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California Supreme Court Slashes Punitive Damage Award in Employment Case

BY KATHERINE C. HUIBONHOA AND AMY C. HIRSH

In *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408 (2003), the United States Supreme Court took up the gauntlet against runaway punitive damage awards, warning that punitive damages are a "powerful weapon" that pose an "acute danger of arbitrary deprivation of property" in contravention of the Due Process Clause of the Fourteenth Amendment. In a pair of cases — *Simon v. San Paolo U.S. Holding Co., Inc.*, 35 Cal. 4th 1159 (2005) and *Johnson v. Ford Motor Co.*, 35 Cal. 4th 1191 (2005) — the California Supreme Court recognized that *State Farm* "tightened the noose considerably" around "the problem of . . . punitive damages awards run wild" and made clear that all punitive damages awards must pass independent federal constitutional review. On November 30, 2009, the California Supreme Court in *Roby v. McKesson Corporation* took another significant step to rein in massive punitive damage awards, this time in the context of a disability discrimination and harassment case. In a 5-2 decision, the Court slashed the punitive damages awarded to Plaintiff Charlene J. Roby from $15 million to $1.9 million.

On a more cautious note for employers, in a unanimous portion of the *Roby* opinion, the Court held that evidence of discrimination may also support a harassment claim under the California Fair Employment and Housing Act ("FEHA"). In doing so, the Court not only declined an opportunity to reinforce the distinction between discrimination and harassment it had drawn in *Reno v. Baird*, 18 Cal. 4th 640 (1998), and affirmed in *Jones v. The Lodge at Torrey Pines*, 42 Cal. 4th 158 (2008), but arguably muddled it some.

This Client Alert discusses these aspects of the *Roby* case and the implications for California employers.

I. The Decision in *Roby*

A. Case Background

McKesson is a distributor of pharmaceutical and health care products. Plaintiff Roby worked for McKesson from 1975 until her termination in 2000. At the time of termination, Roby worked as a customer service liaison at a local distribution center.

In 1997, Roby began experiencing panic attacks. This condition caused Roby to incur absences under McKesson's attendance policy, which required 24-hour advance notice for all absences, including medical absences. In addition, the medication that Roby took for her condition caused her to have unpleasant body odor and to develop a nervous disorder which caused her to dig her

fingernails into the skin on her arms, producing open sores. Roby claimed that her supervisor, Karen Schoener, made negative comments about Roby's body odor and called her "disgusting" because of her arm sores and excessive sweating, and openly ostracized Roby in the office.

Roby eventually was terminated for excessive absenteeism and sued McKesson for wrongful termination, failure to accommodate, and disability-based harassment and discrimination. Roby also sued Schoener personally for disability harassment. Following trial, the jury found in favor of Roby and ordered McKesson to pay $2.8 million in compensatory damages and $15 million in punitive damages. The jury also found Schoener was liable for $500,000 in compensatory damages and $3,000 in punitive damages. The trial court later denied defendants' motion for a new trial and for judgment notwithstanding the verdict, and the parties appealed.

The Court of Appeal reversed the jury's harassment finding, citing *Reno v. Baird*, and reasoning that most of the alleged harassment involved "commonly necessary personnel management actions . . . [which] do not come within the meaning of harassment." The court accordingly reduced the award of compensatory damages against McKesson to $1.4 million. The court also found that the $15 million punitive damage award was unconstitutionally excessive, and reduced it to $2 million.

The California Supreme Court granted review on three issues, one of which involved whether the punitive damages award exceeded the federal constitutional limit. The Court also granted review as to whether the Court of Appeal erred in allocating Roby's evidence between her harassment claim and her discrimination claim, and based on that allocation, in finding insufficient evidence to support the harassment verdict.

B. Punitive Damages

The Court in *Roby* reiterated that due process considerations place constraints on state court awards of punitive damages. The Court reviewed the now-familiar *State Farm* "guideposts" for reviewing punitive damages: (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 (*i.e.*, proportionality); and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases. Based on its analysis of these guideposts, the Court in *Roby* concluded that a one-to-one ratio between compensatory and punitive damages was appropriate. The Court thus remanded the case and directed the Court of Appeal to reduce the punitive damage award from $15 million to $1.9 million.

