IN THE SUPREME COURT OF THE STATE OF OREGON

EVERGREEN WEST BUSINESS CENTER, LLC, an Oregon limited liability company,
Plaintiff-Respondent
Cross-Appellant,
Petitioner on Review,
v.
TERRY W. EMMERT,
Defendant-Appellant
Cross-Respondent,
Respondent on Review,
And
PREMIER WEST BANK,
Impartial.
S061049 (Control)

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Plaintiff-Respondent
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S0611158

PETITIONER TERRY W. EMMERT'S OPENING BRIEF ON THE MERITS

On Review from a decision of the Court of Appeals on appeal from a judgment of the Circuit Court of Clackamas County, Honorable Jeffrey S. Jones
Opinion Filed December 27, 2012

Author of Opinion: Schuman, P.J.
Concurring Judge: Armstrong
Dissenting and Concurring (on other issue): Wolheim

August 2013

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I. LEGAL QUESTIONS PRESENTED ON REVIEW

When reviewing a punitive damage award in a case where a jury has found only nominal damages of $1.00, may the trial court depart from the 4:1 ratio analysis announced in *Goddard v. Farmers Insurance Co.*, 344 Or 232, 179 P3d 645 (2008) without first making a specific finding that the conduct giving rise to the punitive damages award was "particularly egregious?"

Should the review procedures applied by the trial court reasonably assure that a defendant whose conduct has caused only nominal actual damage will not be required to pay a significantly higher amount of punitive damages than a similarly situated defendant who causes significantly higher actual damages? In other words should this court articulate a procedure to assure that defendants whose conduct causes only nominal damage are not punished more severely than defendants whose similar conduct causes greater economic harm?

In a case involving only economic harm where there is no threat or possibility of physical injury or violence, is a ratio between punitive damages and actual damages of 600,000:1 unconstitutionally excessive and a violation of due process as a matter of law, regardless of the reprehensibility of the defendant's conduct?

II. PROPOSED RULES OF LAW

In a case where there is only economic damage and the amount of damages is $1.00, the amount of punitive damages awarded may not exceed the 4:1 ratio unless the defendant's conduct is "particularly egregious."

If the defendant's conduct is found to warrant a departure from the 4:1 ratio, the punitive damages awarded may not exceed the amount of punitive damages that could be awarded had the damages not been relatively small. Alternatively, the maximum amount of punitive damages may be established by reference to the maximum allowable civil fine for analogous conduct.

In a case where there is only economic harm and there is no threat or possibility of physical injury or violence, a ratio of punitive damages to actual damages of 600,000:1 is unconstitutionally excessive and violates due process as a matter of law.

III. NATURE OF THE ACTION

Plaintiff Evergreen West Business Center, LLC ("LLC") sued Mr. Emmert seeking damages for an alleged breach of fiduciary duty. Plaintiff also sought alternative relief in the form of a constructive trust. Plaintiff's complaint asserted that Mr. Emmert agreed to provide financial assistance to the LLC in order to forestall the scheduled foreclosure of a note and trust deed by which the LLC had acquired a loan to purchase and develop property. The complaint also alleged that Mr. Emmert agreed to obtain a new development loan on behalf of the LLC. Instead, the complaint alleged, Mr. Emmert purchased the note and trust deed, foreclosed on the property, and purchased the property for himself.

IV. RELIEF SOUGHT IN THE TRIAL COURT

The LLC sought money damages from Mr. Emmert measured by the amount Mr. Emmert profited from purchasing the LLC's property. In the alternative, it sought an order requiring the property to be sold and imposing a constructive trust on certain proceeds received from the sale of the property. The jury returned a verdict finding that Mr. Emmert had breached his fiduciary duty to the LLC. It found he was liable for $1.00 in actual damages and $600,000 in punitive damages. Upon Mr. Emmert's motion, the trial judge reduced the punitive damage award to $4.00. Upon the LLC's motion, the trial judge imposed a constructive trust on the property, ordered the LLC to sell the property and pay Mr. Emmert the first $613,979.49 from the sale.

