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PUNITIVE DAMAGE AWARDS: THE REST OF THE STORY

A RESPONSE TO THE CENTER FOR JUSTICE & DEMOCRACY WHITE PAPER

by

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A recent white paper issued by the Center for Justice & Democracy (CJ&D), “What You Need to Know About . . . Punitive Damages” (Sept. 2011), argues that punitive damage awards, unconstrained by procedural safeguards or statutory or constitutional limits, are needed to protect Americans from corporate misconduct and unsafe products. This *Legal Backgrounder* highlights some of the significant flaws and half-truths in the CJ&D white paper’s reasoning. Ironically, contrary to its assertions, aspects of the white paper demonstrate the importance of proportionality and due process safeguards, and how punitive damages overkill can eliminate the public’s access to beneficial products.

Claim: Punitive damage awards are rare.

Response: It is not the number of actual awards that measure the fairness of the punitive damages process, but whether procedural safeguards and standards exist. Without them, those who are sued are likely to settle regardless of the merits rather than risk a multi-million or billion dollar verdict.

CJ&D cites a Bureau of Justice Statistics (BJS) study, *Civil Bench and Jury Trials in State Courts, 2005* (2008), to emphasize the rarity of punitive damage awards. That study found that punitive damages were requested in 13% of the approximately 14,000 general civil trials in which plaintiff’s prevailed in 2005. One in three of these trials (700) resulted in punitive damages. The study also found that 24% of cases resulted in punitive damages at least three times greater than the compensatory damage award. A separate BJS study of state court verdicts, *Civil Bench and Jury Trials in State Courts, 2005* (2008), found that jury awards in product liability cases were five times higher and medical malpractice cases two-and-a-half times higher than in 1992, even after adjustment for inflation. One third of product liability awards are now over \$1 million.

For businesses, these figures are an invitation to play a rigged game of Russian roulette. Where the plaintiff seeks punitive damages in a state that lacks due process safeguards, a business, particularly one based in another state, will be at great risk of a bankrupting verdict when tried before a locally-elected judge and hometown jury. As the Supreme Court has recognized, the “real problem” with punitive damages is their “stark

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unpredictability” – “the spread is great, and the outlier cases subject defendants to punitive damages that dwarf the corresponding compensatories.” *Exxon Shipping Co. v. Baker*, 128 S. Ct. 2605, 2625 (2008). Given the fear of an excessive award, the vast majority of cases settle out of apprehension, not the merits of the case. Personal injury lawyers know that even a small risk of an extraordinary verdict can significantly boost the settlement value of their cases.

Today, punitive damages are under better control precisely because the U.S. Supreme Court and state legislatures intervened to clamp down when they were “run[ning] wild.” *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 18 (1991).

Claim: Punitive damages have been “around for centuries.”

Response: True, but today’s punitive damages would be unrecognizable to the Founding Fathers, Abraham Lincoln, or even Harry Truman.

Historically, punitive judgments were both rare and, by today’s standards, almost trivial in amount. John Calvin Jeffries, *A Comment on The Constitutionality of Punitive Damages*, 72 VA. L. REV. 139, 141 (1986). That began to change in the late 1960s and 1970s for three basic reasons.

First, the nature of cases in which punitive damages are available changed. Such awards were once available only in a small set of intentional torts involving harm knowingly inflicted by one person on another, such as assault and battery, libel and slander, false imprisonment, and trespass. They were thought to help avoid the instinct for self-help, such as duels and feuds, and instead encourage use of the legal process. *See Merest v. Harvey*, 128 Eng. Rep. 761, 761 (C.P. 1814). In such one-on-one cases, “punitive damages at least were based on a manageable jury inquiry.” Jeffries, 72 VA. L. REV. at 141. Today, the standard for awarding punitive damages has expanded to cover conduct viewed as reckless or grossly negligent and often broadly focuses on the defendant’s conduct toward the public at large.

