4th Civil Case No. G015482

IN THE COURT OF APPEAL

OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

SURGIN SURGICAL INSTRUMENTATION, INC.,

Plaintiff and Respondent,

vs.

TRUCK INSURANCE EXCHANGE,

Defendant and Appellant.

Appeal from the Orange County Superior Court
Honorable C. Robert Jameson, Judge
Case No. 66 22 16

APPELLANT'S OPENING BRIEF

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

CASES

CONSTITUTIONS

STATUTES

RULES

TREATISES

INTRODUCTION

Truck Insurance Exchange appeals from a $57.8 million default judgment, including $57.2 million in punitive damages, rendered after the imposition of terminating sanctions.

$57.8 million.

$57.2 million in punitive damages.

No trial.

One of the largest punitive awards in California history — following the harshest possible discovery sanction.

This extraordinary judgment resulted from the systematic denial of due process. It followed the unjustifiable entry of terminating sanctions for nonexistent discovery violations. The default prove-up violated almost every statutory and constitutional protection to which a defendant — even a defaulted defendant — is entitled. The parade of basic, fundamental error is seemingly endless. For example:

- The ultimate sanction — the civil equivalent of the death sentence — was imposed for what the trial court itself candidly characterized as a "gross misunderstanding."

- Two plainly-worded statutes, as well as due process guarantees and more than a century of unswerving California Supreme Court precedent, establish that a default judgment *jurisdictionally* cannot exceed the amount alleged in the complaint, here $270,000. This award *exceeds* that maximum *by more than $57.5 million.*

- The default prove-up and judgment were based on facts never pleaded in the complaint — a clear violation of statute as well as due process.

- The award was rendered in the face of controlling contrary authority — this Court's recent *Watercloud* decision, a case conclusively establishing that plaintiff had absolutely no cause of action against Truck. The trial court, however, expressly refused to consider *Watercloud.*

- A cornerstone of plaintiff's proof concerned an unalleged claim that Truck engaged in a pattern and practice of misconduct, specifically, Truck's asserted conduct in another case, *Waller v. Truck Insurance Exchange*. The Court of Appeal, however, has held that Truck acted perfectly properly in *Waller* and was entitled to a directed judgment in its favor.

- The punitive damage award, which confiscates 25% of Truck's net worth and is over 11 times its 1992 pre-tax net income, is *$23 million larger than* even the plaintiff itself requested.

The judgment in this case defies rational explanation. It necessarily resulted from passion, prejudice and bias. At long last, the time has come to correct this outrageous miscarriage of justice.

SUMMARY OF ARGUMENT

We begin with fundamental errors — jurisdictional, due process and failure-to-state-a-claim errors — because the facts and legal principles underlying them are relatively straightforward and quickly demonstrate both that the default judgment cannot stand and that it cannot under any circumstances exceed $270,000. We then demonstrate that even a $270,000 compensatory award is unsupported by substantial evidence and that the punitive award is grossly excessive and unconstitutional. Finally, we turn to the factually more complex, but equally egregious, errors that demonstrate the ultimate irony: There was never a basis for imposing any sanctions, and certainly not terminating sanctions.

Truck's main points include these:

1. As a matter of *jurisdiction* as well as due process, a default judgment — even one that follows terminating discovery sanctions — cannot be greater than, and is *void* to the extent it exceeds, the amount stated in the complaint, here $270,000. (*Greenup v. Rodman* (1986) 42 Cal.3d 822, 826; Code Civ. Proc., § 580 [judgment "cannot exceed that which (plaintiff) shall have demanded in his or her complaint"]; Code Civ. Proc., § 585(b) [default judgment may not exceed "the amount stated in the complaint"].)

2. Taking full advantage of Truck's forced absence from the trial, plaintiff Surgin Surgical Instrumentation, Inc., presented — and the trial court expressly based its punitive damage award on — a host of asserted material facts never alleged in the complaint. Reliance on these *unpleaded* facts automatically opened the default and invalidated the default judgment. (Code Civ. Proc., §§ 580, 585(b); *Jackson v. Bank of America* (1986) 188 Cal.App.3d 375, 387-388.)

3. The only claim alleged in the complaint is that Truck's "advertising injury" coverage obligated it to defend four related suits and that Truck failed to live up to an agreement, subject to

a reservation of rights, to defend Surgin by failing to pay Surgin's chosen defense counsel. Under the clear language of Truck's policy and under this Court's controlling decision in *Aetna Surety & Cas. Co. v. Superior Court (Watercloud Bed Co.)* (1993) 19 Cal.App.4th 320, 327-331 — which the trial court *expressly refused to consider* — Truck had no obligation to defend any of the suits. Since the complaint does not state a viable cause of action, the default judgment cannot stand.

4. The $574,284.79 award of compensatory damages is thoroughly flawed. It is more than double the $270,000 jurisdictional limit. It is also unsupported by Surgin's own evidence: (a) 99% of the defense fees Surgin incurred related solely to the separate, noncovered patent infringement actions and therefore are not recoverable under *Hogan v. Midland National Ins. Co.* (1970) 3 Cal.3d 553, 563-564; the remaining 1% of supposed defense fees were not linked to defense of *any* identifiable action; and (b) the award includes substantial attorney's fees attributable to Surgin's prosecution of tort claims against Truck, sums expressly *not* recoverable under *Brandt v. Superior Court* (1985) 37 Cal.3d. 813, 817-819; because Surgin failed to carry its burden of segregating its attorney's fees between recoverable and nonrecoverable items, it could not recover *any Brandt* fees. Surgin's failure to prove entitlement to *any* compensatory damages requires not just a reversal, but a reversal with directions to enter judgment in Truck's favor.

5. The $57.2 million punitive damage award flunks every constitutional and substantive test. Indeed, it is subject to *summary reversal* simply because it exceeds the jurisdictional dollar limit stated in the complaint and is based on a compensatory award that itself is jurisdictionally excessive and grossly inflated. Aside from these fatal defects, the astronomical size of the punitive award alone compels the conclusion it necessarily resulted from passion, prejudice and bias, especially when compared with other punitive awards that have been affirmed by published California decisions. By any measure, the punitive damage award is not earthbound. It violates both federal and state due process standards and California substantive law. It must be vacated.

6. Among the most bizarre and unjust aspects of this case is the fact that Truck's discovery conduct did not warrant *any* sanctions, much less terminating sanctions. Truck provided extensive discovery and, when ordered to provide more, it did so without objection, exactly as directed. Nonetheless, the trial court imposed terminating sanctions because Truck failed to divine

— until it was told by the court for the first time *after* terminating sanctions had *already* been imposed — that, in the court's world of tersely-worded discovery orders issued without hearings and unaccompanied by any explanation, "denied without prejudice" really meant "granted," and "granted" meant whatever Surgin claimed it meant, even if it included a belated demand that Truck turn over all patently privileged communications from its trial counsel in this very case.

But, even if there had been a discovery violation, the trial court's response was completely out of line with any offense committed. Far from the arrogant stonewalling that Surgin undoubtedly will claim occurred, Truck produced extensive discovery, complied with the obvious meaning of all court orders, repeatedly expressed its willingness to comply with any clear discovery order, and further complied (even *after* terminating sanctions had been imposed) when the court clarified what it expected. The trial court imposed the ultimate civil punishment — "death penalty" terminating sanctions, followed by $57.2 million in punitive damages — for what the court itself candidly characterized as a "gross misunderstanding" regarding a small subset of discovery requests. (RT 2.)

No fair system of justice can tolerate such a result. The judgment must be reversed either with directions to enter judgment in Truck's favor or with remand for plenary disposition on the merits. In no event may any default judgment exceed $270,000.

STATEMENT OF THE CASE

In a default proceeding, liability can only be based on the well-pleaded factual allegations of the complaint, since "[a] default admits the material allegations of the complaint, and no more." (*Ellis v. Rademacher* (1899) 125 Cal. 556, 557.) Truck was deprived of the opportunity to defend itself and does not concede either the truth of the complaint's allegations or the evidence introduced at the default prove-up. We nonetheless recite the complaint's allegations as deemed admitted because they furnish the *exclusive* standard against which the validity of the default judgment must be measured.

A. The Complaint's Allegations Of Insurance Bad Faith.

The operative complaint is the first amended complaint ("complaint"), brought by Surgin against Truck and other defendants who were later dismissed. (Joint Appendix ("JA" 146, see JA 5698-701 [dismissed].) It alleges:

1. Truck insured Surgin under a policy covering "advertising liability" (or "advertising injury," as it is also called), defined in the policy as "piracy or unfair competition . . . committed or alleged to have been committed in any advertisement, publicity article, broadcast or telecast and arising out of the named insured's advertising activities." (JA 179 [Defines, "advertising liability"].) The policy excluded coverage "for advertising activities . . . for . . . incorrect description of any article or commodity." (JA 182 [Exclusions, para. (7),(c)].)

2. Beginning in June 1989, Alcon Laboratories, Inc., sued Surgin in four actions ("Alcon actions"). (JA 195; see also JA 149-151.) In three of the four Alcon actions, the only claim was that Surgin had infringed various Alcon patents (JA 150-51, 206-26, 231-38); the remaining Alcon action alleged that Surgin falsely described and advertised one of its own products as federally approved and suitable for certain uses (JA 149-50, 198-200).

3. In March 1990, Surgin tendered defense of the Alcon actions to Truck. (JA 151.) In August 1990, Truck agreed to defend subject to a full reservation of rights, including the rights to deny coverage, withdraw from the defense, and seek reimbursement of any defense fees paid. (JA 152-54, 247-52.) Truck selected a law firm to defend Surgin, but Surgin insisted on being represented by Frisenda, Quinton & Nicholson. (JA 155.)

4. Truck delayed and denied payment of Surgin's defense costs and tried to force Surgin to accept less than Truck owed. (JA 157, 161-62, 165.) As a result, Surgin was forced to settle the Alcon actions. (JA 156.)

5. The complaint seeks damages for: (a) "compensable losses in a sum in excess of $270,000," specifically including Surgin's out-of-pocket expenses, the value of its attorneys' and employees' time in defending the Alcon Actions, and its attorneys' fees and costs "incurred in obtaining a defense from Truck for the Alcon actions [so-called *Brandt* fees]"; (b) unspecified

consequential damages for lost profits; and (c) unquantified punitive damages. (JA 160-61, 163-64, 157, 167.) The complaint does not allege any other amount or type of damage. (JA 146-70.)

Surgin alone brought suit; neither of its principals is a party. The complaint says nothing about Truck's handling of any claim other than the tendered Alcon actions or about Truck's claims-handling practices generally. It alleges nothing about any "pattern or practice" of misconduct.

B. Discovery And The Imposition Of Terminating Sanctions.

The complex details of the discovery dispute resulting in terminating sanctions are spelled out separately in Section VII below. The following suffices as a brief overview.

In the context of Truck's provision of substantial discovery, a dispute arose whether Truck's further responses and further production of documents complied with the trial court's terse direction compelling further discovery. (JA 1593-96.) Surgin moved for terminating sanctions. (JA 1585.) Without holding a hearing, the trial court "denied without prejudice" Surgin's motion. (JA 2022.) Surgin and Truck then disputed the meaning and effect of that order, and Surgin renewed its terminating sanctions motion. (JA 2390-92, 2066.)

At the hearing on the renewed motion, the trial court concluded there had been a "gross misunderstanding" as to the meaning of its order. (RT 2-3.) Nonetheless, it imposed terminating sanctions (RT 10) and refused to explain in what way Truck's further responses had been deficient (JA 2474; see JA 2457-61; JA 2465-68). Truck moved for reconsideration. (JA 2479.) The trial court granted the motion, but in the same breath affirmed terminating sanctions, now changing its characterization of Truck's discovery conduct from a "gross misunderstanding" to "cool and calculating" and "blatant, willful and in bad faith." (RT 72-73.) At the reconsideration hearing, the court expressed, *for the first time*, that it adopted Surgin's interpretation of the meaning of its order, stating that "denied without prejudice" was a "clear flag" that further production was expected. (RT 72.) Within a week, Truck produced to Surgin an additional eight boxes of documents in response to the trial court's new interpretation of its order. (See JA 7493-98, 7577.)

C. The Irregular Prelude To The Default Prove-up.

The default prove-up hearing was preceded by a series of irregularities, including *ex parte* communications and correspondence between Surgin's counsel and the court that were never documented in the court's files. According to Surgin's lawyers' bills, the communications included some sort of "agreement" about "non-standard requests." (E.g.: JA 6873 [entries of 7/14/93], 6869.)

On the mandatory Judicial Council form used to obtain a default prove-up hearing, Surgin did not fill in the required information concerning the amount of damages demanded in the complaint. (JA 5710, 5723; see Cal. Rules of Court 982(a)(6).) Nonetheless, the court set and heard the default prove-up, without insisting on compliance or even making inquiry as to this jurisdictionally crucial piece of information. (JA 5725; see e.g., RT 77-78, 318-24.)

At the outset of the default prove-up, the court held an unreported meeting with Surgin's counsel in chambers. (JA 7979.) The court refused a request by Truck's counsel to observe the meeting (JA 7970) and ignored Truck's statutory request that all proceedings be reported (JA 5776-80). Both the court and Surgin's counsel confirmed that they discussed Surgin's request for an advisory jury, the court stating this was a "major" part of the discussion about the case. (RT 358; JA 8030-31.) When Surgin's counsel emerged from chambers, he abandoned Surgin's prior request for an advisory jury, announcing that, after conferring with the trial court and his client, "our belief [is] that a jury would serve no other purpose, [no] better purpose than having the court hear it, [and] we've elected to do it just to the court." (RT 77.)

D. The Default Prove-Up.

It will come as no surprise that, with Truck and its counsel figuratively bound and gagged, Surgin was unrestrained in its one-sided portrayal of Truck as a corporate ogre. Legally, however, only the well-pleaded facts alleged in the complaint were deemed admitted by Truck's default, and evidence of unpleaded facts was not permissible. The significance of Surgin's two-day presentation — without cross-examination or rebuttal — of lopsided evidence and character assassination does

not rest in its truth or falsity, but rather in the unbridgeable chasm it created between the factual allegations of the complaint and the unpleaded "proof" at the default hearing.

The only topic addressed by the complaint's factual allegations and therefore deemed admitted by the default is Truck's handling of the Alcon claims. But the trial court allowed Surgin to range far afield from this limited topic, permitting (and ultimately relying on) evidence that encompassed the following *unpleaded* matters: (1) Surgin revisited the same discovery dispute that resulted in terminating sanctions, seeking once again to show that Truck's discovery responses were not truthful and offering evidence on that subject that wasn't even offered in support of the discovery motions. (RT 188-204, 208-222, 232-233, 238-239, 294-295, 302-305.) (2) Surgin sought to establish a "pattern and practice" of wrongful conduct in Truck's handling of unrelated claims in other matters. The evidence included: (i) reference to a then non-final bad faith judgment in another case, *Waller v. Truck Insurance Exchange*, Orange County Superior Court Nos. 523537, 525150, & 521922, a judgment which was subsequently reversed with directions to enter judgment in Truck's favor (RT 85-86, 83-88; JA 8278; *Waller v. Truck Insurance Exchange* (1994) 94 Daily Journal D.A.R. 11365); and (ii) testimony by a disaffected former employee of Farmers Group, Inc., an entity affiliated with Truck, that prior to February, 1985 — which was over four years *before* Alcon even sued Surgin and over five years *before* Surgin even tendered the Alcon actions to Truck — Truck had destroyed and withheld documents in unidentified cases of an unknown nature (RT 110-111, 208, 212-213, 218-223, 225-232.) (3) Surgin presented evidence of emotional distress claimed by one of its co-owners, Masskamp, arising out of his concern about potential exposure to personal liability in the Alcon actions, even though neither of Surgin's owners was a party to this lawsuit. (RT 290-293.)

In its closing argument, Surgin sought $12.5 million in compensatory damages, consisting of $270,000 for defense fees, $302,000 for *Brandt* fees, and $12 million for lost profits. (RT 314.) As to punitive damages, Surgin's counsel stated: "[T]he most [Surgin is] prepared to ask for . . . [is] [$]34 million or 15 percent" of Truck's $229 million net worth. (RT 317.) This represented a ratio of approximately 2.5 times the $12.5 million in compensatory damages Surgin claimed. (RT 305, 317.)

The court awarded Surgin $572,143.79 (the exact amount it requested) in compensatory damages for various attorney's fees, but declined to award any amount for "lost profits," finding the evidence speculative. (RT 320-321.) The court awarded $57,214,379 in punitive damages (RT 324), exactly 100 times the compensatory award.

In imposing punitive damages, the court expressly relied on, among other things, the unpleaded matters Surgin raised for the first time at the default prove-up hearing, basing the award on its conclusions that (1) Truck's handling of Surgin's tenders "appears to be consistent with a pattern and practice within the industry for Truck Exchange," and (2) Truck's conduct *in defending the present litigation*, "at every possible turn from the first notice of claim *through the litigation which terminated a few weeks ago*," was "despicable." (RT 322, emphasis added.) The court further based its punitive damage award on the "lost profits" that it had found too speculative to support compensatory damages, and it used the punitive award as a mechanism "to compensate for the aggravation" caused "by this litigation and the trials and tribulations of litigation." (RT 323.)

E. The Irregular Proceedings After The Default Prove-Up And The Resulting Judgment.

Two months after the court announced the $57.2 million punitive award, it permitted Surgin to reopen its case, *ex parte*, to present evidence to bolster the previously-issued award, including evidence of (1) the relationship between Truck and other legally separate insurers, at least some of whom were previously named as defendants but were eventually dismissed, and (2) the net worth of those non-party insurers. (See JA 7418-78; JA 5698-5701.)

At the same time, Surgin submitted and the trial court promptly signed a proposed default judgment that, instead of the usual form language, contained several unusual features:

- Although the trial court had never said anything about the subject, the proposed judgment contained a gratuitous statement that Truck had "actual knowledge of a claim for $3 million in compensatory damages and $62 million in punitive damages before February 9, 1993." (JA 7480.)
- Although the court had never said anything on this subject either, the proposed judgment volunteered that if Truck had complied with the court's discovery orders

at any time before September 15, 1993, it would have avoided continued entry of its default. (JA 7480.)

- The compensatory award in the proposed judgment was $2,141 more than the $572,143.79 the court said it was awarding. (RT 320, JA 7482.)

F. Truck's Post-Judgment Motions.

Truck moved for a new trial, for judgment notwithstanding verdict, and to vacate and set aside the judgment as void. (JA 7489, 7525, 7548, 8005.) Among other things, Truck contended that both the compensatory and punitive damages were excessive and void to the extent they exceeded the $270,000 pleaded in the complaint. (E.g., JA 7540-47, 7563-70, 7953-54, 7956-65, 8012-26, 8168-201.) Truck also proved that on May 11, 1993, well before the September 15 last-chance date mentioned in the judgment, it had complied even with the court's interpretation of its "deemed without prejudice" order, as announced for the first time at the hearing on the motion for reconsideration. (JA 7577.) Specifically, in support of its motions, Truck lodged with the trial court the eight boxes of documents, as well as its supplemental further discovery responses, which it furnished to Surgin on May 11. (JA 7493-98, 7622-44.)

