” or “despicable” conduct.

Plaintiffs asserting employment law-based tort claims, such as for discrimination or harassment under the Fair Employment and Housing Act, wrongful termination in violation of public policy, fraud, or defamation, may seek punitive damages. But the courts will not award punitive damages merely because a defendant employer is found liable for tortious conduct. The California Court of Appeal, in Scott v. Phoenix Schools, Inc., recently clarified the distinction between liability for wrongful termination and the malice required for punitive damages.

Scott v. Phoenix Schools

In Scott, a parent brought her two-year-old daughter to a nursery school for a tour. She later complained that the school’s director, Scott, had not been welcoming and suggested the school was full. At a later visit, a different school staffer said there was plenty of room for the child and encouraged her to enroll soon. (The parent’s complaint implied that Scott was biased against Spanish-speaking children.)

The school fired Scott for failing to enroll the two-year-old. The ex-director explained she did not enroll the child was because she did not have enough teachers at the school to meet the state-mandated minimum staffing ratios in the classroom, even if there were

unfilled student slots in the “Ladybug” classroom for two-year-olds.

The jury agreed with Scott, finding she had been fired for her efforts to comply with the minimum staffing ratios. She was awarded over \$1 million in lost wages and emotional distress, and another \$750,000 in punitive damages. The school disputed whether it even knew the Ladybugs classroom was understaffed, and therefore could not have fired the director for trying to meet the staffing ratios (arguing instead that her failure to make the parents feel welcome was reason enough to fire her). Even so, the Court of Appeal found there was enough evidence for the jury to find that the employer was motivated to fire the director for insisting on following the staffing ratios.

However, the evidence was not sufficient to require the employer to pay punitive damages. To recover punitive damages against a corporation, the plaintiff must establish the corporation’s officers, directors or managing agents acted with “malice” within the meaning of Civil Code Section 3294. “Malice” is defined in part as “despicable” conduct. “Despicable conduct,” the Scott court explained, is “so vile, base, contemptible, miserable, wretched, or loathsome that it would be looked down upon and despised by ordinary decent people.”

In Scott, “the only evidence of wrongful conduct directed at [the ex-director] was her termination for an improper reason.” After considering a series of employment law cases that awarded punitive damages to plaintiffs, the court found that each contained an element of despicable conduct over and above the discharge itself. Therefore, it held that “wrongful termination, without more,

will not sustain a finding of malice or oppression.”

Sufficient Malice or Oppression

The court in Scott noted an earlier decision in Smith v. Brown-Forman Distillers Corp. There, the plaintiff believed his employer repeatedly asked him to violate the law by requiring him to provide free labor to retailers of his employer’s liquor. The employer’s management did nothing to investigate whether or not the practice violated alcoholic beverage control laws, and gave the employee the choice of performing the work or being fired. The court of appeal upheld the jury’s award of punitive damages.

Similarly, in Stephens v. Coldwell Banker Commercial Group, the plaintiff prevailed on an age discrimination claim. The court upheld a punitive damages award. The court noted that the plaintiff’s manager concocted a series of negative performance evaluations to justify terminating the plaintiff for false reasons.

In contrast, the defendant employer in Scott terminated the plaintiff’s employment. But it did not engage in any abusive or fraudulent conduct to accomplish the discharge. The jury found it was more likely than not that the discharge violated public policy. The court of appeal merely recognized that punitive damages require significantly egregious conduct, and clear and convincing evidence of same. Therefore, the court held, punitive damages are not automatically justified based on a finding of wrongful termination.

Managing Agent

Corporations are considered separate legal entities, but they obviously need

human beings to carry out their activities. The law recognizes that corporations cannot automatically be held responsible for punitive damages when lower-level employees commit legal wrongs. For the corporation to be held liable, a corporate “officer, director, or managing agent” either must perpetrate or ratify the required “malice, oppression or fraud.”

Officers and directors are not involved in many day-to-day decisions. Liability for punitive damages most often turns on whether a “managing agent” authorized or ratified tortious conduct. The California Supreme Court explained in White v. Ultramar that managing agents are “employees who in fact exercise substantial authority over decisions that ultimately determine corporate policy.” A supervisor or low-level manager with the power to hire or fire is not a managing agent. However, a regional manager who oversees a substantial portion of the employer’s operations may be. The key issue will be how much discretion the manager possesses and whether that discretion affects operations as a whole.

A lower-level employee’s misconduct may trigger punitive damages liability if a “managing agent” ratifies the misconduct. For example, in Gober v. Ralphs Grocery Co., several employees recovered damages because of a store manager’s repeated misconduct. The court determined the store manager was not a “managing agent.” However, the district manager, who had authority over several stores, transferred the store manager to a new store rather than firing him. Because the district manager was a managing agent, his failure to take sufficient action against the store manager was adequate to impose liability on the corporation.

Calculating Punitive Damages

The jury is permitted to set an award of punitive damages. However, the court must review the award to ensure it complies with constitutional requirements of due process. The U.S. Supreme Court in a series of cases has held that excessive punitive damage awards are unconstitutional under the Fourteenth Amendment’s Due Process Clause.

A reviewing court analyzes three primary factors: (1) the degree of reprehensibility of the defendant’s misconduct; (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award; and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases.

The U.S. Supreme Court and the California Supreme Court have recognized that punitive damages awards that are more than 9 or 10 times the amount of actual damages will rarely be constitutional. The higher the compensatory damages award, the more likely the court will strike down a high ratio of punitive to actual damages. In addition, the courts must consider the defendant’s financial condition so the award does not destroy the defendant.

Very few published California court decisions have applied these limits on punitive damages to employment law. In the Gober case, a jury awarded each plaintiff \$5 million in punitive damages. The court of appeal struck down the awards, which ranged from 25 to 100 times the plaintiffs’ respective actual damages. After considering the evidence, the court held that the

maximum award permitted under the constitution would have been 6:1. The facts in Gober were fairly egregious. Therefore, the constitutional maximum could well be lower in other cases. However, courts in unpublished decisions have relied on Gober to approve 6:1 ratios in a few employment law cases.

Preventing Punitive Damages Liability

As discussed above, punitive damages will be imposed only when higher-level management engages in egregious conduct, or approves of lower-level employees’ misconduct. The best way to avoid punitive damages liability is to ensure upper management reacts appropriately to supervisors’ and lower-level employees’ misconduct. Upper management – managing agents – by definition set and influence corporate policy.

Proper anti-discrimination, harassment and retaliation policies, and effective complaint resolution procedures, go a long way towards guiding senior management’s actions. In fact, the U.S. Supreme Court has held that effective anti-discrimination policies implemented in good faith may be asserted as a defense to punitive damages liability under federal anti-discrimination law. The California courts have not yet adopted that view, although the California Supreme Court appeared to endorse it in White v. Ultramar, Inc., discussed above. Nevertheless, strong policies, and upper management’s demonstrated commitment to enforce them, will go a long way toward preventing a punitive damages award.

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