V. NATURE OF THE JUDGMENT

The LLC decided it preferred the constructive trust remedy to a money judgment for $5.00. It elected the equitable remedy. The trial court then entered a general judgment ordering the LLC to sell the property and pay proceeds from the sale in the amount of $613,979.49 to Mr. Emmert.

VI. STATEMENT OF MATERIAL FACTS

This court is obligated to state the facts in the light most favorable to the plaintiff LLC because the LLC was the prevailing party at trial. *Hamlin v. Hampton Lumber Mills, Inc.*, 349 Or 526, 528, 246 P3d 1121 (2011). This statement of material facts will follow that admonition.

LLC was formed to purchase land and develop a small business park. Tr. 139. Terry Emmert was one of four original members of the LLC. He was asked to become a member of the LLC because of his financial strength and the other members' financial positions could not support a loan of the size needed to purchase the property and develop the business park. Mr. Emmert held 1/3 of the membership interests directly and another 1/12 of the interests indirectly as the 50% owner of Builder's Inc., a member of the LLC that was a corporation. Tr. 145-146. The LLC was managed by one of its members, Brad Taggart. Mr. Taggart held 1/6 of the membership interests directly and another 1/12 of the interests indirectly as the other 50% owner of Builder's Inc. *Id.*

In early 2004, LLC was running out of money needed another loan to continue its development work and pay off the existing bank loan. Tr. 161 – 162. As manager, it was Mr. Taggart's responsibility to handle all financial affairs of the LLC, including arranging financing. Ex. 2. Throughout 2004, Mr. Taggart attempted to locate alternative financing for the LLC. Tr. 161 – 171. The original lender, West Coast Bank, began to threaten foreclosure. It notified

LLC that it would hold a foreclosure sale in August 2004. Tr. 179. The bank then moved the foreclosure date to September 15, 2004. Id. At Mr. Taggart's request, Mr. Emmert paid West Coast Bank $50,000 get the bank to postpone the foreclosure sale another 30 days to October 15, 2004. Tr. 170 – 173, 179. The reason for the extension was to get more time to try to arrange take out financing through Premier West Bank. Tr. 165 – 166. Mr. Emmert waited until the eve of foreclosure to pay the $50,000.00 to forestall the September foreclosure. Tr. 179-180. At that point, no loan could have been made because Evergreen was administratively dissolved as of August 2004 and the bank would not loan to an administratively dissolved LLC. (Tr. 84-88, 452-453)

Had Mr. Emmert not stepped in and paid the foreclosing bank $50,000 on behalf of LLC, the bank would have foreclosed on the property in September 2004. Tr. 173, 180, 189-190. Nothing in the Evergreen Operating Agreement (Ex. 2) or Oregon statutes (ORS 63.001 et seq.) would have prohibited Mr. Emmert from purchasing the property at a foreclosure sale.

Mr. Emmert had personally guaranteed the West Coast Bank loan on the subject property. Mr. Emmert had been notified that the bank would look only to him to repay the loan. Ex 112. Mr. Emmert began discussing the possibility of purchasing the note and trust deed from West Coast Bank in early September 2004. Tr. 182. Mr. Emmert did not tell Mr. Taggart that he was discussing the possibility of purchasing LLC’s note and trust from West Coast Bank and foreclosing on the property himself. Tr. 173 – 174, 577 – 578.

By October 14, the day before the scheduled foreclosure, and the date upon which Mr. Emmert purchased the note and trust deed from West Coast Bank, it was apparent that LLC could not possibly have redeemed the property from foreclosure status. Tr. 182, 566-568. LLC lost the property because it failed to make payments to the bank and was dilatory in seeking financing, all obligations of the manager of the LLC, (Tr. 176-204, Tr. 407-454), not because of anything Mr. Emmert did or failed to do. Mr. Emmert did not disclose to LLC members that he had purchased the note and trust deed, conducted the foreclosure sale, and purchased the property. Tr. 577 – 578.