At the hearing on Truck's post-judgment motions, Truck called the court's attention to this Court's controlling decision in *Watercloud*. (RT 339-340.) That case — decided before the default prove-up hearing and published before the court signed the default judgment — established that *Truck never had any duty under its policy to defend the Alcon actions*. The trial court didn't care, stating: "Let's not get into that. . . . Truck forfeited their right to litigate that issue . . . . Let's not be arguing postdecisions [*sic*] that didn't exist at the time this trial was had." (RT 340.)[1/]

Faced with proof that Truck had, in fact, *complied* with the September 15 last-chance deadline mentioned in the judgment, Surgin simply changed the rules. Without any prior notice, Surgin orally moved to amend the already-entered judgment by changing the September 15 date to

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1/ The trial court's statement that Truck forfeited its right to litigate the *Watercloud* issue was wrong. As the authorities cited in Truck's post-judgment motions demonstrated, a defaulted defendant has a right to bring post-judgment motions and one ground for attacking a default judgment is failure to state a cause of action. (JA 7534-35.)

a date *before* Truck produced the additional documents. (JA 8292-96; see RT 350-352, 359-365.) The trial court immediately obliged, revising the judgment exactly as Surgin requested. (JA 8291.) The court further ordered Truck to remove the eight boxes of documents it had lodged. (JA 8541.)

The trial court denied Truck's post-judgment motions (JA 8289-91) without asking a single question concerning the jurisdictional, statutory, constitutional and due process issues Truck raised and now reiterates on this appeal. (RT 326-359.) The court's only comment (other than to deny Truck's motions and grant Surgin's request to change the September 15 finding) was to proclaim that a portion of its *ex parte*, unreported in-chambers meeting with Surgin's counsel was devoted to discussing sports, while the "major part" of the substantive discussion concerned Surgin's request for an advisory jury. (RT 357-59.)

Finally, Truck filed an offer of proof as to a Code of Civil Procedure section 473 motion it would bring for mandatory relief from default based on its counsel's mistake and inadvertence regarding the imposition of terminating sanctions. (JA 8300.) However, without any advance notice, explanation, citation of authority, or hearing, the court struck Truck's offer of proof from the court files.[2/] (JA 8541.)

STATEMENT OF APPEALABILITY

In three separate notices of appeal, Truck timely appealed from the judgment, the amended judgment, the orders denying its post-judgment motions, a post-appeal "consolidated" order once again denying Truck's post-judgment motions, and the order striking Truck's offer of proof and requiring removal of the lodged documents. (JA 8532-33, 8563-66, 8600-02.) This Court assigned the same number to all three appeals. The appeals are proper, as they seek review of the final judgment in this action (Code Civ. Proc., § 904.1(a)(1)), the separately-appealable orders denying post-judgment motions (Code Civ. Proc., § 904.1(a)(2),(4)), and orders made after judgment (Code

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2/ Truck made an offer of proof instead of a formal motion because the trial court, in determining Truck's motion for reconsideration, found that Truck's asserted discovery derelictions were wilful. (JA 8301.) That finding, although without factual support, precluded a section 473 motion based on mistake or inadvertence. (Code Civ. Proc., § 473.)

Civ. Proc., § 904.1(a)(2); see *Lakin v. Watkins Associated Industries* (1993) 6 Cal.4th 644, 650-656).

LEGAL DISCUSSION

I.

THE $57.8 MILLION DEFAULT JUDGMENT IS VOID TO THE EXTENT IT EXCEEDS THE $270,000 JURISDICTIONAL MAXIMUM DEMANDED IN THE COMPLAINT.

The imposition of judgment without trial affronts the core beliefs of American jurisprudence. That is why default judgment procedures are invested with strict procedural protections. That is why reviewing courts insist that such procedures be rigorously enforced. Only then can abuse be prevented.

One of the most basic protections in default cases is a limit on the amount of the judgment. Both due process guarantees (U.S. Const., Amend, XIV, § 1; Cal. Const., art. I, § 7, hereafter collectively "due process") and statute forbid a default judgment greater than the amount specifically demanded in the complaint. These are *jurisdictional* limits. Any greater judgment is *void*.

Here, the only amount alleged in the complaint is $270,000 in compensatory damages, yet the trial court awarded over double that amount in compensatory damages alone and a whopping $57.2 million in punitive damages. As a matter of law, the default judgment cannot exceed $270,000. At a minimum, the judgment must be reduced to that amount.

A. A Court Has No Jurisdiction To Enter A Default Judgment Greater Than The Amount Pleaded In The Complaint. Any Excess Is Void.

There is no common law right to a default judgment; the procedure is entirely statutory. "[T]he court's jurisdiction to render default judgments can be *exercised only in the way authorized by statute.*" (*Burtnett v. King* (1949) 33 Cal.2d 805, 807, original emphasis; *In Re Marriage of Lippel* (1990) 51 Cal.3d 1160, 1167; *Becker v. S.P.V. Construction Co.* (1980) 27 Cal.3d 489, 493 ["a court *has no power* to enter a default judgment other than in conformity with (Code of Civil

Procedure) section 580," emphasis added]; *Greenup v. Rodman* (1986) 42 Cal.3d 822, 828 ["unless and until the Legislature specifically provides a separate procedure . . . [Code of Civil Procedure] sections [580 and 585] remain the sole statutory procedures for default judgments"].)

The statutory restrictions on the maximum amount of recovery are clear:

1. "The relief granted to the plaintiff, if there be no answer, *cannot exceed that which he shall have demanded in his complaint.*" (Code Civ. Proc., § 580, emphasis added.)

2. "[T]he . . . court shall hear the evidence offered by the plaintiff, and shall render judgment in his or her favor for such sum (*not exceeding the amount stated in the complaint*), as appears by such evidence to be just." (Code Civ. Proc., § 585(b), emphasis added.)[3/]

The Supreme Court has "long interpreted section 580 in accordance with its plain language. Section 580, [the Court has] repeatedly stated, means what it says and says what it means: that a plaintiff cannot be granted more relief than is asked for *in the complaint.*" (*In re Marriage of Lippel*, *supra*, 51 Cal.3d at p. 1166, emphasis added.)

The rule is so strict that "a default judgment greater than the amount specifically demanded is *void* as beyond the court's jurisdiction." (*Greenup v. Rodman*, *supra*, 42 Cal.3d at p. 826, emphasis added; accord *Don v. Cruz* (1982) 131 Cal.App.3d 695, 703.) It is also *unconstitutional*: "[D]ue process requires notice to defendants, whether they default by inaction or by wilful obstruction, of the potential consequences of a refusal to pursue their defense." (*Greenup*, *supra*, 42 Cal.3d at p. 829; accord *Pino v. Campo* (1993) 15 Cal.App.Supp. 1, 4 [A default judgment that

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3/ Except as noted, all further statutory references are to the Code of Civil Procedure. The quotations are from sections 580 and 585(b) as they read at the time of the default proceedings in this case. Effective January 1, 1994 (after entry of this default), these statutes were amended to add that, in personal injury and wrongful death cases subject to section 425.11's requirement of a separate "statement of damages," a default judgment shall not exceed the amount stated in the "complaint or in the statement required by Section 425.11. . . ." (§§ 580, 585, subd. (b).) In these types of cases, the plaintiff must serve the defendant with a separate statement of damages "setting forth the nature and amount of damages being sought" before obtaining a default. (§ 425.11, subds. (a), (b).)

"exceeds . . . the demand of the complaint (exceeds) the court's jurisdiction . . . (and) is also a denial of the due process right to a fair hearing"].)

Under these rules, general allegations of damages "according to proof" or "in excess of" the amount pleaded do not satisfy the jurisdictional mandate limiting default recovery to the amount demanded in the complaint. (*Becker v. S.P.V. Construction Co.*, *supra*, 27 Cal.3d at pp. 492, 494 ["a prayer for damages according to proof passes muster under section 580 only if a specific amount of damages is alleged in the body of the complaint"; held, damages on default limited to $20,000 even though prayer was for damages "in excess of $20,000 . . . or according to proof"]; *Engebretson & Co. v. Harrison* (1981) 125 Cal.App.3d 436, 444 [complaint praying for damages "in excess of $5,000" "will support a default judgment for $5,000 only"]; *Fehlhaber v. Fehlhaber* (5th Cir. 1982) 681 F.2d 1015, 1025-1026 [applying California law, complaint alleging marital property subject to equal division "in excess of $15 million" could not support default judgment greater than $7.5 million].)

The same restrictions on default judgments apply to defendants who have been subjected to terminating sanctions for discovery misconduct: ". . . the damages awarded must be limited by the terms of the same section[s] [580 and 585(b)]: when an answer is stricken as a sanction for the defendant's obstruction of discovery, it is as if no answer had been filed in the first instance. . . . [W]e cannot open the door to speculation on this subject without undermining due process — a protection to which every defendant is entitled, even one as obstreperous and as guilty of reprehensible conduct as this defendant." (*Greenup*, *supra*, 42 Cal.3d at pp. 828-829.)

Surgin's $57.8 million default judgment vastly exceeds the $270,000 Surgin demanded in its complaint. The excess is void. The judgment cannot exceed $270,000.

B. Contrary to Surgin's Contention Below, Its Settlement Demands Cannot Overcome The Constitutional and Statutory Directives Limiting Default Judgments To The Amount Stated In The Complaint.

In the face of such clear limits on default judgments, Surgin resorted to stratagem. After the default prove-up, Surgin attempted to cure the glaring jurisdictional defect in the award by

gratuitously inserting into its proposed default judgment, which the court promptly signed, unsolicited and previously-unmentioned "findings" that Truck had received "actual notice" of a potential $62 million or $100 million judgment. (JA 7480.) The only possible basis for these recitals is two settlement letters which Surgin sent towards the conclusion of the contested portion of the trial court proceedings and which referenced these numbers. The assertion that these letters can somehow avoid explicit statutory and constitutional mandate is preposterous.

1. Settlement Letters Do Not Satisfy The Statutory And Constitutional Rule Mandating That A Default Judgment Cannot Jurisdictionally Exceed The Amount Of Damages Demanded In The Complaint.

The unswerving focus of the default statutes is on the amount pleaded *in the complaint* — here, $270,000. They forbid a plaintiff or a court from looking anywhere else. The language of section 580 "means what it says and says what it means: that a plaintiff cannot be granted more relief [in a default proceeding] than asked for *in the complaint*." (*In re Marriage of Lippel*, *supra*, 51 Cal.3d at 1166-1167, emphasis added; § 425.10 [amount of money or damages "shall be stated" in the complaint].) The statutes provide no exception for letters.

> "*[D]ue process* requires *formal* notice of potential liability; *actual notice may not substitute for service of an amended complaint*. . . . It is precisely when there is no trial . . . that *formal* notice . . . become[s] critical." (*Greenup*, *supra*, 42 Cal.3d at pp. 826-827, emphasis added.)

See *Parish v. Peters* (1991) 1 Cal.App.4th 202, 207-210 [minimum due process principles in default proceedings "require '*formal* notice of potential liability'"; "the due process concerns enshrined in our constitutions — concerns which are fundamental to all precepts of jurisprudence . . . and codified in section 580 — forbid a judgment against a defendant in excess of that demanded *in the complaint* without any *formal* notice of an increase of the amount in issue," emphasis added]; *Pino v. Campo*, *supra*, 15 Cal.App.4th.Supp. 1, 5 ["Even if defendants may be deemed to have constructive notice of the (court's $25,000) jurisdictional limit, due process requires that they know exactly what risk they assume by not responding to the pleading. . . . The statute and due process requires that defendants be told exactly what their exposure is. . . . (S)ection (580) is not merely

procedural but a statutory expression of the mandates of due process, which require formal notice of potential liability," internal quotation marks omitted].)

In cases not involving personal injury or wrongful death, even formal notice of damages *outside the complaint* is legally irrelevant and cannot support a default award of damages greater than the amount specifically alleged in the complaint. For instance, in *Engebretson & Co. v. Harrison*, *supra*, the court held, in a non-personal injury, non-wrongful death action, that even service of a formal section 425.11 "statement of damages" (see footnote 3, *supra*) is *insufficient* to increase the damages recoverable on default. The reason is that the plaintiff is statutorily required to notify the defendant of any request for increased damages "*by service of an amendment to the complaint (or an amended complaint).*" (125 Cal.App.3d at pp. 440-441; emphasis added.) Similarly, in *Galliano v. Kilfoy* (1892) 94 Cal. 86, 88, the Supreme Court modified a default judgment to delete relief sought in an amended complaint that had not been formally served, even though the proposed amended complaint had accompanied a formally-served notice of intention to file an amended complaint and even though the amended complaint itself had been filed.

There is only one exception to the requirement that the amount of money or damages "shall be stated" in the complaint. (§ 425.10.) That applies only in actions "to recover actual or punitive damages for *personal injury* or *wrongful death*"; in these cases, the nature and amount of damages sought must be set forth in a separate statement of damages, as required by section 425.11. (See footnote 3, *supra*.) As discussed above, where an action is *not* for personal injury or wrongful death, even a formal "statement of damages" will not substitute for pleading the damage amount in the complaint. (*Engebretson & Co. v. Harrison*, *supra*, 125 Cal.App.3d at pp. 440-441.) And even in personal injury and wrongful death actions, where the law expressly permits notice of damages outside the complaint, reviewing courts uniformly *reject* notices that are far more specific, formal and clear than Surgin's settlement letters here. Among the types of notices that reviewing courts have held *do not qualify* as separate "statements of damages" are: a formal section 998 settlement demand (*Debbie S. v. Ray* (1993) 16 Cal.App.4th 193, 199-200); a damage amount stated in an at-issue memorandum (*ibid.*); damage amounts disclosed in formal discovery responses (*Morgan v. Southern Cal. Rapid Transit Dist.* (1987) 192 Cal.App.3d 976, 986-987 [damage amounts specified

in interrogatory responses], disapproved on other grounds in *Schwab v. Rondel Homes, Inc.* (1991) 53 Cal.3d 428, 434; *Fehlhaber v. Fehlhaber*, *supra*, 681 F.2d at p. 1026 [request for admission]); and amounts discussed in settlement negotiations (*Debbie S.*, *supra*, 16 Cal.App. 4th at p. 199; *Morgan*, *supra*, 192 Cal.App.3d at p. 986).

Since Surgin's letters were nominally settlement demands, the reason reviewing courts refuse to look to settlement negotiations for notice is particularly instructive here:

> "The function of settlement negotiations between counsel is, of course, to facilitate settlement on an agreed upon figure, rather than to fix the potential judgment to be awarded at trial. . . . [¶] An 'indication' of the value of a case made in the course of settlement discussions between counsel for the parties is not the actual notice . . . required . . . . [¶] (A plaintiff) . . . is to give the defendant a specific notice of damages sought that is separate and apart from the existing mechanisms of settlement conference statements and the at-issue memorandum." (*Debbie S.*, *supra*, 16 Cal.App.4th at p. 199.)

See *Morgan*, *supra*, 192 Cal.App.3d at pp. 986 ["the possibility the defendant could divine the amount of damages claimed through collateral sources does not satisfy due process"].)

In the face of this overwhelming authority refuting Surgin's position, the only remaining argument Surgin could muster below was that Civil Code section 3295(e) had somehow, *sub silentio*, eviscerated the longstanding, statutory and due process jurisdictional limitations on damages in default proceedings. (JA 8051-53, 8081-84.) Not so — not even remotely so. In its entirety, Civil Code section 3295(e) merely provides that "[n]o claim for exemplary damages shall state an amount or amounts." It says absolutely nothing about default proceedings, and it makes no pretense to negate over a hundred years of explicit statutory and constitutional protections afforded to defaulted defendants. Such a sweeping alteration of entrenched law cannot be presumed. (See, e.g., *Theodor v. Superior Court* (1972) 8 Cal.3d 77, 92 ["it should not 'be presumed that the Legislature in the enactment of statutes intends to overthrow long-established principles of law unless such intention is made clearly to appear . . . .'"]; *In re Christian S.* (1994) 7 Cal.4th 768,

776 ["we are aware of no authority that supports the notion of legislation by accident. . . . '(A)n intention to legislate by implication is not to be presumed'"].)

By explicit statutory and constitutional directive, the damages recoverable in this case cannot exceed the $270,000 amount alleged *in the complaint*. Ignoring plainly-worded jurisdictional requirements and attempting to supplant them with settlement letters was not a permissible option.

2. The Tardiness And Ambiguity Of Surgin's Letters Further Underscore The Need For, And The Wisdom Of, The Requirement Of Formal Notice In The Complaint.

Surgin's settlement letters came at the last minute — in fact, after the last minute. By the time Surgin faxed its first letter (less than a week before the terminating-sanctions hearing), Truck had already filed its opposition to Surgin's renewed motion for terminating sanctions. (JA 7580-82.) The second letter was sent *after* Truck's default had already been ordered. By any standard, the letters were too late. (See *Greenup v. Rodman*, *supra*, 42 Cal.3d at pp. 825-827 [statement of damages contained in form requesting entry of default *after* terminating sanctions imposed came too late]); *Wiley v. Rhodes* (1990) 223 Cal.App.3d 1470, 1473 [plaintiff must "furnish() (the defaulting defendant) with notice of the amount sought *before requesting* entry of default," emphasis added]; *Plotitsa v. Superior Court* (1983) 140 Cal.App.3d 755, 761 [one day notice insufficient for section 425.11 statement of damages]; *Twine v. Compton Supermarket* (1986) 179 Cal.App.3d 514, 517 [same regarding three days notice]; cf. *California Novelties, Inc. v. Sokoloff* (1992) 6 Cal.App.4th 936,945 [17 days notice sufficient for section 425.11 statement of damages].)

Surgin's settlement letters were also ambiguous at best. The first letter advanced a "settlement demand . . . of $825,000" and recited that Surgin was "confident" a jury would award "a minimum of $2-$3 million in punitive damages," which Surgin characterized as "a conservative estimate given the recent award against Truck in the amount of $62 million in *Waller, et al. v. Truck Ins. Exchange* for identical claims mishandling as occurred in this case."[4/] (JA 7580-82.)

4/ In fact, the *Waller* judgment awarded only $6 million in punitive damages against Truck (reduced from the jury's $6.5 million verdict), not the claimed $62 million; the judgment awarded another $50 million in punitive damages against a different defendant. (JA 8276, 8278.) As (continued...)

The second letter demanded settlement of $25 million and declared that Surgin was now "confident" a jury "will award punitive damages in an amount exceeding $100 million given the previous award against Truck in the amount of $62 million in the *Waller v. Truck* action" and that $100 million is the minimum amount Surgin would argue as necessary to deter future wrongdoing. (JA 6573-74.)