1. Degree of Reprehensibility

The Court found McKesson's conduct to be at the "low end" of the reprehensibility scale. On the one hand, the Court found that the harm to Roby was physical in that it affected her emotional and mental health, and was not purely economic. The Court also found that it was "objectively reasonable to assume that McKesson's acts of discrimination and harassment toward Roby would affect her emotional well being," and thus was conduct that "evinced an indifference to or a reckless disregard of the health or safety of others." Moreover, Roby was financially vulnerable as a relatively low-level employee who had depleted her savings and lost her medical insurance as a result of her termination.

On the other hand, however, the Court found that McKesson was not a recidivist. Instead, McKesson's wrongdoing with regard to the discrimination claim was limited to its one-time decision to adopt an attendance policy that, in requiring 24-hour advance notice before an absence, might not reasonably accommodate employees with certain disabilities or medical conditions. The Court concluded that McKesson's act of discharging Roby was simply an application of that attendance policy. Regarding the harassment claim, McKesson's failure to take prompt corrective action when Roby complained likewise constituted only a single event of corporate misconduct.

The Court also found that, though McKesson acted with "conscious disregard" of the rights of others, it did not act with "intentional malice." The evidence did not suggest that McKesson adopted its attendance policy to discriminate, but to enable supervisors to plan for adequate staffing. Nor did the evidence suggest that McKesson's managers acted with "oppression, fraud, or malice" warranting an award of punitive damages, especially in light of the facts that Roby had missed work without notice 11 times in a period of about 15 months, that she had never requested FMLA leave, and that her reports about her condition lacked specificity about accommodations she might need.

Significantly, the Court reversed the Court of Appeal's finding that Schoener was a managing agent. Schoener worked in a local distribution center supervising four of McKesson's over 20,000 employees. She did not have "discretionary authority" over "formal policies that affect a substantial portion of the company and that are the type likely to come to the attention of corporate leadership." The Court went on: "It is this sort of broad authority that justifies punishing an entire company for an otherwise isolated act of oppression, fraud, or malice."

2. Proportionality Between Harm and Punitive Damages, and Comparable Penalties

The Court further found that the second and third guideposts of the *State Farm* analysis weighed in favor of a lower constitutional limit. With respect to the second guidepost, the Court held that the significant compensatory damage award of $1.9 million — $1.3 million of which was for physical and emotional distress — likely "reflected the jury's indignation at McKesson's conduct" and thus included a punitive component. The Court noted that the Supreme Court in *State Farm* suggested that a one-to-one ratio might be the constitutional limit in a case involving relatively low reprehensibility and a substantial award of noneconomic damages. Regarding the third guidepost, the Court observed that the civil fines under the FEHA could not exceed $150,000, "[o]bviously" favoring a lower constitutional limit.

C. Allocating Evidence of Discrimination and Harassment

In determining whether the Court of Appeal erred in finding that Roby's harassment claim lacked evidentiary support, the Court revisited the distinction between discrimination and harassment that it first set forth in *Reno v. Baird*. The Court reviewed that *discrimination* concerns "official action taken by the employer" (such as hiring, firing, promotion, etc.), while *harassment* does not involve the official exercise of personnel management authority properly delegated by an employer. Harassment, explained the Court, instead focuses on situations in which the "social environment of the workplace becomes intolerable because the harassment (whether verbal, physical, or visual) communicates an offensive message to the harassed employee."

However, the Court went on to state that some official personnel management actions may also have the secondary effect of communicating a hostile message when the actions establish a widespread pattern of bias, and therefore can be evidence of harassment. For this holding, the Court relied heavily on *Miller v. Department of Corrections*, 36 Cal. 4th 446 (2005), in which it held that the demeaning message conveyed by widespread sexual favoritism — in the form of official employment actions, including promotions and favorable job assignments given to female employees involved in sexual relationships with a particular male supervisor — gave rise to an actionable hostile work environment claim on behalf of the plaintiffs, who were not subject to any demands for sexual favors.