VII. SUMMARY OF THE ARGUMENT

Before a court can allow a punitive damage award exceeding a 4:1 ratio, it must find that the defendant’s conduct was particularly egregious. Mr. Emmert’s was not particularly egregious and did not, therefore, justify a departure from that ratio.

Even if the court finds that Mr. Emmert’s conduct justifies imposition of punitive damages more than 4 times the amount of the actual damage caused by his conduct, the court may not impose punitive damages in an amount greater than the state could impose by way of civil penalties or fines for similar conduct or the amount of punitive damages that could be imposed had the actual damages been more than “small.”

While the court may under certain circumstances find justification for imposing punitive damages greater than might otherwise be imposed via civil penalties for similar conduct, a ratio of 600,000:1 is a violation of due process as a matter of law and can never be justified.

VIII. ARGUMENT

A. Introduction

In *BMW of North America, Inc. v. Gore*, 517 US 559, 116 S Ct 1589, 134 L Ed 2d 809 (1996), the Supreme Court set forth guideposts to be followed to determine whether a punitive damage award violates due process. The guideposts are: 1) the degree of reprehensibility of the defendant’s misconduct; 2) the disparity between the actual or potential harm suffered and the amount of the punitive damages award; and, 3) the difference between the punitive damages awarded and the civil penalties authorized or imposed in comparable cases. *Id* at 575.

Five years ago, this court issued its seminal opinion in *Goddard* acknowledging the applicability of the *Gore* guidelines to the analysis of punitive damages in this state and announcing a general guideline for cases such as this involving only economic harm. The *Goddard* guideline established that, in general, punitive damages should not exceed 4 times actual damages where there was only economic injury. The court stated:

> With respect to cases ... involving injury to economic interests, our best estimate points to the four-to-one ratio between punitive and compensatory damages that the Supreme Court sometimes has identified as bordering on excessiveness. ***We conclude that, as a very general rule of thumb, the federal constitution prohibits any punitive damages award that significantly exceeds four times the amount of the injured party's compensatory damages, as long as the injuries caused by the defendant were economic, not physical. Of course, ... a higher ratio might be appropriate in unusual circumstances, such as when the economic damages are relatively small in relation to the theoretical injury, where the injury is difficult to detect, where the conduct causes noneconomic harm that is hard to value, or where the conduct is "extraordinarily" reprehensible.

Id. at 260. The court left open the question what "higher ratio" might be acceptable in cases where the jury returned an award of nominal damages.

Three years later in *Hamlin,* the court was presented with the opportunity to begin to flesh out guidelines for the lower courts to follow when reviewing the reasonableness of punitive damages awards where actual damages were a "relatively small $6,000 in lost wages." *Id*. at 538. In *Hamlin*, the court reinstated a punitive damages award of $175,000, finding that a ratio of 22:1 was not grossly excessive given the facts of the case and given the state’s interest in deterrence and retribution. The *Hamlin* dissent argued, however, that the majority opinion ignored Supreme Court guidance when it dropped the requirement that a defendant's conduct must be "particularly egregious" to warrant a departure from the single-digit ratio requirement. The dissent went on to discuss how the court's opinion had left punitive damages awards "open ended" in cases where actual damages were small and how the majority's approach made it possible that defendants whose conduct caused less actual economic damage could be assessed higher punitive damages than defendants whose conduct caused significantly higher economic damage.