The first letter referred to multiple numbers, fixing on none of them: Did it supposedly give notice of the $825,000 settlement demand,[5/] or $2-3 million in punitive damages (Surgin's *belief* as to the amount to be awarded), or $6 million in punitive damages (the actual amount of the judgment against Truck in the *Waller* case, since reversed), or $62 million in punitive damages (the amount Surgin mistakenly claimed had been awarded against Truck in the now-reversed *Waller* case)? No one knows. Did the second letter — sent *after* Truck's default had already been ordered — give "notice" of a maximum of $25 million, undifferentiated between compensatory and punitive damages (see footnote 5, *supra*) or $100 million in punitive damages? No one knows. Even Surgin could not identify what amount, if any, it had demanded when, months later, it completed the mandatory Judicial Council Request For Entry Of Default form without filling in any of the pertinent blanks relative to damages. (JA 5710, 5723; see Cal. Rules of Court 982(a)(6).)

Since Truck *prevailed* in the *Waller* appeal and that judgment is now reversed, how could Surgin's misplaced reliance on "the recent award against Truck . . . in *Waller* . . . for identical claims mishandling" possibly serve as a legitimate basis for avoiding the requirements of sections 580 and 585(b)? Clearly, it could not. It is precisely to avoid uncertainty — exemplified perfectly by Surgin's repeated misplaced references to the then-pending, now-reversed *Waller* case — that courts uniformly insist on rigorous enforcement of sections 580 and 580(b). Notice *in the complaint*

4/(...continued)
previously noted, the *Waller* judgment has been reversed with directions to enter judgment in favor of Truck and its co-defendant. (*Waller v. Truck Insurance Exchange*, *supra*, 94 Daily Journal D.A.R. at 11372.)

5/ The $825,000 settlement demand was undifferentiated between compensatory and punitive damages; for that reason alone, it could not possibly qualify as proper notice. (See, e.g., *Becker v. S.P.V. Construction Co.*, *supra*, 27 Cal.3d 489, 494-495 ["compensatory and punitive damages are different remedies in both nature and purpose, a 'demand or prayer for one is not a demand legally, or otherwise, for the other, or for both'"].)

is the requirement. If Surgin's references to *Waller* meant anything, they meant that Truck's liability was zero, as the Court of Appeal has concluded. That is exactly the effect that should be given to the letters — zero.

"[N]o matter how reasonable an assessment of damages may appear in the specific case [courts] cannot open the door to speculation on [the] subject [of the amount of damages demanded] without undermining due process. . . ." (*Greenup*, *supra*, 42 Cal.3d at pp. 826, 829; *Morgan*, *supra*, 192 Cal.App.3d 986-987 [discovery responses do not suffice to provide notice of damages sought because they *might* be open to interpretation]; *Ludka v. Memory Magnetics International* (1972) 25 Cal.App.3d 316, 322-323 [allegation that plaintiff suffered damage "in a sum equal to the present market value of (2500) shares (of stock)," less plaintiff's ten cents per share cost, insufficient to support default judgment because amount claimed is open to speculation].) As vividly demonstrated by the *Waller* result, the multiple sums haphazardly and erroneously thrown out in Surgin's settlement letters were classic saber-rattling hyperbole and post-sanctions bravado, not formal notice designed or sufficient to meet statutorily and constitutionally mandated due process standards.

The due process requirement of formal notice *in the complaint* is of utmost importance because "under section 585 there is no contest whatever once a defendant defaults." (*Greenup*, *supra*, 42 Cal.3d at p. 829; *Devlin v. Kearny Mesa AMC/Jeep/Renault, Inc.* (1984) 155 Cal.App.3d 381, 386 [justifying preclusion of defendant from participating in hearing on punitive damages because "(u)nder no circumstances will a defaulted defendant suffer judgment for a claim of unliquidated damages or for an amount in excess of that stated in the complaint"].) The defaulted defendant has no opportunity to attack or rebut a plaintiff's unsupported damage claims, unwarranted character assassination, or forays into irrelevant, inflammatory and unpleaded matter.[6/] Formal

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6/ In sharp contrast to California's procedure, federal courts and many states allow the defaulted defendant to participate fully in a damages-only trial. (See *Greenup*, *supra*, 42 Cal.3d at pp. 828-829; see *Hunter v. Spaulding* (1990) 97 N.C.App. 372, 380, 388 S.E.2d 630, 635.) Yet even with that participation, most federal courts hold that Rule 54(c) of the Federal Rules of Civil Procedure caps any recovery at the amount pleaded in the complaint. (*Greenup, supra,* 42 Cal.3d at p. 828, citing *Fong v. United States* (9th Cir. 1962) 300 F.2d 400, 404-406.)

notice *in the complaint* of the amount sought is a core procedural protection afforded to defaulting defendants. In light of California's one-sided default procedure, due process compels — and reviewing courts uniformly insist on — zealous enforcement of this protection. (*Greenup*, *supra*, 42 Cal.3d at pp. 828-829.) Without it, the temptation and opportunity after default for both the plaintiff and the trier of fact to run wild following a lopsided, uncontested presentation of inflammatory evidence could be irresistible. Unfortunately, it was not resisted here.

II.

DUE PROCESS PRECLUDES ENTRY OF A DEFAULT JUDGMENT BASED ON PROOF OF FACTS DIFFERENT FROM THOSE PLEADED IN THE COMPLAINT. PRESENTING A DIFFERENT CASE IS A *DE FACTO* AMENDMENT THAT AUTOMATICALLY OPENS THE DEFAULT.

A. A Plaintiff's Proof Of Unpleaded Claims Is A *De Facto* Amendment Of The Complaint.

Just as a court's jurisdiction to enter a default judgment is limited to an amount "not exceeding the amount stated in the complaint . . ." (§ 585(b)), it is also limited to "relief consistent with *the case made by the complaint* and embraced within the issue." (§ 580, emphasis added; § 585(b) [plaintiff may only apply for the "relief demanded in the complaint"].) A plaintiff has no power to proceed, and a court no jurisdiction to enter judgment, in a default proceeding on the basis of facts other than those alleged in the complaint because "[a] default admits the material allegations of the complaint, and no more." (*Ellis v. Rademacher*, *supra*, 125 Cal. at 557; *Jackson v. Bank of America* (1986) 188 Cal.App.3d 375, 387-388 [same].)

Jackson v. Bank of America is directly on point. There, the plaintiff, exactly like Surgin here, obtained a default and then "proved" its case with facts different from those alleged in the complaint, including (as here) conduct occurring *after* he filed the complaint. (*Jackson*, *supra*, at pp. 383-84.) Division Two of this Court reversed the default judgment, squarely holding the

variance between pleading and proof was a *de facto* amendment that opened the default. The court observed:

> "A defendant in a default action '"ha[s] the right to assume that the judgment which would follow a default on her part would embrace *only* the issues presented by the complaint. . . ."'" (*Id.* at p. 389, emphasis added.)
>
> "'[U]nless the *facts* essential to the support of the case be *alleged* upon the record, *evidence* upon such omitted facts cannot be heard or considered.' . . . 'To hold otherwise would mean that this court sanctions a procedure under which a defendant may be *trapped* by a default judgment.'" (*Id.* at p. 387, original emphasis.)

These principles implement due process requirements: "If a judgment other than that which is demanded is taken against him, [the defendant] has been deprived of his day in court — a right to a hearing on the matter adjudicated." (*Burtnett v. King*, *supra*, 33 Cal.2d at p. 808; see *Greenup*, *supra*, 42 Cal.3d at p. 829; *In re Marriage of Lippel*, *supra*, 51 Cal.3d at p. 1167.)

B. Surgin *De Facto* Amended Its Complaint And Opened The Default By Introducing Evidence Of Numerous Facts, Events And Issues Not Pleaded In The Complaint.

The *facts* alleged in Surgin's complaint narrowly and specifically addressed one thing, and one thing only: Truck's conduct in responding to Surgin's claim for a defense of the Alcon actions. But the evidence Surgin presented at the default prove-up hearing, and on which the trial court expressly relied in entering judgment, went far beyond the case made by the complaint. For example:

1. Not one of the fifty-two paragraphs in Surgin's complaint even hinted at any "pattern and practice" of mistreating policyholders, nor suggested that Truck's conduct in other actions was in issue.

2. The complaint said nothing about discovery misconduct in this or any other case — not surprising, since the discovery dispute here arose *after* Surgin filed its complaint, and Surgin never sought to amend. (Compare JA 146 [operative complaint filed 11/8/91] with 1121, 1076, 1030, 1173 [discovery in dispute served 4/14/92, 4/15/92, 4/21/92 and 7/8/92].) *Jackson v. Bank*

of America, *supra*, expressly holds that a default judgment cannot be based on proof of unalleged events occurring *after* the complaint is filed. (188 Cal.App.3d at p. 390.)

3. The complaint did not allege any damages for emotional distress and aggravation — again not surprising, since Surgin, a corporation, was the only plaintiff. Yet, at the default prove-up, one of Surgin's owners and officers testified to his personal emotional distress and aggravation. (RT 290-293.)

4. The complaint made no claim and alleged no facts that Truck was the alter ego of any other entity or vice versa. Accordingly, there was no factual basis alleged to support Surgin's after-the-fact evidence regarding Truck's asserted financial ties with other entities, introduced for the purpose of bolstering the already-rendered punitive damage award. (See *Vasey v. California Dance Co.* (1977) 70 Cal.App.3d 742, 749 [even allegation that corporation is alter ego of individuals is *insufficient* to support default judgment against individuals, without pleading of appropriate alter ego facts].)

Under *Jackson*, Surgin's introduction of evidence regarding these unpleaded matters amounted to a *de facto* amendment of its complaint. The trial court expressly relied on the unpleaded evidence (e.g., regarding pattern and practice, post-complaint discovery conduct, and aggravation from the trials and tribulations of litigation) to justify its award of punitive damages. (RT 322-323; see discussion, *supra*, at p. 9.) Since Surgin opted to proceed by way of default, both it and the court were bound to abide by the strict statutory and due process limitations inherent in default procedure. They failed to do so. The judgment must be reversed.

III.

THE COMPLAINT FAILS TO STATE A CAUSE OF ACTION AND THEREFORE CANNOT SUPPORT A DEFAULT JUDGMENT.

Where "a judgment on default . . . rests on a complaint which fails to state a cause of action, such judgment must be reversed." (*William v. Foss* (1924) 69 Cal.App. 705, 707 [failure to allege consideration for contract precludes default judgment for specific performance]; *Rose v. Lawton* (1963) 215 Cal.App.2d 18, 19 [following *Foss* on similar facts]; accord *Vasey v. California Dance*

Co., *supra*, 70 Cal.App.3d at p. 749 [default admits only well-pleaded facts, and not legal conclusions]; *Morehouse v. Wanzo* (1968) 266 Cal.App.2d 846, 850; *Taliaferro v. Davis* (1963) 216 Cal.App.2d 398, 409.)

Here, Surgin's complaint fails to state a cause of action. On its face, it shows that Truck had no obligation to defend Surgin against the Alcon actions; and, without a duty to defend, the default judgment collapses. The complaint also failed to allege facts sufficient to permit a punitive damage recovery; this failure separately vitiates the punitive award.

A. There Was No Obligation To Defend Any Of The Claims Alleged In The Complaint.

The complaint's premise is that Truck owed Surgin a duty to defend the Alcon actions and conditionally agreed to defend those actions subject to a reservation of rights, but failed to pay for counsel selected by Surgin. (JA 149-51, 194-226, 231-38, First Amended Complaint, paras. 11, 12, 14 & 16, Exhs. B through E.) The complaint's allegations, however, conclusively demonstrate that Truck's policy provided no coverage for Alcon's claims. "[I]f there is no potential liability for covered damages as a matter of law, there cannot be potential for indemnification, nor can there be a duty to defend." (*Aetna Casualty & Surety Co. v. Superior Court (Watercloud Bed Co.) ("Watercloud")*, *supra*, 19 Cal.App.4th 320, 327.)

1. There Was No Duty Under Truck's Policy To Defend Surgin Against The Alcon Patent-Infringement Actions.

In *Watercloud*, this Court squarely held that advertising injury coverage does not — *and cannot* — cover claims of patent infringement: "patent infringement cannot be covered under the [advertising injury coverage of] the subject policies."[7/] (*Watercloud*, 19 Cal.App.4th at p. 328,

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7/ The policies in *Watercloud* provided coverage for "advertising injury," defined as "'injury arising out of an offense committed during the policy period occurring in the course of the named insured's advertising activities, if such injury arises out of libel, slander, defamation, violation of the right to privacy, piracy, unfair competition or infringement of copyright, title or slogan.'" (*Watercloud*, *supra*, 19 Cal.App.4th at p. 325.) Surgin's policy is substantially identical, providing: "Advertising Liability means: "(1) Libel, slander or defamation; (2) Infringement of copyright or of title or of slogan; (3) Piracy or unfair competition or idea misappropriation under an implied contract; (4) Invasion of right of privacy; committed or alleged to have been committed in any (continued...)

emphasis added; accord, *Gitano Group, Inc. v. Kemper Group* (June 23, 1994) 94 Daily Journal D.A.R. 8875; *Iolab Corp. v. Seaboard Surety Co.* (9th Cir. 1994) 15 F.3d 1500; *Intex Plastics Sales Co. v. United National Ins. Co.* (9th Cir. 1994) 24 F.3d 247; *Everest & Jennings v. American Motorists Ins. Co.* (9th Cir. 1994) 23 F.3d 226; *New Hampshire Ins. Co. v. R.L. Chaides Equipment Co.* (N.D. Cal. 1994) 847 F.Supp. 1452.)

Patent infringement was the *only* claim alleged in three of the four Alcon actions (the so-called '493, '509 and '532 actions). (*See* JA 150-151, 206-26, 231-38.) *Watercloud* precludes any possible cause of action based on a failure to defend these actions. As demonstrated below (Section IV, *infra*, at pp. 29-31), Surgin's own evidence established that the patent-infringement actions accounted for almost 99% of the attorney's fees and costs awarded to Surgin (i.e., $267,145.09 out of $270,622.04).

2. There Was No Duty To Defend Surgin Against Alcon's Counterclaim For False Advertising/Misdescription Of Surgin's Own Product.

There is also no potential that Truck's advertising liability coverage could attach to the one remaining Alcon action (the '264 action), which alleged that Surgin falsely described and advertised one of its own products as FDA-approved and as suitable for use with one of Alcon's products. (JA 149-150, 198-200.) This is so for two reasons.

First, false description of one's own product is not "unfair competition" within the meaning of advertising injury coverage. As this Court observed in *Watercloud*, the tort of unfair competition "refers to the *passing off* of one's goods as those of another." (*Watercloud*, *supra*, 19 Cal.App.4th at p. 327, emphasis added, citing *Bank of the West v. Superior Court* (1992) 2 Cal.4th 1254, 1263.) There are no allegations in Surgin's complaint that any of the Alcon actions asserted (or could conceivably be construed as asserting) that Surgin "passed off" its goods as manufactured by Alcon or anyone else.

7/(...continued)
advertisement, publicity article, broadcast or telecast and arising out of the named insured's advertising activities." (JA 179.)

Second, the false description allegations bring the claim directly within the scope of an explicit coverage exclusion for "incorrect description of any article or commodity." (JA 182 ["Exclusions," para. (7), (c)].) In *New Hampshire Insurance Co. v. Power-O-Peat, Inc.* (8th Cir. 1990) 907 F.2d 58, 59, the court held that a comparable exclusion for incorrect description of goods or products precludes coverage for a competitor's claim that the insured falsely described its own product. Here, too, the "incorrect description" exclusion negated any duty by Truck to defend the '264 counterclaim. (See, *Bank of the West v. Superior Court*, *supra*, 2 Cal.4th at p. 1264 ["If contractual (policy) language is clear and explicit, it governs. (Civ. Code, § 1638)"].)

3. Truck's Alleged Agreement To Defend Subject To A Full Reservation Of Rights Could Not Possibly Have Created A Duty To Defend Where None Otherwise Existed.

The only other factual allegations that might conceivably support a duty to defend are that Truck agreed to defend subject to a full reservation of rights, including the rights to deny coverage and withdraw from the defense. Even Surgin conceded that "a finding that a duty of defense arose is a necessary predicate determination to demonstrating breach of the duty of defense." (JA 801.) As the court observed in *Love v. Fire Ins. Exchange* (1990) 221 Cal.App.3d 1136:

> "[A] bad faith claim cannot be maintained unless policy benefits are due. . . . [T]he covenant (of good faith and fair dealing) is implied as a *supplement* to the express contractual covenants. . . . Absent [the] primary right [of benefits due], however, the *auxiliary* implied covenant has nothing upon which to act as a supplement, and should not be endowed with an existence independent of its contractual underpinnings." (*Id.* at p. 1153, emphasis in original.)

This principle has just been strongly reaffirmed in *Waller*, where Division One of this Court held: "In light of our conclusion that there was no contractual liability on the part of Truck, *there can be*

no valid bad faith claim." (*Waller v. Truck Insurance Exchange*, *supra*, at p. 11373, fn. 10, emphasis added.)[8/]

This holds true even where a carrier agrees to defend but then refuses to pay for insured-selected counsel, so-called *Cumis* counsel. That was the precise circumstance in *State Farm Fire & Cas. Co. v. Geary* (N.D. Cal. 1987) 699 F.Supp. 756. Concluding the carrier never owed a duty to defend in the first place, the court granted summary judgment in favor of the carrier on the insured's claim of bad faith. It held that, even though the carrier had agreed to defend, "where there is no duty to defend, there can be no bad faith refusal to defend or to provide *Cumis* counsel." (*Id.* at p. 760.)

B. The Complaint Failed To Allege Facts Sufficient To Support A Punitive Damage Award.

The complaint's allegations also fail to support any basis for awarding punitive damages. By statute, an employer "shall not be liable" for punitive damages based on an employee's acts "unless the employer . . . authorized or ratified the wrongful conduct for which the damages are awarded or was personally guilty of oppression, fraud, or malice"; the "authorization, ratification or act of oppression, fraud, or malice must be on the part of an officer, director, or managing agent of the corporation." (Civ. Code, § 3294, subd. (b).)

