PUNITIVE DAMAGES

In Consumer Actions

By Joseph Sanders*

Editor's note: In Texas, punitive damages are regulated by Chapter 41 of the Texas Civil Practice and Remedies Code. Many believe that Chapter 41 imposes restrictions and limits clearly within the constitutional boundaries established by the United States Supreme Court. In light of the exceptions provided by Chapter 41 and the possibility of awards exceeding the numerical cap Chapter 41 establishes, however, punitive damages in Texas may raise constitutional issues. The following paper, recently presented at the Center for Consumer Law's "Teaching Consumer Law Conference," discusses punitive damages in the consumer context and reviews the current state of constitutional limits.

In my remarks I wish to review where we stand on punitive damages today and how this affects the availability of this remedy in consumer actions. In this brief overview I address four issues: a) the criteria for awarding punitive damages, b) the empirical evidence on the frequency and amount of punitive damages, c) punitive damages and tort reform, and d) constitutional limits on punitive damages. I focus most of my attention on the last of these topics.

A. The criteria for awarding punitive damages.

Until a few years ago, many jurisdictions permitted the award of punitive damages if the defendant was more than merely negligent. Intentional torts, recklessness, and even gross negligence were grounds for punitive damages. Today, few jurisdictions permit the award of punitive damages absence a showing of fraud or malice, i.e. some form of intentional wrongdoing. This restricts the availability of punitive damages in many tort actions, but presumably has less of an effect in many consumer law cases where fraud or malice are easier to prove. Generally, juries are instructed that where punitive damages are appropriate the size of the punitive damages should reflect factors such as the nature of the wrong, the degree of culpability of the wrongdoer, and the net worth of the defendant. These specific instructions reflect the two goals of punitive damages: to deter wrongdoing and to punish the plaintiff.

B. Empirical data on punitive damages.

Studies conducted in the 1990s indicate that punitive damages are relatively infrequent, but there is substantial variation across jurisdictions.[1] One 1992 study indicated that punitive damages were awarded in 6% of jury trials. When this is broken down by types of cases, punitive damages are more frequently awarded in contract cases (12%) than in tort cases (4%). Here, of course, punitive damages were most frequent in fraud and intentional tort cases (around 20%). They are also very frequent in employment cases (27%).[2]

The size of most punitive damage awards is relatively modest. The studies report median awards of around $50,000. Of course the controversy surrounding punitive damages is not about the run-of-the-mill award but rather the large awards at the upper end of the distribution. The impact of these awards is reflected in the fact that mean punitive damage awards are much larger than median awards. Depending on the source, mean awards are reported to be between half a million and two million dollars.[3]

Judges frequently impose downward adjustments to punitive damage awards. Recently, this has occurred because of statutory caps and recent United States Supreme Court opinions discussed below, but apparently the practice was widespread even before these developments. [4] Apparently, many of these adjustments have come in cases where the award would have survived scrutiny based on statutory caps or constitutional limits.

Given the now widespread existence of punitive damages caps, a related question is how often punitive damages must be adjusted because of cap violations. There is little data on this point. A Rand study estimated that caps would effect 65% of the punitive damage in financial injury cases.[5] This is a higher figure than one would estimate looking at punitive damage awards in all types of cases. One recent article that focused on Florida cases decided between 1989 and 1998 indicates that across all cases the ratio of punitive damages to compensatory damages was approximately 1.1 to 1.[6] In discrimination/harassment and professional negligence cases, the median ratios of 2.3:1 and 2.5:1, respectively. In only a few states would these ratios violate statutory caps.

The authors of this study also looked at the 20 largest punitive damage awards during this period. Excluding the very largest award (total compensation of $542,650,919 with punitive damages of $325,590,551)[7] the ratio of punitive damages to compensatory damages in the remaining case was approximately 5.9 to 1. This ratio is more likely to exceed statutory caps.[8]

C. Punitive damages and tort reform.

Apparently, five states either prohibit punitive damages or severely restrict their use.[9] Statutory caps in at least in some form exist in half the states. Limits tied to the amount of actual or economic damages exist in 14 states.[10] Many punitive damages statutes alter the existing common law in other ways as well. They may require proof of intentional wrongful conduct, they may raise the plaintiff's burden of proof to a clear and convincing standard, or they may require that that the award be shared with the state. Thus far, efforts to pass legislation at the national level have failed.

D. Punitive damages and substantive due process.

On at least five occasions since 1991 the Supreme Court has addressed the constitutionality of punitive damages. Many of these cases involve consumer law or insurance law issues. In the first case, Pacific Mut. Life Ins. Co. v. Haslip, 499 U.S. 1, 111 S.Ct. 1032, 113 L.Ed.2d 1 (1991) several insureds sued a life insurer because its agent fraudulently continued to accept premium payments even though the policy had been cancelled without notice to them. Mrs. Haslip was awarded $200,000 in actual damages and $840,000 in punitive damages. The insurer appealed, claiming that the award of punitive damages violated due process. In rejecting the argument the Court stated:

> We need not, and indeed we cannot, draw a mathematical bright line between the constitutionally acceptable and the constitutionally unacceptable that would fit every case. We can say, however, that general concerns of reasonableness and adequate guidance from the court when the case is tried to a jury properly enter into the constitutional calculus.[11]

The Court went on to examine the state standards in place for assessing punitive damages, including jury instructions, post-trial review, appellate review, and the size of the award in a given case. The Court concluded that awarding of punitive damages four times compensatory damages and 200 times the plaintiff's out-of-pocket losses was constitutional but "close to the line."