The first reported case to attempt to apply the new *Hamlin* approach was *Lithia Medford LM, Inc. v. Yovan*, 254 Or App 307, 295 P3d 642 (2012). In *Lithia,* the court was divided as to how *Hamlin* was to be applied. The six-judge majority held that the “more than minimally reprehensible” conduct of Lithia Motors coupled with possible civil penalties that could be imposed for the same conduct justified a departure from the *Goddard* ratio and found a ratio of 200:1 not “grossly excessive.” Furthermore, the court acknowledged that the state’s interest in deterring and punishing violations of the Unlawful Trade Practices Act provided additional justification to depart from the single digit multiplier established by *Goddard.* In a dissent, four of the ten judges, however, found that because Lithia’s conduct was not exceptionally reprehensible and because applicable civil penalties would be about $25,000, the civil penalty limit should be the cap for punitive damages in the case – a ratio of 10.5:1.

With the Court of Appeals' opinion in this case, the largely theoretical conundrum discussed in Justice Gillette's dissent has now become reality – as long as damages are nominal, the sky is the limit for punitive damages and a mindboggling ratio of 600,000:1 does not offend due process. Oddly, under existing Oregon case law, the less actual damage a defendant may cause, the more he or she may be required to pay in punitive damages. This court needs to clarify and harmonize the confusing and sometimes contradictory standards trial courts are to apply so as to assure that punitive damage awards are not unconstitutionally excessive and proportional.

B. In this case, where actual damages of only $1 were assessed by the jury, the court must find that defendant's conduct was particularly egregious in order to warrant a departure from the *Goddard* 4:1 ratio. Mr. Emmert's conduct does not rise to the level of being particularly egregious.

Gore and State Farm Mut. Ins. v. Campbell, 538 US 408, 425, 123 S Ct 1513, 155 L Ed 2d 585 (2003) both explicitly state that accepted ratios between punitive damages and actual damages may be exceeded only where "a particularly egregious act has resulted in only a small amount of economic damages." *Campbell*, supra at 425, *Gore*, supra at 582. In *Goddard* this court acknowledged the "particularly egregious" exception and added that "extraordinarily reprehensible" conduct as exemplified in *Williams v. Philip*

Morris, Inc. 340 Or 35, 127 P3d 1165 (2006)[1] could also justify exceeding the single-digit ratios established by *Gore and Campbell. Goddard,* supra at 258.

Hamlin purports to add another consideration that can justify departure from the single-digit ratios, that is the state's interest in deterrence and punishment. *Hamlin,* supra at 540. Given the factual context of that case, however, (violation of workplace safety rules and employment statutes) and the court's comment that states "have a particular interest in deterring and punishing conduct that causes its citizens physical harm, evidences a disregard of their health or safety, or takes advantage of their vulnerability," *Hamlin* really seems to be saying that subjecting an employee to dangerous conditions that caused serious physical injury and then using a pretext to refuse to reinstate him, the defendant engaged in particularly egregious misconduct. The applicability of *Hamlin* to this case is questionable because it explicitly justifies the state interest exception by reference to a number of factors all of which to a greater or lesser degree involve more than just economic injury. Nonetheless, by choosing to label the state's interest in deterrence and punishment as a new factor instead of factor to gauge the reprehensibility of misconduct, *Hamlin* has injected ambiguity and confusion into the punitive damage calculus.

[1] *Williams* presented a most unusual situation in which the court allowed a ratio of 159:1 because Philip Morris, "engaged in a massive, continuous, near-half-century scheme to defraud the plaintiff and many others, even when Philip Morris always had reason to suspect -- and for two or more decades absolutely knew -- that the scheme was damaging the health of a very large group of Oregonians -- the smoking public -- and was killing a number of that group." *Williams* at 63.

The confusion caused by *Hamlin* is apparent in the recent court of appeals opinions in *Lithia* (a 6-4 opinion) and this case (2-1 opinion with a judge from the minority in *Lithia* changing sides to write the majority opinion). An affirmative statement from this court that reiterates the clear guidance first articulated in *Gore,* and followed by *Campbell,* and by this court in *Goddard* will clarify what a court must find in order to avoid offending due process. Under existing law, a court must find that a defendant's conduct causing the economic injury was "particularly egregious."