Surgin's complaint does not satisfy these criteria. It does not allege that Truck's management understood, authorized, or ratified any tortious conduct or that any officer, director or managing agent engaged in oppressive, fraudulent or malicious conduct. Indeed, the complaint does not even allege the position, status or conduct of *anyone* at Truck who assertedly engaged in wrongful

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8/ Accord: *State Farm Fire & Cas. Co. v. Jioras* (1994) 24 Cal.App.4th 1619, 1627 [where insurer had no duty to defend, it could not be held to have waived grounds for noncoverage by failing to reserve rights]; *Dykstra v. Foremost Ins. Co.* (1993) 14 Cal.App.4th 361, 368-369 [where there is no duty to defend, judgment properly granted in favor of carrier in suit for bad faith failure to defend]; *B & E Convalescent Center v. State Compensation Ins. Fund* (1992) 8 Cal.App.4th 78, 87, 102 [same]; *Devin v. United Services Auto. Assn.* (1992) 6 Cal.App.4th 1149, 1155, 1158, 1162 [same]; 1A Cal. Insurance Law & Prac. (Mathew Bender 1994) § 13.03[2][b] ["no matter how outrageous an insurer's behavior, no cause of action for breach of the implied covenant exists unless policy benefits were in fact due"].

conduct. Surgin's failure to plead *facts* satisfying the statutory preconditions for a punitive damage recovery is fatal to its default punitive damage award. (Civ. Code, § 3294, subd. (a); see, e.g., *William v. Foss*, *supra*, 69 Cal.App. at p. 707; *Rose v. Lawton*, *supra*, 215 Cal.App.2d 18; *Cripps v. Life Ins. Co. of North America* (9th Cir. 1992) 980 F.2d 1261, 1267 [necessary facts not in pleading are not admitted on default].)

Moreover, reaching the correct result cannot constitute bad faith, nor be deemed despicable, regardless of the carrier's state of mind. (*Waller*, *supra*, 94 Daily Journal D.A.R. at pp. 11365. 11372-11373, fn 1 ["Because we find the Truck policy did not require Truck to defend plaintiffs against the underlying third-party lawsuit, that is, there was no coverage under the policy, we need not reach any other issue," including liability for bad faith and the propriety of punitive damage award]; *Strauss v. Farmers Insurance Exchange* (1994) ___ Cal.App.4th ___, 31 Cal.Rptr.2d 811, 814 [carrier not liable for bad faith, even if it had bad motive, where not otherwise obligated to accept settlement offer].)[9/]

The complaint's *affirmative allegations* conclusively show the absence of any duty to defend under Truck's policy; the complaint also fails to allege facts sufficient to permit recovery of punitive damages. Since the default judgment is not supported by a complaint alleging *facts* sufficient to state a valid cause of action, it must be reversed.

9/ Accord: *Beckham v. Safeco Ins. Co. of America* (9th Cir. 1982) 691 F.2d 898, 904 [applying California law, "It is irrelevant that Safeco may have acted wantonly and maliciously, as alleged by Beckham, since it is the defendant's conduct, not its state of mind, that must be outrageous"]; *Stewart v. Truck Ins. Exchange* (1993) 17 Cal.App.4th 468, 478-479, 482-483 [evidence that claims supervisor had policy of delaying claims-handling is insufficient to support punitive damage claim where no showing of delay in handling particular claim at issue]; *Brodkin v. State Farm Fire & Casualty Co.* (1989) 217 Cal.App.3d 210, 218 ["Even if there was evidence the claim was improperly handled, there could be no cause of action for breach of the covenant of good faith or of any statutory duty since State Farm correctly denied the claim"]; *Kopczynski v. Prudential Ins. Co.* (1985) 164 Cal.App.3d 846, 849 [same].

IV.

THE COMPENSATORY DAMAGE AWARD IS NOT SUPPORTED BY SUBSTANTIAL EVIDENCE AND IS EXCESSIVE AS A MATTER OF LAW.

Section 585(b) requires the trial court to "hear the evidence . . . and render [default] judgment . . . for such sum (not exceeding the amount stated in the complaint . . .), as appears by such evidence to be just." It is not enough merely to plead a damage amount. The plaintiff must *prove* its damages, and the trial court must scrutinize the evidence to assure the damages are supported by substantial evidence. (*Uva v. Evans* (1978) 83 Cal.App.3d 356, 364; *Don v. Cruz*, *supra*, 131 Cal.App.3d at pp. 702-706.) In assessing whether substantial evidence exists, a reviewing court may not ignore undisputed evidence negating the damages claimed. (See, e.g., *People v. Johnson* (1980) 26 Cal.3d 557, 577; *People v. Bassett* (1968) 69 Cal.2d 122, 138-139; *Bowers v. Bernards* (1984) 150 Cal.App.3d 870, 873.)

The trial court awarded Surgin $574,284.79 plus interest as compensatory damages, twice the jurisdictional maximum. This consisted entirely of attorney's fees and costs incurred in defending the Alcon actions (defense fees) and in prosecuting the present action (*Brandt* fees). In addition to violating sections 580 and 585(b), the award also fails because: (a) 99% of the claimed defense fees are *indisputably* allocable to defense of the noncovered patent infringement actions and the remaining 1% were never tied to *any* of the Alcon actions; and (b) the claimed *Brandt* fees facially include substantial charges for items not lawfully recoverable, and Surgin failed to carry its burden of segregating these fees between recoverable and nonrecoverable charges.

A. The Evidence And Judgment As To Compensatory Damages.

1. *Surgin's Evidence.* The complaint sought "compensable losses in a sum in excess of $270,000," specifically alleging that this amount included both defense and *Brandt* fees. (JA 160, 163, 167.) Surgin's evidence showed:

a. *Defense Fees.* The declaration of Frank Frisenda, Surgin's counsel in the Alcon actions, attached a set of four bills totalling $267,145.09. These were broken down into four categories: (1) defense of the '532 action, $161,764.54 (JA 5930-49); (2) defense of the '493

action, $30,608.25 (JA 5950-57); (3) defense of the '509 action, $22,902.50 (JA 5923-29); and (4) prosecution of Surgin's appeal of a preliminary injunction entered in one of the patent-infringement actions, $51,869.80 (JA 5917-22; see JA 5918 [2/15/90 entry], 5936 [12/18/89 entry]). None of these bills purported to relate to defense of the '263 action.

Also attached to the Frisenda declaration were a set of bills from Hyman, Phelps & McNamara, P.C., totaling $3,477.80. (JA 5892-916.) These bills contained neither a comprehensible explanation of services rendered, nor any reference to the matters on which the services were performed. No other evidence referred to these bills.

b. *Brandt Fees.* Surgin claimed $298,746.79 in attorney's fees for prosecuting the present action. (RT 295, 314.) However, the bills supporting that claim totalled only $285,745.79 (JA 6691), and no explanation for the $13,001 discrepancy appears anywhere in the record. Surgin also claimed $4,916.00 in fees for its insurance coverage counsel, Lloyd Stamp, although it submitted no bills supporting this claim. (RT 294, 314.)

2. *The Judgment.* The judgment awards compensatory damages of $574,284.79, consisting of $270,622.00 for "reasonable attorneys' fees and costs incurred in defense of the underlying action" and $303,662.79 for "reasonable attorneys fees and costs incurred in obtaining the benefits of the insurance policy." (JA 7481.) The $574,284.79 figure exceeds by $17,917 the total of the bills Surgin submitted in evidence; it is also $2,141.25 more than Surgin requested and the trial court awarded at the prove-up. (RT 295, 320; JA 6913.)

B. Surgin's Evidence Conclusively Demonstrates That Virtually All Of The Defense Fees Were Expended Defending Noncovered Actions; There Is No Evidence That The Remainder Were Even Incurred In Defense Of Any Of The Alcon Actions.

An insured may not recover damages for failure to defend where there is "undeniable evidence of the allocability of specific expenses" to a noncovered claim. (*Hogan v. Midland National Ins. Co.*, *supra*, 3 Cal.3d at p. 564 [carrier wrongfully refusing to defend owes no obligation to pay fees that are indisputably allocable to noncovered claims]; *California Union Ins. Co. v. Club Aquarius, Inc.* (1980) 113 Cal.App.3d 243, 248-249 [same].) A fortiori, an insured

may not recover fees indisputably allocable to defense of an entirely noncovered *action*. Here, Surgin's undisputed evidence established, on its face, that virtually all of Surgin's defense fees related solely to noncovered actions.

As shown in Section III, *supra*, Truck's policy affords no coverage for defense of patent infringement claims, yet the bills of Surgin's counsel specifically allocate nearly 99% ($267,145 of $270,622) *solely* to noncovered defense of the patent infringement actions (the '493, '509, and '532 actions). Moreover, the $51,869.80 in fees allocated to appealing a patent-infringement preliminary injunction are not covered because injunction actions are not suits seeking recovery of "damages" subject to defense under Truck's policy. (JA 179 [Truck's policy promises only to defend actions "seeking *damages* on account of such . . . advertising liability," emphasis added]; *Crist v. Insurance Co. of North America* (D. Utah 1982) 529 F.Supp. 601, 604-605, 606 [fees for appeal of a preliminary injunction are indisputably allocable to a noncovered claim and are not recoverable under *Hogan v. Midland National Ins. Co.*, *supra*, 3 Cal.3d at p. 564].)

This leaves only the '264 action as a potentially viable source for recovery of defense fees. But, as shown in Section III above, there is no coverage for the '264 action. Besides, Surgin offered no evidence establishing it incurred *any* fees in defense of the '264 action. The only bills not explicitly tied to the noncovered patent infringement actions and appeal of the injunction claims are those of Hyman, Phelps & McNamara, P.C., totaling $3,476.95, but there is *no evidence* relating those bills to *any* of the Alcon actions.

C. The Trial Court Awarded Attorney's Fees Specifically Precluded Under *Brandt v. Superior Court*, And Surgin Failed To Carry Its Burden Of Proving Which Fees Are Recoverable.

Brandt holds that the *only* attorney's fees recoverable in an action for insurance bad faith are those incurred to obtain *contractual* benefits actually owing and tortiously denied; fees "attributable to the bringing of the bad faith action itself" and "to obtaining any portion of the plaintiff's award which exceeds the amount due under the policy [e.g., tort, consequential and punitive damages for bad faith] are not recoverable." (*Brandt v. Superior Court*, *supra*, 37 Cal. 3d at pp. 818, 819;

Slottow v. American Cas. Co. (9th Cir. 1993) 1 F.3d 912, 919 ["fees expended on obtaining amounts in excess of the policy, such as consequential damages, aren't recoverable"].) Because *Brandt* only allows recovery of fees incurred in seeking policy benefits actually owed and tortiously denied (*Brandt, supra*, 37 Cal.3d at pp. 817-818), fees incurred in seeking benefits not owed (i.e., relating to defense of noncovered patent actions) cannot be collected. (*Brandt, supra*, 37 Cal.3d at p. 819 ["The fees recoverable, however, may not exceed the amount attributable to the attorney's efforts to obtain the rejected payment *due on the insurance contract*"].)

The bills supporting Surgin's *Brandt* claim are littered with countless entries for matters facially precluded under *Brandt*, such as: "prepare memo . . . re elements for punitive damages," "obtaining financial information on defendants for punitive damages at trial," "evaluate damages for bad faith failure to defend" and "review documents provided by client re: lost profits." (JA 6696, 6776, 6832, 6775 [entries dated 9/1/93, 12/28/92, 6/10/91, and 12/28/92].)[10/] None of these items is recoverable.

Also, Mr. Stamp declared his services related primarily, if not exclusively, to tendering Alcon's claims to Truck and obtaining Truck's agreement to defend Surgin. (RT 109-124.) These items likewise are not recoverable. (See California Judges Association, *Insurance Litigation 1994* (The Rutter Group 1994) ¶ 13:123, at p. 13-23 [under *Brandt*, "fees incurred *prior* to the insurer's

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10/ The billings contain innumerable other references to nonrecoverable charges, including: (1) many entries for meetings with, and preparing and deposing, witnesses whose testimony related solely to the tort aspects of Surgin's case, e.g., Lloyd Stamp (Surgin's coverage counsel who tendered Surgin's defense to Truck, obtained Truck's agreement to defend, and testified on whether Truck acted tortiously) (RT 109-124); John Marshall (who testified as an insurance expert regarding bad faith) (RT 143-172); Bruce Ross (an accountant who testified solely on Truck's financial condition for purposes of imposing punitive damages) (RT 172-180); Neal Pedersen (an attorney in the *Waller* action, who testified as to Truck's conduct at issue in, and the now-reversed punitive damage judgment in, that case, all in support of punitive damages here) (RT 183-188); Lauren Kramer (an attorney in Texas who testified whether certain manuals were responsive to Surgin's discovery requests, in support of Surgin's claim for punitive damages) (RT 199-204); Michael Conn (who testified solely as to Truck's conduct in handling other claims, in support of Surgin's claim for punitive damages) (RT 204-236); (2) numerous charges for researching Truck's financial status (necessary in order to establish punitive damages) (see, e.g., RT 181-82); and (3) numerous charges for review and mathematical analysis of lost sales to prove consequential tort damages for lost profits (see, e.g., JA 6695-707, 6773-77).

wrongful refusal to pay are not recoverable (e.g., fees in connection with presentation of a claim)"].)

Surgin had the burden of proving what portion of its counsel's bills constituted charges properly recoverable under *Brandt*. (See, e.g., *Adams v. Murakami* (1991) 54 Cal.3d 105, 119-123 [plaintiff bears burden of proving all elements of damages].) A plaintiff may not recover *any Brandt* fees if it fails to segregate the claimed attorney's fees between recoverable fees incurred in obtaining policy benefits and nonrecoverable fees incurred in pursuing consequential or other tort damages. (*Slottow v. American Cas. Co.*, *supra*, 1 F.3d at p. 919 [where insured "made no effort to segregate its litigation expenses as required by *Brandt*," trial court properly awarded *no* fees]; see also *Conrad v. Ball Corp.* (1994) 24 Cal.App.4th 439, 444 [after Proposition 51, defendant who fails to prove allocation of settlement between economic and noneconomic damages is entitled to *no* offset for settlement].)

Here, Surgin's proof included numerous components *facially* not recoverable under *Brandt*. Since Surgin failed to segregate its attorney's fees to permit determination of the amount properly recoverable under *Brandt*, the entire $303,662.79 award for *Brandt* fees must be reversed.

For these reasons, the compensatory award must be reversed in its entirety. Because Surgin failed to prove entitlement to any compensatory damages, the reversal must be *with directions to enter judgment in Truck's favor.* (§ 629; *McCoy v. Hearst Corp.* (1991) 227 Cal.App.3d 1657, 1661 [held, "where the plaintiff's evidence is insufficient as a matter of law to support a judgment for plaintiff, a reversal with directions to enter judgment for the defendant is proper"]; *Bank of America v. Superior Court* (1990) 220 Cal.App.3d 613, 625-626.)

V.

THE PUNITIVE DAMAGE AWARD VIOLATES DUE PROCESS. IT IS STAGGERINGLY EXCESSIVE AND IS THE PRODUCT OF PASSION, PREJUDICE AND BIAS.

Punitive damages "'constitute a windfall, create the anomaly of excessive compensation, and are therefore not favored in the law.'" (*Las Palmas Associates v. Las Palmas Center Associates*

(1991) 235 Cal.App.3d 1220, 1258, quoting *Dumas v. Stocker* (1989) 213 Cal.App.3d 1262, 1266; *Rosener v. Sears Roebuck & Co.* (1980) 110 Cal.App.3d 740, 750.) Indeed, "the Constitution imposes a *substantive* limit on the size of punitive damage awards." (*Honda Motor Co. v. Oberg* (1994) 114 S.Ct. 2331, 2335, emphasis added.) Because "[p]unitive damages pose an acute danger of arbitrary deprivation of property," due process mandates that punitive damage awards be subject to searching appellate review. (*Id.* at p. 2340.)[11/]

As the United States Supreme Court declared in its most recent decision on punitive damages (*Honda*, *supra*): "'grossly excessive' punitive damages would violate due process" (*id.* at p. 2335); there must be "assurance that those whose conduct is sanctionable by punitive damages are not subjected to punitive damages of arbitrary amounts" (*id.* at p. 2341); the "whole purpose" of the Due Process Clause is to "prevent" "arbitrary deprivations of property." (*Id.* at p. 2342.) The Court pointedly observed:

> "What we are concerned with is the possibility that a guilty defendant may be unjustly punished; evidence of guilt warranting some punishment is not a substitute for evidence providing at least a rational basis for the particular deprivation of property imposed by the State to deter future wrongdoing." (*Id.* at p. 2339.)

To survive appellate scrutiny, punitive damage awards must pass multiple tests, including these:

- The award must bear a reasonable relationship to (1) the nature and amount of harm caused, as measured by compensatory damages, (2) the financial condition of the defendant, and (3) the reprehensibility of the defendant's conduct "in light of the types of misconduct that will support punitive damages." (*Adams v. Murakami*, *supra*, 54 Cal.3d at pp. 110-112 & fn. 2; *Neal v. Farmers Insurance Exchange* (1978) 21 Cal.3d 910, 928; *Rosener v. Sears, Roebuck & Co.*,

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11/ See also: *Pacific Mut. Life Ins. v. Haslip* (1991) 499 U.S. 1, 21, 111 S.Ct. 1032, 1045, 113 L.Ed.2d 1, fn. 10 [suggesting that review for mere "passion or prejudice" or "excessiveness" would be insufficient]; *Las Palmas Associates v. Las Palmas Center Associates*, *supra*, 235 Cal.App.3d at p. 1258 [affirming constitutionality of California's "passion or prejudice" standard of review of punitive damages, but interpreting that standard to require "(a)ppellate courts [to] *scrutinize* punitive damage verdicts" (emphasis added) and to conduct a searching review of the criteria supporting the award].

supra, 110 Cal.App.3d at p. 751.) In addition, "the magnitude of the punitive award, including the amount by which it exceeded the compensatory [award is a] proper consideration[] for determining whether the award was excessive as a matter of law." (*Grimshaw v. Ford Motor Co.* (1981) 119 Cal.App.3d 757, 822.) As our Supreme Court put it:

> "Because the quintessence of punitive damages is to deter future misconduct by the defendant, the key question before the reviewing court is whether the amount of damages 'exceeds the level necessary to properly punish and deter.'" (*Adams v. Murakami*, *supra*, 54 Cal.3d at p. 110.)

Answering this question requires assessing "whether the difference between the two figures [for compensatory and punitive damages] is so wide that the punitive damages have been divorced from the societal goals of retribution and deterrence." (*Boyle v. Lorimar Productions, Inc.* (9th Cir. 1994) 13 F.3d 1357, 1361.)

- The award may not be "reached in proceedings lacking the basic elements of fundamental fairness." (*Browning-Ferris Industries of Vermont, Inc. v. Kelco Disposal, Inc.* (1989) 492 U.S. 257, 276, 109 S.Ct. 2909, 2921, 106 L.Ed.2d 219.)

- The award may not result from passion, prejudice or bias. (*Ibid.*; *Adams v. Murakami*, *supra*, 54 Cal.3d at pp. 109-110.)

Although a failure to satisfy *any* of these standards would require reversal, the $57.2 million punitive damage award here *fails under each*.

A. The Punitive Damage Award Must Be Reversed Because It Is Based On A Jurisdictionally Void, Grossly Excessive And Legally Insupportable Compensatory Award.