Second, the purpose of punitive awards gradually changed. Originally, these awards were intended largely to compensate plaintiffs for intangible losses that were not recoverable under the common law. *Cooper Indus., Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424, 438 n.11 (2001). For example, early punitive damages provided a means to compensate the plaintiff for the shame and humiliation resulting from “affronts to the honor of the victims” and “insults that were likely to provoke reactions of outrage.” Dorsey D. Ellis, Jr., *Fairness and Efficiency in the Law of Punitive Damages*, 56 CAL. L. REV. 1, 15 (1992). Exemplary damages were therefore often akin to today’s awards for noneconomic damages like pain and suffering. Later, the law changed to recognize compensation for noneconomic injuries, but punitive damages were not restricted accordingly, increasing the potential for duplicative recovery.

Third, it was only in the late 1960s that courts began awarding punitive damages in mass tort litigation, particularly in the developing field of product liability. With punitive damages available in strict-liability cases, “[a] single design error [or] inadequate warning ... can permeate an entire product line, resulting in tens, hundreds or thousands of personal injury lawsuits with accompanying punitive damages claims. Individual awards that appear reasonable can aggregate to threaten the very survival of a business entity.” Jeffries, 72 VA. L. REV. at 142. Courts spotted the potential problems immediately. As Judge Friendly observed, “We have the gravest difficulty in perceiving how claims for punitive damages in such a multiplicity of actions throughout the nation can be so administered as to avoid overkill.” *Roginsky v. Richardson-Merrell, Inc.*, 378 F.2d 832, 839 (2d Cir. 1967). This was not mere speculation, as the new developments led to an explosion of claims against manufacturers. *See, e.g.*, Richard A. Seltzer, *Punitive Damages in Mass Tort Litigation: Addressing the Problems of Fairness, Efficiency, and Control*, 52 FORDHAM L. REV. 37, 51-52 (1983).

Claim: Support for unlimited punitive damages goes back to biblical times.

Response: Actually, the Bible supports the very opposite -- proportionality.

The CJ&D white paper draws from the Bible and other ancient sources to support its position that unlimited punitive damages are needed to deter misconduct, but, read more closely, those sources strongly support proportionality and a maximum penalty. As the CJ&D paper itself notes, Exodus 22:4 states that *double restitution* is the appropriate response to theft, and Luke 19:8 provides restitution of *four times damages* as a remedy for fraud. The CJ&D paper also notes that “[t]he ancient Romans also enacted law in 450 B.C. that mandated the imposition of *multiple damages* as a means of punishing egregious conduct.” These remedies are in line with Supreme Court rulings requiring a relationship between compensatory damages and punitive damages, statutory limits on punitive damages, and state consumer protection laws that provide for treble damages. *See State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 425 (2003) (recognizing that “an award of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety,” and referring to “a long legislative history . . . providing for sanctions of double, treble, or quadruple damages to deter and punish”).

Claim: Unlimited punitive damages are necessary to protect Americans.

Response: If this assertion is accurate, then one would expect greater reports of injury in states without punitive damages or with statutory limits. There is no such evidence.

At the core of the CJ&D paper’s argument is its assertion that the threat of unlimited punitive damages is necessary to motivate businesses to produce safer products. There is an glaring problem with this assertion that is left unexplained by the white paper—where is the data? Six states—Connecticut, Louisiana, Massachusetts, Michigan, Nebraska, New Hampshire, and Washington—generally do not allow or severely constrain punitive damages. *See Baker*, 128 S. Ct. at 2622-23. An additional 24 states limit the size of punitive damage awards. Many of these statutory limits have been in place for years. Moreover, the United States stands alone in permitting such extraordinary awards. Despite this legal landscape, no study has found that residents of states (or countries) that do not have, or have constrained, punitive damages are more likely to be injured by a defective product, misled by a fraudulent advertisement, or otherwise placed at a greater likelihood of harm than states that permit unlimited awards. For example, for over 23 years Virginia has placed a \$350,000 limit on punitive damages, while West Virginia has not adopted a cap. Is there any showing that the conduct of corporations is worse in Virginia than West Virginia? We are unaware of even anecdotal evidence supporting this view. Market forces, the threat of basic lawsuits, and government regulation and enforcement are more than enough to encourage optimum behavior.

Claim: Punitive damages lead to removal of unsafe products from the market.