The court of appeals opinion in this case acknowledges that the reprehensibility of defendant's conduct is the single most important indicium of reasonableness. *Evergreen West Business Center, LLC, v. Emmert,* 254 Or App 361, 383, 296 P3d 545, 558 (2012). Yet it proceeds largely to ignore what Mr. Emmert actually did. In assessing the reprehensibility of his conduct one must again go back to *Gore* for an articulation of what five factors should be considered. As with the three *Gore* guidelines mentioned above, *Goddard* adopted the five factors to consider in gauging reprehensibility. *Goddard,* supra at 265. They are: 1) was the harm physical or economic; 2) did the conduct evince an indifference to or a reckless disregard of the health and safety of others; 3) was the target of the conduct financially vulnerable; 4) did the conduct involve repeated actions; and 5) did the harm result from intentional malice, trickery, or deceit.

Of these five factors, only factor number five is clearly applicable. It is arguable that factor number three could be implicated because the LLC was financially vulnerable. What makes the applicability of that factor unclear however are the facts that Mr. Emmert himself was one of the owners, in fact, the largest single owner, and that he was motivated to act not to enrich himself at the expense of the LLC, but rather to protect himself from having to pay on the guarantee he signed to enable the LLC to get the loan in the first place. That may not excuse his failure to disclose what he did to the other members, however, it certainly impacts the analysis of reprehensibility. It is equally important in measuring reprehensibility to consider what was happening to the LLC at the time Mr. Emmert stepped in and purchased the note and trust deed. The court acknowledges in footnote 3 that the property was headed into foreclosure regardless of what Mr. Emmert did. *Evergreen* supra at 383. (The situation is somewhat reminiscent of the interesting philosophical question presented in criminal law classes whether a person who shoots another who is falling to his certain death is guilty of murder.)

One must also keep in mind the context in which this case arose. Mr. Emmert was asked by Mr. Taggart to become a member of the LLC to enable the LLC to carry out its planned purchase and development. He joined the LLC believing that the state statute governing the duties of a member and the operating agreement allowing direct competition amongst the members did not impose any fiduciary obligations on him. Again, this may not excuse his failure to tell his fellow members what he was up to, but it certainly raises a question of just what interest the state may have in imposing penalties upon business people who knowingly choose to create certain legal entities, that are solely a creature of state statute, precisely to avoid the sorts of fiduciary obligations that accompany partnership and other agency relationships.

Accepting as we must that the jury considered Mr. Emmert's conduct deserving of the censure of punitive damages, that alone does not make his conduct so egregious as to warrant a deviation from the *Goddard* ratio. The court erred in finding that because Mr. Emmert's conduct involved intentional malice, trickery, or deceit, it was on par with either Hampton Lumber Mills' misconduct or Lithia Motors' misconduct. Unlike *Hamlin* there was no suggestion that his conduct directly violated statutes or compromised the health, safety, or wellbeing of, or the ability of a former employee to earn a living. Unlike Lithia, there was no lengthy course of conduct, intimidation, lies, and threats of criminal prosecution. Simply stated, Mr. Emmert's conduct while far from exemplary in the eyes of the jury can in no way be labeled "particularly egregious.

C. If the court finds that Mr. Emmert's conduct was so egregious as to warrant a departure from the 4:1 ratio, it must nonetheless cap punitive damages at no more than what civil fines or penalties could be imposed for

similar conduct or the amount that could be imposed under the 4:1 ratio if the actual damages were not small.

The rationale underlying *Gore, Campbell, and Goddard,* is found in the Due Process Clause of the Fourteenth Amendment. First those cases find that due process is implicated because excessive punitive damages do not serve any legitimate purpose and constitute arbitrary deprivation of property. Second, they recognize that sue process requires that a person should be given fair notice of the conduct that may lead to punishment and the severity of punishment that may be imposed. *Goddard,* supra at 251. In order to satisfy these two requirements of due process, that state must be able to tie the level of punitive damages to some known or knowable standard. The third *Gore* guidepost addresses these concerns most directly by looking at the difference between punitive damages and civil penalties that can be imposed in similar cases.