The trial court applied its 100-to-1 punitive-to-compensatory ratio to a grossly overstated, jurisdictionally deficient compensatory damage base. As demonstrated in Sections I and IV above, the compensatory award here cannot exceed $270,000 and the evidence does not even support an award anywhere near that amount. Because punitive damages must bear a reasonable relationship to compensatories, the excessive compensatory award *alone* requires reversal of the related punitive

award. (*Liodas v. Sahadi* (1977) 19 Cal.3d 278, 284 [where "trial court . . . properly granted a new trial on the issue of compensatory damages . . . (e)xemplary damages must be redetermined as well"]; *Kuffel v. Seaside Oil Co.* (1970) 11 Cal.App.3d 354, 367; *Foster v. Keating* (1953) 120 Cal.App.2d 435, 454-455; see *Palmer v. Ted Stevens Honda, Inc.* (1987) 193 Cal.App.3d 530, 541-542.) But there are also many other dispositive reasons why the punitive award must be vacated.

B. The Extraordinary Size Of The Punitive Damage Award Places It Far Beyond Any Possibility Of Approval.

Fifty-seven *million* dollars.

Huge.

But defendants always say that. How big is this punitive award, really?

By any standard, it is gigantic:

- It is over $52 million — more than 10 times — larger than the largest punitive damage award ever approved in a published decision in California. (See *Downey Savings & Loan Assn. v. Ohio Casualty Ins. Co.* (1987) 189 Cal.App.3d 1072, 1100 [approving $5 million punitive award].)

- The differential between punitive and compensatory damages is over $56.6 million — more than 11 times — larger than any ever approved in a published California opinion. (*Id.* at p. 1097 [$5 million punitive award, $4.85 million greater than compensatory award].)

- The punitives as a percentage of Truck's net worth — 25% — is fifty percent greater than the highest such percentage ever approved in a published California decision. (See *Devlin, supra*, 155 Cal.App.3d 381, 391 [approving punitive award constituting 17.5% of defendant's net worth].) Many cases hold that punitive awards in this range are excessive. (See, e.g., *Little v. Stuyvesant Life Ins. Co.* (1977) 67 Cal.App.3d 451, 469 [15% of net worth excessive]; *Burnett v. National Enquirer, Inc.* (1983) 144 Cal.App.3d 991, 1012 [35% of net worth excessive; award reduced to 0.5% of net worth]; *Zhadan v. Downtown L.A. Motors* (1976) 66 Cal.App.3d 481, 500 [33% of net worth excessive]; *Merlo v. Standard Life & Acc. Ins. Co.* (1976) 59 Cal.App.3d 5,18 [30% of net worth excessive].)

- The 100:1 ratio of punitive to compensatory damages is over three times more than the highest such ratio ever approved in any case where compensatory damages exceeded the relatively small amount of $30,000. (*Downey*, *supra*, 189 Cal.App.3d 1072 [punitive damages 32.7 times the $153,000 compensatory award].)[12/]

As striking as these comparisons are, they do not tell the full story. The various mathematical measures utilized in each case should also be viewed in combination. To do this, we employ a method similar to the grammar school exercise of "finding the common denominator." We examine each published California appellate decision where the size of a punitive award was challenged on appeal and affirmed (or remitted and affirmed). By multiplying together the three objective criteria that appellate courts most frequently use to evaluate punitive awards — the ratio of punitive to compensatory damages, the ratio of punitive damages to the defendant's net worth, and the amount of the award — we create a "combined number" for each case, a number that permits application of the same yardstick to all awards, thus permitting meaningful comparison. We do this in the Appendix.

The result is breathtaking. Even with a liberal allowance for the frailties of mathematical constructs and utilizing conservative assumptions which uniformly favor Surgin (all as explained in detail in the Appendix), the $57.2 million punitive award here *dwarfs* every other ever approved by a California appellate court. The comparison is so disproportionate that "out of the ballpark" becomes an absurdly weak metaphor. This one is off the planet.

12/ We anticipate Surgin will parade some higher ratios before this Court, such as the 2000:1 ratio upheld in *Finney v. Lockhart* (1950) 35 Cal.2d 161, 163. That ratio (the highest ever approved in California) seems extraordinarily high, until one recognizes that the actual punitive award was only $2,000, having been built on compensatory damages of $1. The same is true in every other case where the ratio of punitive to compensatory damages is high; in all of them, the high ratio invariably is offset by relatively low compensatory damages. (See, e.g., *Wetherbee v. United Ins. Co. of America* (1971) 18 Cal.App.3d 266 [200:1 ratio, $1,050 in compensatory damages]; *Moore v. American United Life Ins. Co.* (1984) 150 Cal.App.3d 610 [83:1 ratio, $30,000 in compensatory damages]; *Neal v. Farmers Ins. Exchange*, *supra*, 21 Cal.3d 910 [74:1 ratio, less than $10,000 in compensatory damages].)

All Published California Cases	Combined Number
Median	75,614
Mean	1,686,493
Highest	18,000,000
This Case	***1,421,656,513***

When the combined numbers are analyzed, the award in this case is staggering. It is almost *80 times larger* on this basis than the highest punitive award ever upheld in a published California appellate decision, and it increases exponentially when compared against the median and mean numbers.

Other measures also confirm the dramatic excessiveness of this award:

- It is 11.5 *times* Truck's entire 1992 before-tax net income (the last available year at time of the prove-up). (RT 179, 180; JA 6361.) This, too, compels reversal. (*Egan v. Mutual of Omaha Ins. Co.* (1979) 24 Cal.3d 809, 824 [reversing as excessive punitive damage award exceeding seven months of company's net income]; *Burnett v. National Enquirer, Inc.*, *supra*, 144 Cal.App.3d 991, 1012 [punitive damages constituting 50% of net income was excessive as a matter of law].)[13/] Even the 11.5 multiple of net income is actually *much higher* because it is unfairly selective. Surgin's own evidence showed that *Truck suffered multi-million dollar net losses in each of the three years preceding 1992; Truck's four year loss totalled over $37 million.* (JA 6110, 6207 [line 14]; cf. JA 6361 [line 14: 1992].)

- The award is over 38 times the $1.5 million amount that Surgin's expert testified would have a material impact on Truck's financial statements and would be brought to the attention of Truck's senior management. (RT 178.)

By any objective measure, the punitive damage award here is so huge that it is completely out of kilter with punitive awards imposed in other cases and with any rational concept of

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13/ See also L. Johns, CALIFORNIA DAMAGES, LAW AND PROOF (4th ed. 1994) § 18.19, pp. 18-22 to 18-23 ["it appears unreasonable to assess punitive damages on the basis of worldwide earnings of a defendant (large) corporation . . . where the corporation is being punished merely for the tortious and malicious acts of one or two employees in a branch office in California"].

proportionality. For this reason alone, reversal is compelled. (*Honda Motor Co. v. Oberg*, *supra*, 114 S.Ct. at p. 2337 [on review, "(j)udges . . . infer passion, prejudice or partiality from the size of the award"].) But there is still more, much more.

C. Compared To Other Conduct Justifying Punitive Damages, Truck's Conduct Was Not Sufficiently Egregious To Justify A $57.2 Million Award.

By definition, any defendant properly found liable for punitive damages must have engaged in despicable conduct, that is, "conduct which is so vile, base, contemptible, miserable, wretched or loathsome that it would be looked down upon and despised by ordinary decent people." (BAJI No. 14.72.1.) *Adams v. Murakami*, *supra*, 54 Cal.3d at pp. 110-112 & fn. 2, teaches that, in order to evaluate the appropriate size of a punitive award, the court must compare the misconduct being punished to other "types of misconduct that will support punitive damages," not merely to innocent or negligent behavior. As one court put it, determining punitive damages involves "[t]he channeling of just the correct quantum of bile." (*Devlin v. Kearney Mesa AMC/Jeep/Renault, Inc.*, *supra*, 155 Cal.App.3d 381, 388.)

If the trial court had really applied the proper standard, one would have to conclude from the size of the punitive award that Truck ranked among history's most notorious villains and was certainly far more villainous than anyone ever previously punished by punitive damages in California. The record of this case will not sustain such a conclusion or anything remotely like it.

Stripping away the inflammatory, unpleaded facts that Surgin improperly introduced and the court considered, and reducing this case to what was properly at issue — the facts alleged in the complaint — the most that legitimately can be said is that Truck failed to honor a qualified agreement to defend claims that its policy did not require it to defend. In the end, Truck's position here (exactly as in *Waller*) was legally correct — there was no coverage.[14/] Nonetheless, 25% of

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14/ The opinion of Truck's coverage counsel at the time was that Truck had *no* obligation to defend two of the four Alcon actions. (JA 1544.) While that same coverage counsel recommended, in a pre-*Watercloud* environment, that Truck defend the remaining two Alcon actions, that recommendation was based on counsel's mistaken belief as to how the case law regarding coverage for unfair competition and patent infringement *might* develop (JA 1542), a belief Truck's claims (continued...)

Truck's net worth has been transferred to a single policyholder for, *at most*, breaching a gratuitous promise (albeit under a reservation of rights) to provide that policyholder with an undeserved windfall.

It boggles the imagination to conceive how this conduct could be deemed despicable, but assuming for the sake of argument that it warrants punitive damages — in fact, even assuming there was some kind of duty to defend that was wilfully violated — the putative evil still does not even begin to approach the vileness of the conduct punished in many other cases. Consider, for example:

- *Greenfield v. Spectrum Investment Corp.* (1985) 174 Cal.App.3d 111, disapproved on other grounds, *Lakin v. Watkins Associated Industries* (1993) 6 Cal.4th 644: A nationwide car rental company covered up and ratified its employee's physical assault on customer; plaintiff was severely beaten, sustained two fractures, was disabled from work for six months and sustained permanent painful neck injury; punitive damages: $400,000.

- *Gibson v. Gibson* (1971) 15 Cal.App.3d 943, 944: $40,000 in punitive damages against defendant who participated in ex-husband's abduction and continued secretion of plaintiff's children.

- *Grimshaw v. Ford Motor Co.* (1981) 119 Cal.App.3d 757, 821, 822: affirmed reduction of $125 million jury award to $3.5 million where $7.7 *billion* corporate defendant's conduct threatened mayhem and death to thousands of people and resulted from senior management decisions.

- *West v. Johnson & Johnson Products, Inc.* (1985) 174 Cal.App.3d 831, 846-848, 851-852, 869, 875: affirmed reduction of $10 million punitive award to $1 million, where large corporate defendant consciously disregarded known health risk to women by marketing tampons prone to causing potentially fatal toxic shock syndrome.

14/(...continued)
representatives correctly did not share (JA 6045-53). (See, e.g., *Waller*, *supra*, at p. 11371 [applying "the general rule of retroactive application of judicial decisions . . . and the accepted practice of appellate courts to justify an insurer's refusal to defend on the basis of subsequently published opinions"].)

Even Surgin's *unpleaded* assertion of isolated incidents over a 10-year period (hardly a "pattern and practice") does not rise to the level of despicable conduct that motivated punitive damage awards in other cases. No one died. No lives were destroyed. Significantly, the *only* other instance Surgin proffered of an asserted failure by Truck to provide a defense to an insured — indeed, it was the *centerpiece* of Surgin's unpleaded "pattern and practice" claim —was *Waller v. Truck Insurance Exchange*. (RT 305 ["I believe it is (necessary to stop) the pattern and practice. They were aware of what happened in *Waller*, they got hit for $60 million . . . in punitive damages"]; RT 317 ["the *Waller* decision hit them for $60 million, they knew all about it, and it didn't stop them"].) Yet the *Waller* premise was entirely fallacious because there, as here, *Truck owed no duty to defend*. (*Waller*, *supra*.) It is sad, but unfortunately true, that Truck was subjected to crippling punishment here on the basis of conduct which the Court of Appeal in *Waller* held was *completely innocent*. This alone requires reversal. (See *Grain Dealers Mutual Ins. Co. v. Marino* (1988) 200 Cal.App.3d 1083, 1088-1089 [where second decision is premised on ruling in first case that is reversed, second case must be reversed as well].)

Analysis of the pertinent punitive damage cases suggests that a meaningful evaluation of relative reprehensibility requires consideration of three factors: (1) the nature of the injury or injuries inflicted, with death and physical injury being more reprehensible than economic harm; (2) the extent to which the defendant *intended* to inflict injury for its own sake upon another, as opposed to merely disregarding the rights of others in pursuing its own self-interest; and (3) the extent of the harm (i.e., the number of victims and the severity of the injury to each victim). The most egregious end of the comparative reprehensibility scale would include conduct the defendant *knows* will result in death or severe physical injury to many people — mass murder, product tampering, toxic waste dumping, marketing a product known to be physically harmful, and the like. At the opposite end of the scale would be conduct that consciously disregards the rights of others but involves no independent intent to harm and causes moderate economic harm to one or a small number of victims.

By any measure, Truck's conduct registers on the lower end of the relative reprehensibility scale. The injury — assuming there even was one — was purely economic and affected only one

party. There is no hint that Truck was pursuing any vendetta or harbored any intent to harm Surgin. If Truck's conduct is on the reprehensibility scale at all, it does not come remotely close to supporting one of the biggest civil punishments ever imposed in California history. *Honda's* due process concern about "the possibility that a guilty defendant may be unjustly punished" applies here, with one exception — Truck is not guilty. But even if some punishment were warranted, there is no evidence of reprehensibility or need for deterrence that provides any rational basis for the massive deprivation of property that occurred in this case. (*Honda*, *supra*, 114 S.Ct. at p. 2339.)

D. The Court Repeatedly Applied Erroneous Legal And Factual Standards.

The punitive damage award must also be vacated because the trial court applied legally improper criteria. In addition to ignoring the jurisdictional limits on damages and proof (Sections I and II, *supra*), the court misapplied other important principles as well.

1. The Court Erroneously Used Punitive Damages As A Means To Compensate Surgin For Non-Recoverable Losses. An award of punitive damages may not be inflated to compensate for losses that a plaintiff is not otherwise entitled to recover. (See, e.g., *Lakin v. Watkins Associated Industries* (1993) 6 Cal.4th 644, 664 ["by definition (punitive damages) are not intended to make the plaintiff whole by compensating for a loss suffered"]; *Alvarez v. Sanchez* (1984) 158 Cal.App.3d 709, 715 [punitive damages could not be calculated by applying a "benefit of the bargain" measure of compensatory damages where proper compensatory damage standard was "out of pocket loss"].)

Ignoring this principle, the court improperly used punitive damages *to compensate* Surgin for injuries that the court itself found were speculative and unproven (i.e., claimed "lost profits") and expressly "*to compensate*" for unpleaded "aggravation" which Surgin's officers supposedly suffered as a result of "this litigation and the trials and tribulations of litigation." (RT 323, emphasis added.) Neither speculative lost-profit damages nor "stress of litigation" damages are compensable. (E.g., *California Shoppers, Inc. v. Royal Globe Ins. Co.* (1985) 175 Cal.App.3d 1, 62; *Twaite v. Allstate Ins. Co.* (1989) 216 Cal.App.3d 239, 257-258; *Berry v. First State Ins. Co.*

(9th Cir. 1990) 915 F.2d 460, 466; cf. *Don v. Cruz*, *supra*, 131 Cal.App.3d at pp. 707-708 [new default judgment hearing proper where court bases damage award on improper factors].)[15/]

2. The Court Improperly Used The Punitive Damage Award To Impose A Double Punishment On Truck For Its Claimed Discovery Misconduct And To Punish Truck Merely For Exercising Its Constitutional Right To Defend Itself. The court admitted it imposed punitive damages to punish Truck for its asserted discovery misconduct. In giving its reasons, it stated that "at every possible turn from the first notice of claim *through the litigation which terminated a few weeks ago*, Truck has lied, cheated, stonewalled and tromped on the rights of the insured . . . . '*Litigate the hell out of the little* guy until he can't go any further,' appears to be the theory."[16/] (RT 322; see also RT 316 [Surgin argues that punitive damages should be imposed for discovery misconduct in the present case].)

This is unconstitutional. By using Truck's litigation conduct as a basis for imposing *both* terminating sanctions *and* punitive damages, the court improperly imposed a double punishment. "'A defendant has a due process right to be protected against unlimited multiple punishment for the same act. . . . [O]verlapping damage awards violate that sense of "fundamental fairness" which lies at the heart of constitutional due process.'" (*Troensegaard v. Silvercrest Industries, Inc.* (1985) 175 Cal.App.3d 218, 227); *see also Hunter v. Spaulding* (1990) 97 N.C.App. 372, 380, 388 S.E.2d 630, 636 ["It is, for example, questionable whether the damages the jury awarded relate to the real

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15/ The speculative lost-profit damages that the trial court gave Surgin through the back door could never even have been Truck's fault, because they stemmed from events in the Alcon litigation that occurred *long before Surgin even tendered its claim to Truck* and while Surgin was being vigorously defended by counsel of its own choosing. While the complaint alleges Surgin tendered the Alcon claims in March, 1990 (JA 151), Surgin's officer testified that product sales dropped with the filing of the '532 action in August, 1989, and reached zero in December, 1989, because of the pendency of the litigation and the entry of a preliminary injunction. (RT 274-275.) Truck did not cause either the filing of the Alcon actions or Alcon's successful pursuit of a preliminary injunction. (*Comunale v. Traders & General Ins. Co.* (1958) 50 Cal.2d 654, 659-660 [no causation as to resulting judgment where despite carrier's failure to defend, insured is defended by its own counsel].)

16/ As discussed elsewhere, this diatribe was entirely unwarranted.

estate claim or, in part or in whole, to Mr. Spaulding's failure to comply with discovery. Permissible sanctions for the latter do not include the party's answering in punitive damages"].)

Imposing *punitive damages* on Truck for discovery misconduct deprived Truck of its constitutional right to a jury trial on the *facts* of its asserted discovery misconduct, including its intent. The trial court certainly has the right and power to control litigation through the use of discovery sanctions. But punitive damages are different. They are *punitive*. When the trial court steps into the realm of imposing *punitive damages* against a party for unpleaded discovery transgressions, the right to a contested jury trial on that issue constitutionally attaches. Truck unconstitutionally received less protection here than if the trial court had attempted to punish Truck by way of contempt for the same perceived transgressions. (See *International Union, UMWA v. Bagwell* (1994) 114 S.Ct. 2552, 2559-2560 [where trial court imposes serious, non-compensatory contempt fines, constitutional right attaches to jury determination of violation of court orders].) Here, the trial court acted as legislature, judge, prosecutor, jury and executioner in imposing punitive damages against Truck for unpleaded discovery abuse that the trial court itself defined, found and then twice punished.

