WLF Washington Legal Foundation
Advocate for freedom and justice®
2009 Massachusetts Avenue, NW
Washington, DC 20036
202.588.0302

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COURT UPHOLDS $200 MILLION PUNITIVE DAMAGES AWARD

(City of Hope Medical Center v. Genentech, Inc.)

The California Court of Appeal in Los Angeles upheld a trial court ruling that imposed an unprecedented $200 million punitive damages award against a biotech company that was involved in a contract dispute over royalties owed to a developer of synthesized DNA material. In doing so, the court upheld the underlying contract damages award of $300 million and rejected arguments made by the Washington Legal Foundation (WLF) in its brief that the $200 million punitive damages award was unconstitutionally excessive. If not overturned on appeal, businesses involved in typical contract disputes are at risk of lawsuits by plaintiffs' attorneys not only for normal contract damages, but also for multimillion dollar punitive damages awards.

In this case, the City of Hope Medical Center sued Genentech, Inc., over a dispute about the meaning of a 1976 contract provision which details what royalties should be paid to City of Hope over certain DNA products developed by Genentech and licensed to third-parties for sale. After a second lengthy trial, the jury ruled 9-3 against Genentech for breach of contract and awarded City of Hope $300 million in contract damages which Genentech is appealing.

Under California law and other jurisdictions, punitive damages are not allowed to be assessed in breach of contract cases; rather, they are reserved for certain intentional torts committed with malice or fraud. Accordingly, the plaintiffs' attorneys made a novel argument that the contract imposed a fiduciary duty on Genentech. Because the breach of a fiduciary duty is a tort, the jury imposed an unprecedented $200 million punitive damages award after being told that this would be only a small percentage of the company's net worth.

In its brief, WLF decried the pernicious practice of "tortification" of contract law which would adversely affect typical business and contract relations, leaving companies subject to astronomical punitive damages in contract cases. WLF also argued that excessive punitive damages inflict public harms such as higher costs and prices of goods and services, reduced professional services, disincentives to enter into intellectual property agreements, decreased product development, loss of jobs, gratuitous wealth transfers through windfall awards, and public disrespect for the lottery-like civil justice system. WLF also argued that punitive damages should not be based on the wealth of a publicly-held corporation because it would unfairly punish innocent shareholders.

The court devoted only five pages of its 59-page opinion to the issue of punitive damages. Although punitive damages are rarely awarded in contract disputes, the court of appeal ruled that punitive damages can be awarded in this case because the underlying contract dispute involved the breach of fiduciary duties. Accordingly, the award of punitive damages was permissible. As to the amount of the award, the court upheld the unprecedented award of $200 million as not being disproportionally high because it only amounted to two-thirds of the compensatory damages award, and therefore, allegedly within the guidelines set by the U.S. Supreme Court.

Genentech has vowed to appeal this decision to the California Supreme Court, and WLF will support the appeal.

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For further information, contact WLF Senior Executive Counsel Paul Kamenar at 202-588-0302.