Here the court purported to conduct such an analysis and reached a most peculiar, if not bizarre conclusion. The court admitted that there were no statutes or regulations that would directly prohibit Mr. Emmert's but there were statutes and regulations that were close enough that they provided some guidance. The court looked to ORS 646.607, an unlawful trade practice statute and found that a violation of that statute could be punished by a fine of up to $25,000. It also looked to the securities fraud statutes that would allow fines of up to $20,000 per violation up to a maximum of $100,000 for a continuing violation. Instead of viewing those fines as providing guidance as to the maximum allowable punitive damage award, however, the court used the numbers solely as justification to avoid the 4:1 ratio. It is simply inconceivable in light of the third *Gore* guidepost that the court could somehow reason that notice of a fine of up to $20,000, or $25,000, or even $100,000 (although there was certainly no continuing violation here) could have put Mr. Emmert or anyone else on notice that conduct violating those statutes or similar conduct might result in the imposition of a $600,000 penalty.

Another approach, one suggested by the dissent in *Hamlin*, that could at least arguably satisfy due process requirements would be to look at what maximum amount of punitive damages might be allowed if the actual damages were not nominal or "small." The dissent surmised that the *Goddard* ratio would kick in somewhere around $12,000. *Hamlin*, supra at 548. That would suggest that punitive damages in the amount of $48,000 would be the maximum allowable damages. While a bit higher than what the civil penalty approach would allow, the number is nonetheless several orders of magnitude less than the $600,000 found acceptable in this case.

D. No matter what particular standard the court settles upon to mark the upper limit of a punitive damage award in this case, a ratio of 600,000:1 is a violation of due process as a matter of law and can never be justified.

All courts that have wrestled with the *Gore* guideposts acknowledge that the numerical ratio approach suggested by guidepost number 2 and the ratios that have been offered up under that guidepost are sometimes awkward to administer. But they also acknowledge that the ratio concept ensures that punishment will be reasonable and the amount of punitive damages allowed will be proportional to the amount of harm suffered by the plaintiff. *Hamlin* supra at 546. To completely un-tether the amount of punitive damages allowed from any the anchor of actual damage invites exactly the arbitrary and standardless result reached in this case.

As discussed briefly above, the court paid some heed to guidepost number one by at least mentioning the five factors to be looked at in measuring reprehensibility. Similarly, it went through the motions of comparing what civil penalties could be imposed. But having done both, it was guided by neither. Rather, it concluded that because Mr. Emmert's conduct would fit within at least one aggravating factor and because the punitive damages as reduced by the trial court were less than the maximum civil fines, it was somehow freed from paying any attention to the critically important guidepost of proportionality. By doing so it reached a result that it a blatant violation of due process. The decision of the Court of Appeals must be reversed.

IX. CONCLUSION

The Court of Appeals' decisions reversing the trial court's order reducing punitive damages to $4 and reinstating the punitive damage award in the amount of $600,000.00 should be reversed and the case should be remanded to the trial court for entry of a money judgment in the amount of $5.00.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE WITH BRIEF LENGTH AND TYPE SIZE REQUIREMENTS

I certify that: (1) This brief complies with the word-count limitation in ORAP 5.05(2)(b); and, (2) The word count of this brief (as described in 5.05(2)(a)) is 4,359.

I further certify that the size of the type in this brief is not smaller than 14 point for both the text of the brief and footnotes as required by ORAP 5.05(4)(f).

Dated this 2nd day of August, 2013

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CERTIFICATE OF FILING AND SERVICE

I certify that on August 2, 2013, I caused to be electronically filed the foregoing PETITIONER TERRY W. EMMERT'S OPENING BRIEF ON THE MERITS with the Appellate Court Administrator by using the eFiling system.

I further certify that on said date I served two true and and correct copies of said document on the parties listed below, via first class mail, postage prepaid, at Portland, Oregon and addressed as follows:

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