Punitive damages are not available as a discovery sanction for another reason as well. The *in terrorem* use of punitive damages in lieu or on top of discovery sanctions to punish for a discovery violation unconstitutionally punishes a litigant for exercising its constitutional right to defend itself. (See *White v. Western Title Ins. Co.* (1985) 40 Cal.3d 870, 890, 891, conc. opn. of Grodin, J. ["an insurer's litigation tactics will (not) be subject to scrutiny by a jury on the basis of a bad faith claim. An insurer must have the right to defend itself in court against claims it believes to be without merit, and the normal rules of litigation should be adequate to protect against abuse"]; *Nies v. National Auto. & Casualty Ins. Co.* (1988) 199 Cal.App.3d 1192, 1201-1202 [while *White* allows introduction of evidence of settlement offers in a bad faith case, it does not make admissible other post-litigation conduct]; see also *Palmer v. Ted Stevens Honda, Inc.* (1987) 193 Cal.App.3d 530, 542, conc. opn. of Brauer, J. [urging Supreme Court to reexamine *White* to the extent it compromises carriers' right to defend themselves]; cf. *Rosener v. Sears, Roebuck & Co.*, *supra*, 110

Cal.App.3d at p. 754 [punitive damages should be mitigated where some of the actions were based on advice "however desultory" of counsel].)

A litigant should not be liable for a greater amount of damages on the underlying claim merely because it has chosen to defend itself, even if it has done so in an opprobrious manner. (See *Greenup, supra*, 42 Cal.3d at pp. 828, 829 [defendant guilty of reprehensible discovery conduct could not be subject to greater judgment on underlying claim than defendant who failed to answer at all].) Insurers have the same right as anyone else to defend themselves against damage claims premised on misconduct. While other parties who engage in discovery abuse face only monetary, evidentiary, issue, and terminating sanctions, the trial court here improperly subjected Truck to massive additional punishment — punitive damages — for the same conduct. This violates due process, as well as equal protection under both the United States and California Constitutions.

3. The Court Misunderstood And Misapplied The Standards By Which The Reprehensibility Of Truck's Conduct Should Be Judged. The court misconceived the nature of Truck's legal obligations, mistakenly concluding — in the face of directly contrary controlling authority (*Watercloud*), which the court refused even to consider — that Truck's policy and fiduciary duty obligated Truck to pay defense costs. (RT 319, 322.) The trial court was wrong on both counts. (See Section III, supra; *Love v. Fire Ins. Exchange, supra*, 221 Cal.App.3d 1136, 1147-1150 [insurance carrier is not a true fiduciary and owes no duty to defend or pay noncovered claims].) Where, as here, the trial court misunderstands the degree or basis of the wrongfulness of the defendant's conduct, the punitive damage "aspect of the judgment should also be reversed" and remanded for recalculation. (*Potter v. Firestone Tire & Rubber Co.* (1993) 6 Cal.4th 965, 1004; *Honda Motor Co. v. Oberg, supra*, 114 S.Ct. at p. 2339 [there must be a "rational basis for the particular deprivation of property imposed"].)

4. Surgin Misled The Court Regarding The Asserted "Fact" Of A Punitive Damage Award Against Truck In *Waller*. The trial court imposed punitive damages, and certainly gauged the amount of punitive damages, on the basis of its conclusion that Truck's conduct "appears consistent with a pattern and practice within the industry for Truck Exchange." (RT 322.) Surgin's primary argument that there was a "pattern and practice" requiring enhanced punitive damages as

a deterrent was that "the *Waller* decision hit them for 60 million, they knew all about it, and it didn't stop them. So I think a deterrent . . . would be $34 million or 15 percent [of net worth]." (RT 317.)

Surgin was wrong. First, the punitive damage judgment against Truck in *Waller* was only $6 million; second, *Waller* has been reversed. (94 Daily Journal D.A.R. 11365.) This judgment should also be reversed. (See *Grain Dealers Mutual Ins. Co. v. Marino*, *supra*, 200 Cal.App.3d at pp. 1088-1089.)

E. The Punitive Damage Award Is The Product Of Passion, Prejudice And Bias.

Even though passion, prejudice and bias are normally associated with juries, judges are also vulnerable. (*Uva v. Evans*, *supra*, 83 Cal.App.3d at pp. 363-364; *Don v. Cruz*, *supra*, 131 Cal.App.3d at p. 707.) Nothing else explains the award here. The very size of the punitive award alone raises a presumption of passion, prejudice and bias: courts "infer passion, prejudice or partiality from the size of the award" (*Honda*, *supra*, 114 S.Ct. at p. 2337 ["(t)his aspect of passion and prejudice review has been recognized in many opinions of this Court"]; *Zhadan v. Downtown L. A. Motors* (1976) 66 Cal.App.3d 481, 496.)

But the award's mammoth size and disproportionality are not the only indicators of passion, prejudice and bias. A result-oriented disregard of governing law and procedure is also a hallmark. As one court observed: "Prejudice imports the formation of a fixed anticipatory judgment as contradistinguished from those opinions which may yield to substantial evidence. It includes the forming of an opinion without due knowledge or examination, although it does not necessarily indicate any ill feeling." (*Adoption of Richardson* (1967) 251 Cal.App.2d 222, 232-233.)

Examples of the result orientation in this case include:

- The court changed its "gross misunderstanding" characterization to "cool and calculating," "blatant, wilful and in bad faith" when confronted with authority establishing that a "misunderstanding" will not support terminating sanctions. (Compare RT 2 with RT 72-73; see JA 2498-99.)

- The court made after-the-fact jurisdictional findings on issues it had never considered (i.e., the finding of "actual" nature of claims of *$62 million* and *$100 million*), going so far as to eradicate an express finding after Truck provided evidence showing that the finding would require opening Truck's default (i.e., the finding that Truck's default would have been opened if Truck had provided further documents by September 15, 1993, which Truck had in fact done, was changed to May 4, 1993, a date prior to Truck's further production). (Compare JA 7480 with JA 8293.)

- After announcing its punitive award, the court permitted Surgin to re-open its case to introduce financial evidence in an effort to bolster the already-announced award. (JA 7418-78.)

- After reaching its damage decision, the court refused to consider controlling authority — this Court's *Watercloud* decision — establishing that Truck's policy created no duty to defend Surgin against patent-infringement actions. (RT 340.)

- On its own motion and without any notice or basis, the court attempted to purge the record of Truck's offer of proof concerning the section 473 motion it would have made to obtain mandatory relief from default if the court's finding of wilfulness had not precluded it. (JA 8541, 8300.)

- The court awarded almost twice the punitive damages Surgin sought, despite awarding only 1/20 of the compensatory damages Surgin requested. The result was a 100-to-1 punitive-to-compensatory ratio instead of the 2.5-to-1 ratio Surgin asked for. (See RT 305.)

- Although this should have been a conventional perfunctory default proceeding focused exclusively on damages, the court agreed with Surgin's counsel, *ex parte*, to some unspecified "non-standard" procedures. (JA 6873 [entries 7/14/93].) One non-standard procedure indisputably employed here was proceeding with the default prove-up despite Surgin's failure to complete the mandatory Judicial Council form requiring information concerning the damage amount demanded. (JA 5723.)

The judgment confiscates over a quarter of Truck's net worth and transfers it as a windfall to one policyholder, Surgin, all in gross disregard of fundamental due process rights and California substantive law. The result is a grotesque caricature of the societal goals of retribution and deterrence that punitive awards are supposed to serve.

VI.

THE TRIAL COURT'S UNREPORTED, *EX PARTE* MEETING WITH SURGIN'S COUNSEL AT THE OUTSET OF THE DEFAULT PROVE-UP HEARING CREATED AN APPEARANCE OF IMPROPRIETY THAT MANDATES REVERSAL.

The trial court held an *ex parte*, unreported, private meeting in chambers with Surgin's counsel at the outset of the default prove-up. Truck formally requested that all proceedings be reported (JA 5776-80) and that it be allowed to observe the trial court's meeting with Surgin's counsel. (JA 7970.) The court refused. (JA 7970.) The only contemporaneous evidence of what occurred at this meeting was its result: Immediately after the meeting, Surgin announced it had decided to place the fate of its claims in the hands of the trial court, without the advisory jury it had previously requested. (RT 77.)

The private meeting here was not a chance social encounter. It was an extended, half-hour private meeting in the trial court's chambers. It occurred at the appointed time and place for Surgin's default prove-up hearing. It concerned this case. It was held in secret despite Truck's express written request that all proceedings be reported as statutorily required (§ 269) and despite Truck's request simply to observe the meeting.

What influenced Surgin's decision to drop its insistence on an advisory jury is unknowable because no reporter was present. What we do know is that the subject was admittedly discussed in chambers (the trial court later said that the "major part" of the discussion about the case was spent on that topic) and that, immediately afterwards, Surgin announced it would proceed without an advisory jury because it believed it would do as well with the court alone. The next thing that happened was that the trial court — without so much as an inquiry concerning the elementary, century-old jurisdictional constraints on its power — rendered one of the largest punitive damage awards in California history and, in doing so, ran roughshod over Truck's fundamental rights.

It doesn't help that the court and Surgin's counsel later claimed that one of the things they did during the meeting — held during normal court hours, at the time and place scheduled for the default prove-up hearing — was to discuss sports. (RT 358-59, JA 8031.) The appearance of

impropriety exists *regardless* of the conversation's claimed innocence. "[U]nauthorized *ex parte* contacts of whatever nature erode public confidence in the fairness of the administration of justice, the very cement by which the system holds together." (*In re Jonathan S.* (1979) 88 Cal.App.3d 468, 471.) As one court observed:

> "The rule [against ex parte contacts between court and counsel during a proceeding] is unaffected by the judge's good faith belief [as to the innocence of the conversation]. One reason such contacts are improper is that no matter how pure the motive any ex parte contact may allow the judge to be improperly influenced or inaccurately informed. . . . The events that took place in this case illustrate the dangers of even innocently conceived ex parte meetings." (*McElhanon v. Hing* (1986) 151 Ariz. 403, 409, 728 P.2d 273, 279.)

See also: *Dubaldo v. Dubaldo* (1988) 14 Conn.App. 645, 542 A.2d 750 [court's unreported *ex parte* meeting with witness, aligned with one party, to express sympathy at death of the witness' wife created appearance of impropriety that could not be dispelled; held, mistrial warranted].

A trial court's misconduct in creating an appearance of impropriety — raised here as a ground for new trial (JA 7490, 7965-66) — is an irregularity in the proceedings requiring a new trial. (§ 657(1); *Kennick v. Commission on Judicial Performance* (1990) 50 Cal.3d 297, 331-332 [trial court's creation of appearance of impropriety by meeting privately, even if innocently, in chambers with counsel representing one side is misconduct].)

VII.

THE IMPOSITION OF DISCOVERY SANCTIONS, PARTICULARLY TERMINATING SANCTIONS, WAS BOTH UNCONSTITUTIONAL AND AN ABUSE OF DISCRETION.

Discovery sanctions, especially terminating sanctions, should never have been imposed. There are many reasons why:

- Truck complied with the letter of Surgin's discovery requests and the court's cryptic orders compelling compliance with such requests.

- The discovery orders do not yield the interpretations ultimately given them, an unclarity exacerbated by the absence of pre-sanctions hearings or court clarification.

- Neither Truck nor its counsel ever wilfully disobeyed any discovery orders. At worst, Truck's counsel misunderstood those orders.

- Even if *some* discovery sanctions were appropriate here, terminating sanctions were not. Truck provided extensive discovery and manifested no intent to abuse the discovery process.

Exposition of these points necessarily requires detailed chronological analysis of the discovery dispute. No court likes to delve into these issues; we don't either. But where the imposition of sanctions eradicates a litigant's fundamental right to a trial on the merits and results in an astronomical $57.8 million default judgment, the propriety of the sanctions must be scrutinized meticulously, no matter how daunting and unpopular the task.

A. Truck Committed No Discovery Violation. Its Unequivocal, Truthful Further Responses Complied With The Letter Of Surgin's Discovery And The Trial Court's Discovery Orders.

"[W]here there has been no discovery violation or abuse, the [trial] court [goes] beyond its inherent authority in sanctioning [a party] for his conduct." (*Badalamenti v. Dunham's, Inc.* (Fed. Cir. 1990) 896 F.2d 1359, 1364.) Truck's verified further responses were made without objection (exactly as required by the trial court's discovery orders) and were complete, responsive, unequivocal and truthful. Since Truck complied with the trial court's orders, discovery sanctions should never have been imposed.

1. Surgin's Discovery Requests.

Truck provided extensive discovery, including production of well over a thousand pages of documents. (See JA 3092-5070.) Nevertheless, disputes arose and ultimately centered on three specific discovery requests:

a. Identification or production, respectively, of all "claims procedure manuals and written claims handling guidelines which are . . . *used* by your company in determining *claims under the 'advertising injury' provisions* of your policies" or "*referred to or relied upon* by

your claims representatives in handling or adjusting *claims under the 'advertising injury' provisions* of your policies." (JA 1092, 1042 [Request No. 3 & Special Interrogatory No. 5], emphasis added) (collectively, "the advertising injury manuals requests").

b. Production of all documents supporting the contentions in Truck's various affirmative defenses (JA 1043-47 [Requests Nos. 6, 7, 8, 9, 10, 13 & 14]) (collectively, "the affirmative defense requests").

c. Judicial Council form interrogatory No. 12.6 seeking *identification* of any "report" that was made by any person concerning the "incident" (JA 1138) ("the form interrogatory").

2. Truck's Initial Responses And Surgin's Motions To Compel.

Truck initially objected to the three requests on grounds, among others, of attorney-client privilege, overbreadth, burden and ambiguity. (JA 1043-48, 1093, 1139.) However, it agreed to produce all unprivileged documents responsive to the affirmative defense requests plus all responsive privileged documents generated *before* commencement of this suit. (JA 1044-48.) Surgin moved to compel further responses. (JA 1011, 1057, 1107.) As a result of the meet-and-confer process and while motions to compel were pending, Truck produced over 5-inches worth of documents relevant to subjects including the affirmative defense requests. (JA 3083.) In the meet-and-confer process and in its moving papers, Surgin took the following positions:

a. It characterized its advertising injury manuals requests as seeking "in essence . . . any claims procedure manuals and/or written claim guidelines *which are used by [Truck]* in determining *claims under the 'advertising injury' provisions* of [Truck's] policies." (JA 1020, JA 1064-65, emphasis added.)

b. It disavowed that the affirmative defense requests sought privileged attorney-client communications, stating: "it is impossible to understand how the requested documentation could be interpreted as requiring such protected information or why [Truck] has been prevented from otherwise responding to the demand for production without revealing such privileged or protected material." (JA 1023.) Surgin never contended or suggested that Truck's agreement to produce documents (including its agreement to provide privileged documents generated *before*

Surgin's suit) was deficient or that it sought production of any privileged documents generated *after* commencement of its suit. (See JA 1035-36.)

c. Surgin never contended or suggested that the form interrogatory sought either identification or production of any privileged communications between Truck and its litigation counsel. (See JA 1125.)

d. Surgin's moving papers were limited to seeking orders that Truck provide further responses "without objection" to each of its three discovery requests. (JA 1012. 1058, 1108.) The papers gave no hint that Surgin was seeking more or might be seeking to interpret or expand the scope of its discovery requests.

3. The Trial Court's Discovery Orders And Truck's Further Responses.

Without conducting a hearing, the trial court granted Surgin's motions, issuing pre-printed form orders with a check in the "granted" box as to each separate discovery request. (JA 1289-96.)[17/] Surgin's Notice of Ruling simply stated Truck had been ordered to provide further responses without objection. (JA 1297-1301.)

Truck complied, serving further verified responses without objection to each of the disputed discovery requests:

a. Further Response To The Advertising Injury Manuals Requests. Truck stated, "There are [sic] no claims procedural manual or written claim guideline which is used by Truck Insurance Exchange in determining claims under the 'advertising injury' provisions of Truck's policies" and Truck was "not presently aware of any documents that fall within this category." (JA 1660, 1664.)

b. Further Response To The Affirmative Defense Requests. In addition to its previously-produced 5-inch stack of documents, Truck produced still more documents. (JA 4679-5033.) Neither the documents produced in the meet-and-confer process nor those produced

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17/ Although the notation "by phone" appears on each of the orders next to counsel's names (JA 1289-96), there was in fact no telephonic hearing and no oral argument, as confirmed by Surgin's notice of ruling. The court merely informed counsel of its rulings by telephone. (JA 3084; JA 1299; see *Champion/L.B.S. Associates Development Co. v. E-Z Serve Petroleum Marketing, Inc.* (1993) 15 Cal.App.4th 56, 59 [this same trial court entered minute order that counsel appeared by telephone, even though all agreed no hearing was held].)

in connection with Truck's further responses contained any privileged communications generated *after* commencement of this litigation; Truck's verified responses, however, stated unequivocally that Truck was producing "the documents that fall within" the various affirmative-defense categories. (JA 4680-81; see also JA 1749 ["Truck Insurance Exchange has produced the documents which it claims support these various affirmative defenses"].)

c. Further Response To The Form Interrogatory. Truck stated that no reports were made of the incident. (JA 1657.)

4. Surgin's Initial Motion For Terminating Sanctions And The Propriety Of Truck's Further Responses.

Surgin moved for terminating and other sanctions, but it did not move to compel further production or further responses. (JA 1600-02.) Surgin claimed that Truck's further responses, although unequivocal and given under oath and without objection, were false. (JA 1593-96.)

Not so. Truck's further responses were truthful, complete and responsive to Surgin's discovery requests and motions and to the one-word orders requiring further responses. There is no evidence to the contrary. Rather, the asserted discovery violations are premised entirely on pure hypothesis: there *must* be documents of a certain type, as though it would have been impossible to conceive a world in which they did not exist. (JA 1593-96.) But the *unrebutted* evidence is that there simply were no other documents of the type Surgin requested and the trial court ordered produced.[18/]

The law required Truck to respond to the specific discovery requested and ordered. (See *Conn v. Superior Court* (1987) 196 Cal.App.3d 774, 781 ["'defendants have, and have always had,

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18/ Surgin also pointed to other deficiencies, all of which were remedied before the trial court even heard the initial terminating sanctions motion. Specifically, four interrogatories had been overlooked and Truck provided answers to those interrogatories on December 10, 1992, the day after Surgin raised the oversight. (JA 1768-72.) Verifications did not initially accompany the further responses, but were provided by December 15, 1992, less than a week after Surgin first informed Truck of the oversight and a month before the trial court denied Surgin's original motion for terminating sanctions. (JA 1755.) Finally, Surgin asserted that certain documents *referenced in* the further documents Truck produced had not also been produced. Although it is not clear why these additional documents also needed to be produced, Truck informed Surgin that Truck had *already produced* the specific documents in question in prior productions. (JA 1765-66.)

the right to keep their own documents until met with proper discovery requests or ordered to disclose them by the Court'"]; *Marchand v. Mercy Medical Center* (9th Cir. 1994) 22 F.3d 933, 938 [in context of answers to requests for admission, "As (defendant) answered the question asked, sanctions were not warranted"].) Truck answered Surgin's discovery requests as ordered:

a. The Advertising Injury Manuals Requests. Truck was ordered to produce manuals and written guidelines "used," "referred to or relied upon" in handling or adjusting "claims under the 'advertising injury' provisions of [Truck's] policies." The *sole* evidence in the record — Truck's verified responses and its employees' testimony — established that Truck did *not* "use," "refer to or rely upon" *any* manual or written guideline in adjusting advertising injury claims under its policies.[19/]

Faced with a sworn response and unequivocal, consistent, sworn testimony that there were no manuals of the type requested, Surgin presented a *non sequitur* as though it were a smoking gun. It submitted a copy of a generic Truck Branch Claims Office Procedures Manual, which it had obtained independently, as some sort of "proof" that Truck had claims manuals. (JA 1816-2018.) But Surgin never asked whether Truck had claims manuals in general and Truck never denied having them. Surgin asked only about manuals which Truck "used," "referred to or relied upon" in determining *advertising injury claims*. Nothing in the manual Surgin presented even mentioned advertising injury coverage or claims (JA 1816-2018), and there is *no* evidence that Truck ever *used*, *referred to*, or *relied upon* that or any other claims manual in adjusting advertising injury claims. In fact, *all* the evidence is precisely to the contrary. Indeed, had Truck produced generic claims manuals that it did *not* use in response to discovery requests seeking manuals that it *did use*, it would implicitly have been admitting something that was untrue. Truck's answer was truthful.

