



Case Study

“Potential Damages” Used to Determine Constitutionality of Punitive Damages Award

— by Jeffrey D. Eberhard

The Oregon Court of Appeals recently handed down an opinion dealing with a punitive damages award and the type of calculation that should be used to determine whether it was so excessive that it violated the U.S. Constitution. In Vasquez-Lopez v. Beneficial Oregon, Inc., --- P.3d ---, WL 294116 (Or. App. January 31, 2006), the plaintiff, a non-English speaking immigrant from Mexico, purchased an Oregon home in 1996. After a 1999 refinance, he obtained a loan with an annual interest rate of 7% and a monthly payment of \$612. In 2000, the plaintiff met with a Beneficial representative and obtained a second mortgage to pay off debt and make home improvements. The annual interest rate on that second mortgage was 23.23%. Months later, the Beneficial representative contacted plaintiff and, communicating with him entirely in Spanish, advised that he could refinance plaintiff's first mortgage and consolidate it with the high interest second. Based on the Beneficial

Claims Pointer

When determining the constitutionality of a punitive damages award, one factor courts consider is the ratio between compensatory damages and the punitive damages award. Compensatory damages, for the purposes of this ratio, has been held to be the amount of “potential damages” likely to result from the defendant's conduct rather than the actual damages caused by it. However, the court's reasoning is suspect and should not survive further appeal.

representative's representations, plaintiff believed that the interest rate would be lower than the rate he was then paying on the existing mortgages and that his new monthly payment would remain the same. As it turned out, the annual interest rate of the new loan was 12.987%, and the monthly payment was \$1,212.

Plaintiff filed suit against Beneficial for fraud. At trial, the jury awarded him \$26,639 in economic damages, \$5,000 in non-economic damages and \$500,000 in punitive damages. Arguing that a punitive damage award of such magnitude was unconstitutional, Beneficial moved the trial court to reduce the punitive damages to \$100,000. The court

allowed a partial reduction after applying standards set out in the U.S. Supreme Court case State Farm Mut. Automobile Ins. Co. v. Campbell, 538 US 408 (2003), which instructs that “few awards exceeding a single digit ratio*** will satisfy due process” and that a punitive damages award “of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety.” In this case, the trial court's reduced award was about 7.5 times the amount of the actual compensatory damages that plaintiff suffered. Beneficial appealed, arguing that the 7.5 to 1 ratio remained excessive. Plaintiff cross-appealed, arguing that the jury's whole award of \$500,000 was not excessive under any standard.

The Court of Appeals noted that under State Farm, when considering whether a punitive damages award is “grossly excessive”, one factor courts are to consider is the “disparity between the actual and potential harm suffered by the plaintiff and the punitive damages award.” In this case, the court found that plaintiff's potential damages would have been the total amount of interest that Beneficial would have earned over the life of the refinance loan (approximately \$326,752). Using that figure, the jury's award of \$500,000 in punitive damages was only 1.5 times the potential damages amount. Therefore, the trial court erred when it reduced the jury's award.

It is worth mentioning that it appears that the defendant in this case did not submit an alternative to plaintiff's calculation of “potential damages” (i.e. the \$326,752 total interest over the life of the new loan). Therefore, the court accepted plaintiff's figure without much discussion. However, in future cases, defendants would be wise to argue for at least two downward adjustments to this figure. First, defendants should argue that the total combined interest that would have accrued under plaintiffs' original loan(s) should be offset from the “potential damages.” Secondly, defendants should ask the court to apply a further reduction to account for the present value of money. ❖