Response: Unlimited punitive damages overkill also results in elimination of safe, beneficial products.

CJ&D’s white paper argues that punitive damages have led to the removal of dangerous products from the market, but it actually shows how overkill has led to the loss of safe, beneficial products due to liability concerns. For instance, the paper highlights how a punitive damage verdict led to the removal of the Copper-7 IUD from the market. But was that a good or bad outcome for society? Probably bad and this is why. CJ&D blurs the safety of Copper-7 IUD with the unsafe Dalkon Shield IUD. Personal injury lawyers did the same thing after the maker of the Dalkon Shield declared bankruptcy in 1984. As a result of a single \$8.75 million punitive damage award, an entire method of contraception used by millions of women was voluntarily removed from the

market. Unlike the Dalkon Shield, the FDA and health advocates considered Copper-7 to be safe. Nevertheless, after the Dalkon Shield bankruptcy, plaintiffs' lawyers turned their fire on the Copper-7. By 1988, juries were so prejudiced against IUDs due to the Dalkon Shield litigation that a substantial award was only a matter of time. Prior to the punitive damages verdict, device-maker Searle won 19 of 23 cases that went to trial; the 4 that it lost resulted in combined total of \$689,000 in damages. Faced with about 500 pending lawsuits and the heightened risk of repeated punitive awards, Searle stopped selling the Copper-7 and began settling outstanding cases. In fact, the lone punitive damage award served little purpose—it was assessed against Monsanto, which had only recently acquired G.D. Searle due to interest in its Nutrasweet® business, not those who designed Copper-7. Although no longer available, Copper-7 continues to have FDA approval today. In fact, while IUDs, including a variant of the Copper-7, are the most common reversible method of birth control used by women in the world, less than 1% of women in the U.S. use an IUD as their method of birth control.

Claim: Deducting punitive damages from taxable income encourages bad conduct.

Response: This is untrue. Punitive damages are not equivalent to a criminal penalty and are appropriately treated in the same manner as other civil damages.

For decades, the tax code has allowed a deduction for damages paid or incurred as ordinary and necessary expenses in carrying on a trade or business, regardless of whether such damages were compensatory or punitive in nature. Proponents for the denial of a deduction for punitive damages payments argue that a change in the tax code is warranted because punitive damages are akin to criminal fines, which are currently not deductible. Punitive damages awards, however, are fundamentally different from criminal punishment. They are typically awarded *without* (1) proof beyond a reasonable doubt; (2) a showing of actual malice; (3) a requirement of proportionality between the award and the plaintiff's actual injury; and (4) protections against repetitive punishments. Most importantly, punitive damages do not result from an objective standard for determining "guilt" or innocence.

It is not surprising that the organized plaintiffs' bar and its allies want to deny defendants the ability to deduct punitive damage awards. Such a change in tax law would provide trial lawyers with increased ammunition to use the threat of unpredictable punitive damages to force early settlement of civil actions. This would occur because amounts paid in settlement, however unwarranted, could be deducted as a "business expense," but a punitive damages verdict would come off the "bottom line." Defendants would need to factor the tax implications of a potential punitive damages award into their calculus in deciding to take a case to trial. Congress has wisely rejected this proposal to alter the tax code.

Conclusion. Almost every decade it seems that a new "study" appears that reflects the plaintiffs' bar's view that our current punitive damages system is "just fine." See, e.g., Victor E. Schwartz, *Demystifying The Roscoe Pound Foundation Study of Punitive Damages — Propaganda On Parade*, LEGAL BACKGROUNDER, (Washington Legal Foundation, 1992). But each attempt, like that recently put forth CJ&D, relies on limited data to argue points that conflict with real world experience. In recent history, no state that has placed rational limits on punitive damages or adopted procedural safeguards has repealed them. Ultimately, all trends are in the other direction, placing CJ&D on the wrong side of history. At the foundation of a fair justice system and the importance America places on due process is that individuals and businesses have fair notice of their liability and that punishment is proportionate to any wrongful conduct. We have tried our best to put the truth to the myths of the most recent study and trust that both judges and legislatures will do likewise.