19/ The Branch Claims Manager — when asked "would [a claims adjuster] ever refer to the Branch Claims Office Manual to determine how the claim that [he or she is] handling should be processed?" — testified "No." (JA 2396; see also JA 2021S-2021T [Truck's claims representative knew of no documents other than the policies themselves and a set of California cases used to assist in interpreting policy provisions and exclusions]; JA 2021M [Truck claims representative recalled no materials providing guidance on interpreting provisions in policies other than the effect of an uninsured motorist property damage provision].)

But even if there really were a legitimate factual dispute about the accuracy of Truck's responses (there wasn't), the court had no right to resolve that dispute summarily in a discovery hearing. The presence of a disputed factual issue material to the outcome of Surgin's claims gave Truck a constitutional right (Cal. Const., Art. I, § 16) to a jury trial on whether it "used," "referred to or relied upon" manuals in adjusting advertising injury claims. Just as the trial court could not possibly have entered summary adjudication against Truck on this factual issue in the face of Truck's sworn denial, it could not indirectly do the same thing by entering terminating discovery sanctions premised on its view of how *it* might resolve the disputed factual issue if it were the jury. "Discovery sanctions . . . are meant to deter intentional abuse of the discovery process, not as a means to resolve the merits of a case." (*Ingalls Shipbuilding v. United States* (Fed. Cir. 1988) 857 F.2d 1448, 1451.) Here, the trial court improperly addressed and decided the merits without an iota of evidence to support its decision.

b. The Affirmative Defense Requests. Truck produced numerous documents in response to the affirmative defense requests, including promised privileged pre-litigation documents. Surgin's sole complaint was that Truck produced no privileged documents generated *after* commencement of this litigation, arguing: "The fact that Truck's original answers to discovery [i.e., interposing attorney-client privilege and work-product objections] presupposed and asserted *by implication* that responsive documents exist proves that Truck is wilfully failing to comply with the Court's Order." (JA 1596 emphasis added footnote omitted.) In fact, *there is no evidence — just Surgin's speculation and supposition — that such documents exist.* The only evidence is to the contrary: Truck stated under oath it had produced "the" documents supporting its affirmative defenses. (JA 1664-65, 1749.) Surgin has never proven otherwise.

But even if somehow there were responsive privileged documents generated after commencement of this litigation (there were not), the trial court could never properly have compelled Truck to produce them. (See, e.g., *Transamerica Title Ins. Co. v. Superior Court* (1987) 188 Cal.App.3d 1047, 1052-53 [communications to carrier by counsel defending insurance bad faith action are privileged].) Indeed, in opposing a writ petition brought by Truck *after* terminating sanctions had been imposed and seeking this Court's protection against any order which might be

interpreted as compelling it to disclose post-litigation privileged communications with its counsel, Surgin conceded the trial court had *never required* Truck to produce privileged documents, stating: "[A]bsolutely no such order was entered." (RJN 2-3.)

c. The Form Interrogatory. There is no evidence that Truck's response to the form interrogatory was incorrect. At most, Surgin merely *speculated* that Truck's counsel in the bad faith suit *must* have given "reports" to its client concerning the "incident" and that those reports had to be both identified and also produced, even though there was no request to produce them. (JA 2383, 2372-75.) In addition to the obvious flaw that an *interrogatory* does not call for the *production* of documents, Surgin's interpretation of the "incident" form interrogatory as requiring a party to identify all communications from its current litigation counsel defies common sense and litigation reality. It would shock every litigator in California to learn that this Judicial Council Form *interrogatory* — intended and commonly used to identify documents generated at the time of a personal-injury type of "incident" (see JA 1129-30 [Surgin conceded that form interrogatories requesting information regarding an "incident" were "best suited" for claims arising from a "discrete occurrence" such as an "automobile accident"]) — somehow pertains to privileged communications with trial counsel and also contains a hidden *request to produce*, encompassing and entitling a party to a complete record of its adversary's relationship with its litigation counsel — on pain of terminating discovery sanctions for failure to so comprehend the interrogatory or make that disclosure!

B. The Trial Court Imposed Terminating Sanctions Even Though Truck's Responses Were Truthful And Complied With Its Orders. It Did So Before Announcing What It Expected Or Explaining Why It Found Truck's Responses Defective.

1. The Trial Court's "Denial Without Prejudice" Of Surgin's Initial Motion For Terminating Sanctions.

The trial court held no hearing on Surgin's initial motion for terminating sanctions. (JA 8612.) Its January 14, 1993, order simply stated that the motion was "denied without prejudice [as to] Terminating Sanctions." (JA 2022.) This order, like the trial court's prior orders granting

Surgin's motions to compel, contained no explanatory notes, nor any additional directives. Moreover, the court did not impose any of the lesser alternative sanctions Surgin requested and it gave no explicit direction or warning it expected anything further of Truck. (JA 2022.)[20/]

2. The Dispute As To The Meaning Of The January 14, 1993, Order.

On January 15, Surgin wrote Truck asserting that the trial court's "denial without prejudice" order meant that "the Court apparently is allowing you one more opportunity to produce the requested documents, including *all* written claims handling guidelines, claims procedure manuals and reports on this litigation by Lichtman & Bruning and Greines, Martin, Stein & Richland [Truck's trial and appellate counsel] before the Court imposes terminating sanctions" and that "[d]iscussions with the Court Clerk indicate that the Court's rationale for not issuing a second order requiring production of documents is based upon the fact that an order requiring such production already exists — the October 20, 1992 order." (JA 2383-84.)

Truck did not read the trial court's "denied" order as requiring further discovery responses or as expanding the scope of Surgin's discovery requests. (JA 2390-91.) However, in light of Surgin's specific reliance on an asserted interpretation by the court's clerk, Truck's counsel showed Surgin's letter to the clerk, who informed Truck that Surgin's interpretation was "convoluted," that Truck was not required to produce further documents as Surgin's counsel demanded, and that defendants had complied with the court's discovery order. (JA 2391-92, 2385-86.) Truck declined to produce the documents Surgin demanded. (JA 2385-86.)

3. Surgin's Renewed Motion For Terminating Sanctions.

Surgin renewed its motion for terminating and monetary sanctions; however, unlike its initial motions for terminating sanctions, Surgin's renewed motion sought to compel production of the disputed documents. (JA 2026-27.) In its moving papers, Surgin claimed that "implicit" in the trial court's January 14, 1993, "denied without prejudice" order was a command that Truck produce *all* written claims handling guidelines and manuals regardless whether "used," "referred to or relied upon" and *all* "reports on this litigation" from Truck's litigation counsel of record. (JA 2365-72.)

20/ The trial court's only other ruling was to continue the trial and extend discovery cutoffs, a result Truck expressly did not oppose. (JA 1745.)

Truck opposed the motion, again on grounds that its further responses complied with the order compelling further responses to Surgin's discovery and that no order required it to produce the expanded list of documents Surgin now demanded. (JA 2407-09.) Nonetheless, if such would resolve the controversy, Truck offered to produce a full copy of its Branch Claims Office Manual, even though, in Truck's view, it was not the subject of Surgin's request to produce or the trial court's discovery orders. (JA 2391.) Surgin refused. (JA 2391.) Truck then lodged the Branch Claims Office Manual and another manual with the court for its review and determination as to whether they were responsive; Truck offered to produce the manuals should the trial court find them responsive. (JA 2402-03, 2417-19.)

4. The Trial Court Orders Terminating Sanctions.

On February 9, 1993, the trial court finally held its first hearing on the discovery dispute. After observing that "it appears that there's a gross misunderstanding here," the court ordered terminating sanctions against Truck. (RT 2-3, 10.) The court did not explain in what respect it found Truck's further responses to be deficient. (RT 1-10.) The court made no mention of the two manuals Truck had lodged. (RT 1-10.) Thereafter, the court, at Surgin's urging, refused Truck's request to clarify how Truck had failed to comply with discovery or to detail the reasons why terminating sanctions were being imposed. (JA 2457-61, 2465-68, see JA 2459.)

5. Truck's Motion For Reconsideration.

Truck moved for reconsideration. (JA 2479.) At the hearing on the motion, the court abandoned its prior "gross misunderstanding" reference and now characterized Truck's discovery conduct as "cool and calculating" and "blatant, willful and in bad faith." (RT 72-73.) *For the first time*, the court announced what it believed its prior orders meant: It accepted Surgin's January 15 interpretation that "denial without prejudice" really meant that Truck had to produce *all* manuals it possessed and *all* post-litigation privileged correspondence with its trial counsel. According to the court, that was "exactly what the court meant and, . . . in my opinion, [the January 14, 1993, order] can have no other interpretation"; according to the court, "denied without prejudice" was a "clear flag." (RT 72.)

6. Truck's Production Of Still Further Documents In Response To The Court's Clarification And Surgin's Disavowal Of Any Order To Produce Privileged Documents.

Now that Truck finally knew how the trial court had interpreted its prior discovery orders, and even though terminating sanctions had already been imposed, Truck made further efforts to comply. It produced boxes and boxes of manuals in response to the court's clarified expectation that "all" manuals had to be produced, rather than merely the manuals which Truck "used," "referred to, or relied upon." (JA 7493-98, 7577.) It also sought a writ of mandate from this Court to preclude enforcement of any directive that it produce all privileged communications between it and its trial counsel. (RJN 1.)

In responding to Truck's writ petition, Surgin, undoubtedly realizing it had drawn the trial court into an indefensible error, completely changed its position. Surgin explicitly renounced the interpretation it had proffered in its January 15 letter and reiterated in its renewed motion for terminating sanctions, the very interpretation the trial court had adopted at the hearing on the motion for reconsideration. Instead, Surgin informed this Court that the trial court's orders did *not* require production of any privileged correspondence from Truck's litigation counsel. (RJN 2 at pp. 1 [""(Truck) would have this court believe that the trial court ordered it to produce attorney-client privileged materials. . . . (A)bsolutely no such order was entered"], 6 ["Judge Jameson never 'actually directed Truck to produce "'all . . . reports on this litigation by Lichtman & Bruning and Greines, Martin, Stein & Richland"'"].) Not surprisingly, in light of Surgin's concession mooting the need for writ relief, this Court denied Truck's writ application without reaching its merits. (RJN 3.)

C. Due Process Precludes The Imposition Of Terminating Sanctions: The Trial Court Never Afforded Truck With Any Timely, Clear Direction Regarding The Discovery It Expected Truck To Provide.

It defies all notions of due process and fundamental fairness that a court would deprive a party of its constitutionally protected right to a trial on the basis of unannounced meanings in its discovery orders. Yet that is exactly what the trial court did here.

1. Due Process Precludes Imposition Of Terminating Sanctions For Failing To Comply With An Unclear Discovery Order.

Terminating sanctions may not be imposed where the underlying discovery order is unclear or ambiguous. Multiple cases so hold.

In *R.W. Intern. Corp. v. Welch Foods, Inc.* (1st Cir. 1991) 937 F.2d 11, 14, the trial court ordered "plaintiffs, *inter alia*, to produce . . . all documents regarding their claimed damages" under a particular statute. Plaintiffs complied to some extent, but failed to produce other documents that defendants claimed were responsive. In reversing an order imposing terminating sanctions, the First Circuit held:

> "[W]hen a court issues a broad-form discovery order, and the party to whom it is addressed complies with it somewhat less than fully, withholding documents arguably outside the order's scope, the [trial] court cannot dismiss without first entering an order commanding production of specific materials. . . . If a general discovery directive could satisfy [the discovery rule's] requirement that a party must disobey 'an order to provide or permit discovery' before his case can be dismissed thereunder, the carefully crafted prophylaxis of [the discovery rules] would be severely eroded and the way paved for case management *in terrorem*. . . . We are, therefore, disinclined to allow broadbrush . . . orders to serve as snares whereby even innocent misunderstandings or inadvertent omissions may lead to summary dismissal." (*Id.* at pp. 17-18.)

Similarly, in *E.E.O.C. v. Troy State University* (11th Cir. 1982) 693 F.2d 1353, the trial court imposed terminating sanctions where, in response to an order compelling discovery, the

responding party produced some documents, but withheld others in reliance on an earlier, effectively superseded protective order. (693 F.2d at pp. 1355-56.) The Eleventh Circuit reversed because "the [trial] court never issued a specific written order delineating precisely what [the responding party] needed to provide in order to forestall dismissal." (*Id.* at p. 1357.) (See also *Ingalls Shipbuilding, Inc. v. United States*, *supra*, 857 F.2d 1448, 1451-1452 [trial court "did not set out the deficiencies it saw in what had previously been filed . . . so (the responding party) was never given a clear statement by the court about its view on the alleged deficiencies in its earlier answers"; held, severe sanctions "inappropriate because the (responding party) was, perhaps understandably, confused about the scope of its discovery obligations"]; *Lodge 743 International Assn of Machinists, AFL-CIO v. United Aircraft Corporation* (D. Conn. 1963) 220 F.Supp. 19, 21 [trial court declined to impose terminating sanctions because its original discovery ruling "did not order or spell out in detail the extent of the analysis required and the applicable penalties . . . which the Court would apply if such were not met on time"].)

Terminating sanctions were reversed or declined in these cases, even though the trial courts there afforded the parties substantial opportunity for clarification of the discovery orders. (*R.W. Intern. Corp. v. Welch Foods, Inc.*, *supra*, 937 F.2d at pp. 17-18 [Court of Appeals could not presume in the absence of a reporter's transcript that the trial court's five-hour conference with the parties had clarified "the words of . . . [an] order [that were] fraught with ambiguities"]; *E.E.O.C.*, *supra*, 693 F.2d at pp. 1355-56 [trial court had conducted numerous hearings, including a telephone conference on the subject of discovery, before the hearing at which the case was dismissed; terminating sanctions reversed because there was no showing the hearings ever clarified any confusion]; *Ingalls Shipbuilding*, *supra*, 857 F.2d at pp. 1451-52 [terminating sanctions reversed even though trial court held status conference before dismissing case].) Here, terminating sanctions were imposed first; the trial court's clarification came later. That violates due process.

2. The Trial Court Violated Due Process And Abused Its Discretion In Imposing Terminating Sanctions Premised Upon Supposed Implicit Hints Or "Flags" In Its Discovery Orders.

Given the trial court's candid recognition of a "gross misunderstanding" and given that the February 9, 1993, terminating sanctions hearing was the parties' *first* opportunity for interchange with the court on the discovery issues, one might have expected there would at least have been some dialogue in which the discovery issues were sorted out[21/] and Truck would be given some opportunity to know exactly what the court expected and thereafter to provide further responses if the court deemed its responses deficient. Not in this courtroom.

The court retroactively transformed "denied" into "granted" and "used," "referred to or relied upon" into "all"; documents relating to the "incident" or "affirmative defenses" became "all" post-litigation attorney-client privileged communications. We do not exaggerate. The court specifically said that Surgin's interpretation of "all" is "exactly what the court meant" by its previous "denied without prejudice" orders. (RT 72.) Rather than provide the parties with clear direction as to its intent *before* imposing terminating sanctions, the court imposed sanctions first and then explained itself later, criticizing Truck for failing to read an "implicit" (JA 2365) "clear flag" in its prior orders. (RT 72.)

Surgin contributed mightily to the confusion. Whenever convenience and occasion suited it, Surgin interpreted the court's orders to have entirely different meanings. (Compare JA 1092, 1042, 1023 [requests limited to manuals "used," "referred to or relied upon" in adjusting advertising injury claims and cannot conceivably include privileged documents] *with* JA 2383-84 [orders required production of "all" manuals and "all" attorney correspondence to Truck] *with* RJN 2 at 2, 5-6 [orders never required production of privileged correspondence].)

21/ Since the trial court had held no prior hearings, the parties did not have the benefit of the usual interchange that occurs on discovery motions, an interchange which often eliminates the very kind of uncertainty that permeated the proceedings here, such as: "Your honor, are we supposed to produce both X *and* Y?" "Counsel, I want you to produce not only X and Y, but Z as well." "Including privileged documents?!" "Well, no, you don't have to do that." "Should we prepare a formal order?" "That would be a good idea."

Relegating the determination of a lawsuit to the parties' ability to read the court's "implicit" semaphore is not due process. An order so protean that it means something different every time someone looks at it cannot support any kind of sanctions, much less terminating sanctions. Due process demands much, much more.

D. Due Process Prohibits Terminating Sanctions Without Wilful Disobedience Of A Discovery Order. Here, There Was No Wilful Disobedience.

1. Terminating Sanctions May Not Constitutionally Be Imposed Without Wilful Misconduct.

A legion of cases hold that a trial court may not impose terminating sanctions against a party unless that party *wilfully* failed to comply with a discovery order. (*E.g.*, *Deyo v. Kilbourne* (1978) 84 Cal.App.3d 771, 787; *Motown Record Corp. v. Superior Court* (1984) 155 Cal.App.3d 482, 489; *Young v. Rosenthal* (1989) 212 Cal.App.3d 96, 114; *Laguna Auto. Body v. Farmers Ins. Exchange* (1991) 231 Cal.App.3d 481, 488.) This is a requirement not only of California substantive law, but of due process. Due process forbids terminating sanctions "in the absence of willfulness, bad faith, or any fault." (*Societe Internationale, et al. v. Rogers* (1958) 357 U.S. 197, 209, 78 S.Ct. 1087, 1094, 2 L.Ed.2d 1255.)

> "[T]he general due process restrictions upon a court's discretion . . . require[] that 'any sanction [imposed pursuant to (a discovery rule)] must be "just."' (Citation.) Fairness demands that the severe sanction of default may not be imposed under [a discovery rule] 'in the absence of willfulness, bad faith or fault.' (Citation.)" (*Fjelstad v. American Honda Motor Co.* (9th Cir. 1985) 762 F.2d 1334, 1340-1341 [conduct must be equivalent of "deliberate malfeasance"].)

