

February 1, 2006

Hon. Bill Lockyer  
Attorney General  
1300 I Street, 17<sup>th</sup> Floor  
Sacramento, California 95814

Attention: Ms. Tricia Knight  
Initiative Coordinator

Dear Attorney General Lockyer:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative, related to punitive damages (File No. SA2005RF0147).

### **Proposal**

Under current law, individuals who have been harmed or injured by the lawful use of a consumer product can seek damages from the individual or company responsible for the product. Additionally, if the defendant is found guilty of oppression, fraud, or malice, as defined by law, the defendant can also be required to pay additional damages in excess of the actual damage caused—known as “punitive damages”—as a form of additional punishment. Current law also requires that 75 percent of any punitive damages awarded in a final judgment be paid to the state, and deposited into the Public Benefit Trust Fund for annual appropriation in the Budget Act. This requirement, however, is set to expire on July 1, 2006. To date, no revenues have been received by the state from this provision. It is also important to note that punitive damages received by an individual are subject to state income tax.

The measure provides that the manufacturer, distributor, or seller of a product shall not be found guilty of oppression, fraud, or malice—and therefore cannot be required to pay punitive damages—if the product that allegedly caused injury was in compliance with all regulations, requirements, or standards of the federal and state agencies responsible for overseeing the product. This provision, however, would not apply if it is shown by clear and convincing evidence that the manufacturer, distributor, or seller intentionally withheld or misrepresented information that was required to be submitted to the governing federal and state agencies. The measure would apply to every case pending in court on or after the date of enactment, regardless of when the case was filed.

**Fiscal Effects**

*State and Local Government.* By making it more difficult to obtain punitive damage awards in certain cases, this measure could reduce government revenues in three ways. First, it could prevent the state and local governments as the plaintiff(s) in a product liability lawsuit from obtaining punitive damages awards in certain cases. Second, since punitive damage awards are subject to state income tax, it could potentially reduce state income tax revenues depending on individual taxpayers' situations and how the money that is not awarded would otherwise be used. Third, it could reduce direct payments under an existing state law requiring that 75 percent of punitive damage awards be paid to the state provided this law is reauthorized. The net impact of these fiscal effects is unknown and would depend on a number of factors, including the number of cases affected by the measure as well as the value of punitive damage awards at stake in such cases, and whether the current law requiring a state share of all punitive damage awards is reauthorized. The measure is not likely to have a significant impact on state costs for court operations.

*Indirect Effects.* The measure could also potentially result in unknown indirect fiscal effects on state and local governments. To the extent that the measure reduces business costs associated with lawsuits, it may improve firms' profitability, encourage economic activity, and thus increase state and local revenues. However, the measure could also reduce firms' incentive to improve product safety, which could increase the number of people who are injured or harmed by these products. This could increase state costs should some of these individuals have their health care costs paid for by government.

**Summary of Fiscal Effects**

- Potential unknown reductions in revenues to the state and local governments resulting from a potential decrease in punitive damage awards in certain product liability lawsuits.

Sincerely,

---

Elizabeth G. Hill  
Legislative Analyst

---

Michael C. Genest  
Director of Finance