The Court did not purport to retreat from *Reno*, and in fact reasoned that its interpretation of *Miller* was wholly consistent with *Reno*. It stated: "*Miller* . . . makes clear that in some cases, the hostile message that constitutes the harassment is conveyed through official employment actions, and therefore evidence that would otherwise be associated with a discrimination claim can form the basis of a harassment claim" and thus held that "there is no basis for excluding evidence of biased personnel management actions so long as that evidence is relevant to prove the communication of a hostile message." As such, concluded the Court, a plaintiff can prove discrimination and harassment under the FEHA with the same (or overlapping) evidentiary presentations.

II. What *Roby* Means for California Employers

Roby is ammunition for employers seeking to reduce punitive damage awards. Not only does *Roby* effectively endorse a one-to-one compensatory to punitive damages ratio ceiling where there is a significant compensatory damage award, but it does so in the context of an employment discrimination and harassment case. Moreover, employers will find the "managing agent" discussion in *Roby* helpful to avoid the imposition of punitive damages in the first instance or to reduce an award.

Roby's analysis regarding what type of evidence can support a harassment claim is of some concern. At a minimum, the Court did not take the opportunity — as several *amici* had urged — to further brighten the line between discrimination and harassment first set forth in *Reno* and recently affirmed in *Torrey Pines*. While *Roby* left intact the principles of *Reno*, employees who seek to characterize as harassment conduct that should be attacked (if at all) as discrimination may find some support in *Roby*. We flag at least three specific concerns for employers going forward.

First, employees often confuse unwelcome supervision with harassment, and *Roby* arguably opens a crack in the door that *Reno* shut. Subjecting supervisors to the threat of litigation for every unpopular management decision, as *Reno* recognized, will impede effective management. Employers should not be forced to make difficult choices between disciplining an employee and facing a threat of harassment liability, or ignoring a situation and facing an unpleasant and unproductive work environment. *Roby* did not provide any specific guidance, which could make this slippery slope even more slippery. For example, though Roby's discrimination claim sought compensation for "official actions" (*e.g.*, termination, disciplinary warnings, reassignment), the Court apparently concluded without explanation that these actions somehow created an offensive message evidencing *harassment*. (The Court of Appeal had considered much of the same evidence and found no actionable harassment). It remains to be seen how lower courts will apply *Roby*'s harassment/discrimination evidentiary holding in practice.

Second, *Roby* may encourage plaintiffs to restyle their discrimination claims as harassment claims so that they may name individual supervisors as defendants, thereby avoiding federal diversity jurisdiction. This gives plaintiffs further incentive to name individual defendants for purely tactical or emotional reasons. Out-of-state employers thus may have more difficulty removing cases to federal court, and cases in federal court on diversity grounds may be more susceptible to remand.

Third, a potential expansion in the scope of personal liability for harassment claims may result in increased transaction costs for employers who should retain separate counsel for individual supervisors sued for harassment. When a plaintiff sues both his or her employer and supervisor, conflicts of interest frequently prevent joint representation of the codefendants. As a result, defendant employers may be required to spend greater amounts on attorney's fees. Similarly, because an employer must indemnify an employee for his or her attorney's fees and costs if the employee is sued for acts within the scope of employment (such as personnel management actions), *Roby* may increase indemnity disputes between individual supervisors and employers, thus further increasing transaction costs.

Employers are advised to thoroughly review and document any proposed personnel management action and take steps to ensure an independent review of the action before it occurs. In addition, employers are advised to review anti-harassment and anti-discrimination policies with supervisors on a regular basis.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

Los Angeles

Heather A. Morgan
213-683-6188
heathermorgan@paulhastings.com

Palo Alto

Maureen E. O'Neill
650-320-1811
maureenoneil@paulhastings.com

San Francisco

Kathy Huibonhoa
415-856-7035
kathyhuibonhoa@paulhastings.com

Orange County

James P. Carter
714-668-6206
jamescarter@paulhastings.com

San Diego

Ray W. Bertrand
858-458-3013
raybertrand@paulhastings.com