This means "'a party's simple negligence, grounded in confusion or sincere misunderstanding of the Court's orders, [does not] warrant dismissal.'" (*Ingalls Shipbuilding v. United States*, *supra*, 857 F.2d at p. 1451, brackets in original, quoting *Marshall v. Segona* (5th Cir. 1980) 621 F.2d 763, 768; accord, *United Artists Corp. v. Freeman* (5th Cir. 1979) 605 F.2d 854, 856-57; *E.E.O.C. v. Troy State University*, *supra*, 693 F.2d at pp. 1357-58.)

2. The Undisputed Facts Establish That Truck Did Not Engage In Wilful Misconduct.

Neither Truck nor its counsel wilfully disregarded any order. In moving for reconsideration, Truck's counsel explained, under penalty of perjury and without contradiction, that he had never understood Surgin's discovery or the trial court's initial tersely-worded discovery orders to require production of *all* manuals, regardless of use, purpose or reference, or of *all* (or any) post-litigation attorney-client privileged correspondence. (JA 3082-90.) He provided a comprehensive chronological explanation of his understanding, including his interpretation of the initial discovery requests and the trial court's orders. (JA 2575-89.) He showed there was no wilful disobedience.

Truck's actions confirmed its words:

- Truck provided further responses without objection after being ordered to do so. (JA 1654-71.)

- When Surgin claimed that the court clerk had interpreted the trial court's "denied without prejudice" order to require production of further documents, Truck promptly contacted the clerk, who disavowed any such interpretation. (JA 2586.)

- Truck offered to produce the generic Branch Claims Office Manual Surgin mistakenly pointed to as a "smoking gun" if that would resolve the discovery dispute, even though, in Truck's view, it was not the subject of Surgin's discovery request or the trial court's discovery orders. (JA 2391.) More interested in sanctions than discovery, Surgin refused, taking the position that all documents it now demanded had to be produced or Surgin would seek sanctions. (JA 2391.)

- When Surgin renewed its motion for terminating sanctions, Truck lodged the disputed Branch Claims Office Manual and another with the court for determination whether they were responsive; if the court determined they were, Truck offered to produce them. (JA 2417-19.) The trial court never responded to Truck's lodging of the manuals.

- When the court finally adopted Surgin's interpretation of its prior orders as requiring production of "all" manuals, Truck produced mounds of manuals, even though Truck did not "use," "refer to" or "rely upon" them in adjusting advertising injury claims. Truck also petitioned this Court for writ relief to preclude compelled production of privileged attorney-client communications,

but Surgin, in a complete about-face, then disavowed to this Court that the trial court had ever ordered such production.

Truck's actions could not rationally be seen as those of a party bent on wilfully flouting discovery. They were the actions of a party with a sincere and legitimate question about the scope of discovery requests, a party who tried to resolve that question either informally or with the court's assistance, and a party who complied and took proper action when the court finally made its intent known. (See *Fjelstad*, *supra*, 762 F.2d at pp. 1341-1342; *Kakuwa v. Sanchez* (9th Cir. 1974) 498 F.2d 1223, 1226.) At the very worst, they are the actions of a party who simply "misunderstood" how the court eventually would interpret its discovery orders, as the trial court itself candidly admitted when it first imposed terminating sanctions. They are *not* the actions that warrant summary civil execution to the tune of $57.8 million.

3. The Admission Of Truck's Counsel That Any Discovery Failure Was His Unintended Fault Precluded Terminating Sanctions And Mandates Reversal Of Such Sanctions.

In support of Truck's motion for reconsideration, its counsel declared that he, and he alone, was responsible for any failure properly to interpret or respond to the discovery requests and orders and that any failure to comply was a result of his misunderstanding, neglect, or mistake. (JA 2575-89, 3082-90.) The trial court, however, found Truck's noncompliance with discovery "blatant," in "bad faith," and "cool and calculating." (RT 72-73.) As discussed above, that finding is without factual basis.

Truck later made an offer of proof regarding a motion for relief from default it was prepared to make pursuant to section 473 based on the same facts that the court concluded had shown Truck's wilful disobedience. (JA 8300.) Truck made an offer of proof instead of filing a motion simply because the court's factual findings on the motion for reconsideration (although unsupported) are the opposite of the surprise, inadvertence, neglect and mistake required by section 473. As demonstrated by Truck's offer of proof, to the extent the trial court's discovery sanctions are premised upon the neglect, mistake, inadvertence or misunderstanding of Truck's counsel (the only factual premise possibly supported in the record), they are wrong.

Under the 1989 amendment to section 473, relief from default upon a showing a attorney mistake, inadvertence, surprise or neglect is *mandatory*; the motion, or in this case offer of proof, is timely if filed within six months of the default *judgment*, as it was here.[22/] (§ 473; JA 8300 [offer of proof filed 1/31/94].) However, without notice, opportunity for hearing or explanation, the trial court improperly struck Truck's offer of proof from the its file. (JA 8541; *Gay v. Torrance* (1904) 145 Cal. 144, 153 [party entitled to have competent affidavits included in court's file].) That the trial court would not even allow Truck's offer of proof to remain in the file for this Court to review is eloquent testimony to the wrath with which the trial court would have greeted a formal section 473 motion had Truck dared to file it.

Since the trial court's factual findings of deliberate wilfulness were unsupported and since Truck's default could only have been premised (if at all) on the mistake, inadvertence, surprise or neglect of its counsel, it is clear that relief under section 473 was mandatory.

E. The Trial Court Abused Its Discretion By Imposing Terminating Sanctions To Punish A Supposed Failure To Comply With A Small Subset Of Discovery.

Even if *some* discovery sanctions were warranted, terminating sanctions were not. Due process requires that sanctions be proportional to the wrongful act. As this Court stated in *Laguna Auto Body v. Farmers Ins. Exchange*, *supra*, "[d]iscovery sanctions 'should be appropriate to the dereliction, and should not exceed that which is required to protect the interests of the party entitled to but denied discovery'. . . . [A court] may not impose sanctions which are designed not to accomplish the object of discovery," but to impose punishment. (231 Cal.App.3d at pp. 487, 488, quoting *Deyo v. Kilbourne* (1978) 84 Cal.App.3d 771, 793; see also *McGinty v. Superior Court*

22/ Section 473 makes relief from a lawyer's mistake mandatory, instead of discretionary; it eliminated the qualification that the mistake be excusable, providing: "Notwithstanding *any* other requirements of this section, the court *shall*, whenever application for relief is made *no more than six months after entry of judgment*, is in proper form, and is accompanied by an attorney's sworn affidavit attesting to his or her mistake, inadvertence, surprise or neglect, vacate any . . . resulting default judgment . . . unless the court finds that the default . . . was not in fact caused by the attorney's mistake, inadvertence, surprise or neglect." (Emphasis added; *Beeman v. Burling* (1990) 216 Cal.App.3d 1586, 1604-1605.)

(1994) 26 Cal.App.4th; *Wilson v. Jefferson* (1985) 163 Cal.App.3d 952, 958; *Caryl Richards, Inc. v. Superior Court* (1961) 188 Cal.App.2d 300, 304.) "[T]he sanction should not operate in such a fashion as to put the prevailing party in a better position than he would have had if he had obtained the discovery sought and it had been completely favorable to his cause." (*Deyo v. Kilbourne*, *supra*, 84 Cal.App.3d at p. 793, citation omitted.)

This is a principle of due process: "While under the statute the court undoubtedly has the power to impose a sanction which will accomplish the purpose of discovery, when the order goes beyond that and denies a party any right to defend the action or to present evidence upon issues of fact which are entirely unaffected by the discovery procedure before it, it not only abuses its discretion but deprives the recalcitrant party of due process of law." (*Caryl Richards, Inc. v. Superior Court*, *supra*, 188 Cal.App.2d at p. 305; accord, *Insurance Corp. of Ireland v. Compagnie des Bauxite* (1982) 456 U.S. 456, 707, 102 S.Ct. 2099, 2107, 72 L.Ed.2d 492 [due process requires that sanctions must relate specifically to the particular claim affected by the discovery sought]; *Fjelstad*, *supra*, 762 F.2d at p. 1342 [same].)

Here, the imposition of terminating sanctions violates these principles for multiple reasons:

1. The Sanction Exceeds The Scope Of Any Discovery Truck May Have Failed To Produce. The punishment overwhelmed the crime, extending far beyond the issues potentially affected by the discovery Truck supposedly failed to provide. Many decisions hold that terminating sanctions are an abuse of discretion where, as here, they deprive a party of the right to litigate issues that have nothing to do with the disputed discovery. (*E.g.*, *Caryl Richards, Inc.*, *supra*, 188 Cal.App.2d at p. 302-05 [terminating sanctions inappropriate where defendant manufacturer refused to disclose chemical composition of hair spray claimed to have harmed plaintiff's eye; even assuming harmful composition, there were still numerous other issues (such as causation and damages) that could defeat plaintiff's claim].)[23/]

23/ Accord: *McArthur v. Bockman* (1989) 208 Cal.App.3d 1076 [failure to appear at deposition for inquiry into financial condition for punitive damages could not justify terminating sanctions]; *Wilson v. Jefferson* (1985) 163 Cal.App.3d 952, 958-959 [defendant attorney's obstinate refusal to authenticate letter alleged as a basis for affirmative defense supported conclusion the defense was (continued...)

The imposition of terminating sanctions here precluded Truck from litigating many issues wholly unrelated to and unaffected by the disputed discovery for which terminating sanctions were imposed. These include: (a) whether Truck had a duty to defend Surgin from Alcon's claims; (b) the entire question of punitive damages, including Truck's financial condition and the critical issue of the state of mind of Truck's personnel in handling Surgin's tender of defense (i.e., whether there was malice or oppression, merely negligence, or even innocent behavior); (c) whether Truck had agreed to counsel of Surgin's choosing only to have Surgin then settle the Alcon cases (see JA 742-43, 3295-97); (d) if there was a defense obligation, the amount of damages Surgin was entitled to collect, i.e., whether Civil Code section 2860(c) limited the amount of fees Truck was obligated to pay to Surgin's defense counsel, whether the defense fees incurred and claimed were reasonable, whether bills for those fees had ever been submitted to Truck (they were not), whether the fees were allocable to services on uncovered claims, whether the fees were legitimate or trumped up; and (e) the recoverability of claimed *Brandt* fees.

Truck's failure to produce generic claims manuals and guidelines could not possibly have impacted these and other issues, yet the imposition of terminating sanctions completely foreclosed Truck from litigating them. Similarly, any failure to produce privileged documents supporting Truck's affirmative defenses could relate only to Truck's affirmative defenses (see, e.g., *Wilson*, *supra*, 163 Cal.App.3d at pp. 958-959, discussed in footnote 23, *supra*) they could have no conceivable impact on the merits of Surgin's affirmative claims, the general denials in Truck's answer, or issues concerning Surgin's entitlement to damages. Finally, the imposition of terminating sanctions for failing to identify undeniably privileged communications had no conceivable nexus to any of these issues or to the massive punishment imposed.

2. Provision Of Other Discovery. Terminating sanctions are inappropriate where, as here, the responding party has provided substantial other discovery. (*Deyo v. Kilbourne*, *supra*,

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23/(...continued)
specious, but could not justify terminating sanctions; the defendant's discovery conduct "related only to that affirmative defense and was not necessarily referable to and certainly not dispositive of other issues present in the cause, such as fraud and the question of punitive damages which . . . were manifestly part and parcel of the default judgment"].

84 Cal.App.3d at pp. 796 ["the court must examine the entire record in determining whether the ultimate sanction should be imposed"]; *Fjelstad*, *supra*, 762 F.2d at pp. 1342-1343.) The trial court, however, simply ignored the extensive discovery Truck had provided. (See JA 3092-5070, 5080-84.)

In fact, Truck produced a mass of documents and information in response to Surgin's discovery requests, including: (a) In its first response to Surgin's document request in December 1991, Truck produced approximately 110 pages of responsive documents (JA 3082-83, 3150-3263); (b) after meeting and conferring with Surgin's counsel *and before any order compelling production*, Truck produced an additional five-inch stack of documents in September 1992 (JA 3083, 3265-4395); and (c) in response to the trial court's initial discovery orders, Truck, in December 1992, produced another three-inch stack of documents and supplemental responses to Surgin's document requests and interrogatories (JA 3085, 4411-5033). Included in the documents and information Truck produced were Truck's *entire* claims file in the underlying Alcon litigation, including Truck's internal memoranda (JA 1749, 3269-4395), as well as communications from Truck's coverage counsel and counsel Truck retained to defend Surgin and coverage counsel's 25-page opinion letter concerning the underlying claims (JA 3307-31); Truck also identified all possible witnesses (JA 5045-47).

Even after the imposition of terminating sanctions, when the court *finally* explained what it believed its discovery orders meant, Truck made further efforts to comply with the trial court's expansive interpretation, producing eight boxes of documents that Truck later lodged with the court. (JA 7493.) If Truck was deliberately withholding documents and obstructing discovery, it was not doing a very good job of it. If that was Truck's purpose, it would never have submitted further discovery *after* terminating sanctions had already been imposed or handed over its entire claims file, including a privileged letter from its coverage counsel recommending (pre-*Bank of the West* and pre-*Watercloud*) that, in light of the potential risks of failing to defend, Truck should defend two of the four Alcon actions. (See *Waller*, *supra*, 94 Daily Journal D.A.R. at p. 11371 [judicial decisions apply retroactively; duty to defend properly evaluated under decisional law decided subsequent to date of tender].)

What Surgin succeeded in doing was to convince the trial court to impose terminating sanctions on the basis of one or two discovery trees, while ignoring the forest of discovery Truck provided. Imposing terminating sanctions under such circumstances is unconstitutional, violating due process.

3. Less Drastic Sanctions Would Have Sufficed. Exercise of the court's power to impose discovery sanctions includes evaluation of the range of options available to vindicate the particular purpose of the discovery at issue. "The courts therefore frown upon the extreme sanction of dismissal of a case for failure to make discovery, and recommend instead lesser sanctions of fines." (*McGinty v. Superior Court* (1994) 26 Cal.App.4th, 204, 210.)

Here, the record does not disclose that the trial court even *considered* imposing lesser sanctions, as due process required it to do. (*Fjelstad*, *supra*, 762 F.2d at 1342.) If it had, it would have been forced to conclude that lesser sanctions were appropriate to the discovery task at hand. For instance, severe monetary sanctions, coupled with a clear warning and specific discovery directions, could have been imposed as a precursor to terminating sanctions. Alternatively, an evidentiary or issue sanction establishing that, for example, Truck had not followed its own internal claims handling procedures could have addressed and punished any failure to produce relevant manuals. (See, e.g., *Caryl Richards, Inc. v. Superior Court*, *supra*, 188 Cal.App.2d at pp. 304-05.) Similarly, the court could have precluded Truck from asserting its affirmative defenses if it really believed Surgin was prejudiced by not receiving documents relating to such affirmative defenses. (See, e.g., *Wilson*, *supra*, 163 Cal.App.3d at pp. 958-959, discussed in footnote 23.)[24/]

24/ True, there are a handful of decisions suggesting the Court of Appeal is not required to impose the least severe sanction appropriate. (*Laguna Auto Body*, *supra*, 231 Cal.App.3d at p. 491; *Do It Urself Moving & Storage, Inc. v. Brown, Leifer, Slatkin & Berns* (1992) 7 Cal.App. 4th 27, 36-37 [evidentiary sanction]; *Collisson & Kaplan v. Hartunian* (1994) 21 Cal.App.4th 1611, 1619-20.) But there is a fundamental difference between those cases and the present case that underscores why such review is appropriate here. In each of these cases, the Court of Appeal expressly found that the trial court had specifically tailored the sanction imposed to the particular abuse. (*Laguna Auto Body*, *supra*, 231 Cal.App.3d at p. 491; *Do It Urself*, *supra*, 7 Cal.App. 4th at p. 37; *Collisson & Kaplan v. Hartunian*, *supra*, 21 Cal.App.4th at p. 1620.) Here, there was no tailoring, nor evidence that it was even attempted. There is no suggestion the trial court ever considered lesser sanctions. Moreover, none of these decisions specifically address the due process limitations on default judgments.

One could multiply such alternatives indefinitely, but the trial court never considered or applied even one. Instead, it went straight for the kill. That is not how our justice system is supposed to work. The trial court's failure to address, let alone consider, less severe sanctions was an abuse of discretion that denied Truck due process.

4. Absence Of Prejudice. Discovery sanctions violate due process where the requesting party has not been prejudiced. (*Wanderer v. Johnston* (9th Cir. 1990) 910 F.2d 652, 656 [discovery "sanctions which interfere with the litigants' claim or defenses violate due process when they are imposed 'merely for punishment of an infraction that did not threaten to interfere with the rightful decision of the case'"], quoting *Wyle v. R.J. Reynolds Industries, Inc.* (9th Cir. 1983) 709 F.2d 585, 591.) There was no possible prejudice here. Surgin *had already obtained* one manual from another source and Truck *lodged* that manual and another with the trial court and informed the court it would promptly turn the manuals over if the court found them responsive. (JA 2417-19.) If the lodged manuals were responsive to the discovery requests, all the court had to do was say so and Surgin would have received them.

Likewise, there can be no possible prejudice from any failure to produce or identify indisputably privileged communications between Truck and its counsel, nor can one conceive how Surgin could possibly have been prejudiced by not receiving privileged documents (or identification of such documents) where there was no basis for ordering the ultimate production of those documents and where Surgin itself denied that any such order ever existed.

For all these reasons, no sanctions should have been imposed. The terminating sanctions order should be reversed and the case remanded for trial on the merits. At a minimum, the terminating sanctions order must be vacated with directions that the trial court determine whether any lesser sanctions are even appropriate given the ambiguity of its orders.

CONCLUSION

The $57.8 million default judgment is divorced from constitutional, statutory and decisional reality. No wonder, since the process that spawned it was surreal. Alice would have readily

recognized this looking-glass world, in which "When I use a word, it means just what I choose it to mean — neither more nor less." In this case,

- "Denied" meant "granted."
- "Some" meant "all."
- "September 15, 1993" became "May 4, 1993."
- "Gross misunderstanding" transformed into "blatant," "cool and calculating."
- "We're not seeking attorney-client communications" transmogrified into "you were ordered to produce all attorney-client communications" — until it suited Surgin's convenience to inform this Court there was no such order.
- "$270,000" transmuted into any number Surgin wanted.
- Controlling authorities — §§ 580, 585(b), *Greenup*, *Watercloud*, *Hogan*, *Brandt* and many others — vanished, along with basic constitutional protections.
- *Waller*, a case where Truck did nothing wrong, was the linchpin of a claim that Truck engaged in a "pattern and practice" of wrongdoing.

It's time to come back through the looking glass.

In the real world, here in California, our federal and state constitutions and our statutes still apply. When their plain language is respected, the judgment cannot stand: It must be reversed with

directions to enter judgment for Truck. At a minimum, it must be reversed and the case remanded for a contested trial on the merits. In no event may any default judgment exceed $270,000.

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Respectfully submitted,

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