The second Supreme Court case to analyze the constitutionality of punitive damages, TXO Production Corp. v. Alliance Resources Corp., 509 U.S.443, 113 S.Ct. 2711, 125 L.Ed.2d 366 (1993), revisited the question of the acceptable ratio between actual and punitive damages. The defendant used its economic power in an oil-and-gas royalty arrangement, to coerce plaintiffs to concede royalty rights to which they were entitled. The jury awarded $19,000 in actual damages and $10,000,000 in punitive damages based on defendant's fraudulent conduct. The court upheld the verdict against defendant's claim of a due process violation, with six judges voting to affirm. Those judges wrote three opinions giving their reasons, but no opinion was joined by a majority of judges.

The third punitive damage opinion is BMW of North America v. Gore, 517 U.S. 559, 116 S.Ct. 1589, 134 L.Ed.2d 809 (1996). The plaintiff purchased a new BMW from a dealer in Alabama. Later he discovered that the car had been repainted by the distributor, due to damage it sustained during transit. At trial, plaintiff introduced evidence that BMW had sold nearly 1,000 cars as new without disclosing the repainting to either the dealer or the customer. The plaintiff contended, and the jury agreed that the plaintiff suffered a $4,000 loss because of the repainting. The jury further agreed with the plaintiff that an appropriate amount of punitive damages would be $4,000,000 (1,000 cars at $4,000 per car). The Alabama Supreme Court reduced the punitive award to $2,000,000 on the ground that the jury improperly multiplied plaintiff's compensatory damages by the number of sales or repainted cars across the entire country, and not the number of sales in Alabama. [The Alabama Supreme Court did not choose to explain how this recalculation generated a value of $2,000,000]. In a 5-4 opinion, the United States Supreme Court set aside the punitive damage award as constitutionally excessive under the Due Process Clause. Writing for the Court, Justice Stevens cited TXO for the proposition that the Due Process Clause prohibits the state from imposing "grossly excessive" punishment.

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The Court observed that Alabama does not have the power to punish BMW for conduct that may have been lawful in other states. The Court went on to state that due process requires,

> that a person receive fair notice not only of the conduct that will subject him to punishment, but also of the severity of the penalty that a State may impose. Three guideposts, each of which indicates that BMW did not receive adequate notice of the magnitude of the sanction that Alabama might impose for adhering to the nondisclosure policy adopted in 1983, lead us to the conclusion that the $2 million award against BMW is grossly excessive: the degree of reprehensibility of the nondisclosure; the disparity between the harm or potential harm suffered by Dr. Gore and his punitive damages award; and the difference between this remedy and the civil penalties authorized or imposed in comparable cases. We discuss these considerations in turn.[12]

The Court noted that the $2 million punitive damage award was 500 times the amount of the plaintiff's actual harm as determined by the jury, that the defendant's conduct did not exhibit a reckless disregard for the health or safety of others, and the award was far larger than any applicable fines. It, therefore, struck down the award as unconstitutional.

In Cooper Industries Inc. v. Leatherman Tool Group, Inc., 532 U.S. 424, 121 S.Ct. 1678, 149 L.Ed.2d 674 (2001) the Court added a procedural footnote to its constitutional jurisprudence. In Cooper Industries, the manufacturer of multifunction hand tool sued competitor for false advertising. The jury awarded $50,000 in compensatory damages and $4.5 million in punitive damages. The district court rejected the defendant's claim that punitive damage award was unconstitutionally excessive. The Ninth Circuit affirmed the punitive damage award, concluding that district court's refusal to reduce award was not abuse of discretion. Certiorari was granted. The Supreme Court, in an opinion written by Justice Stevens, held the court of appeals should apply a de novo standard when reviewing the district court's determination of constitutionality of a punitive damage award.

In perhaps its most important punitive damage case to date, the Court revisited the issue of punitive damages in State Farm Mutual Auto. Ins. Co. v. Campbell, 538 U.S. 408, 123 S.Ct. 1513, 155 L.Ed.2d 585 (2003). Campbell is an insurance coverage case concerning the defense of an underlying automobile accident. Curtis Campbell recklessly attempted to pas six vans on a two lane road. One vehicle coming toward Campbell swerved to avoid a head-on collision, lost control, and collided with another vehicle, killing the driver and permanently disabling the driver of the car with which he collided. Campbell and his wife, who was a passenger in his car, escaped unscathed. The other parities sued, but State Farm refused to settle the claims for policy limits of $25,000 each. At the same time, State Farm assured the Campbells that "their assets were safe, that they had no liability for the accident, that [State Farm] would represent their interests, and that they did not need to procure separate counsel." The jury found Campbell entirely at fault and returned a judgment for $185,849.

At this point, State Farm refused to cover the $135 thousand in excess liability and its lawyer told the Campbells, "You may want to put for sale signs on your property to get things moving." State Farm did not post an appeal bond, and, therefore, Campbell hired his own lawyer to handle the appeal. During this time, Campbell and the defendants entered into an agreement that they would not attempt to collect the $135 thousand from him in return for his agreement to hire their counsel in order to pursue a bad faith claim against State Farm. The agreement gave the defendants in the automobile accident litigation 90% any recovery. Eventually the Utah courts rejected the Campbell appeal of the traffic case and at that point State Farm did pay the entire judgment.

In the subsequent bad faith case, over State Farm's objection, the trial court admitted testimony of alleged conduct that occurred in unrelated cases outside Utah. The plaintiffs were permitted to introduce evidence of the defendant's company-wide policy to cap claims payouts as well as other evidence of State Farm's business practices in numerous states over the preceding twenty years. The jury found against State Farm on fraud and intentional infliction of emotional distress claims and awarded the Campbells $2.6 million in compensatory damages and $145 million in punitive damages. The trial court reduced these awards to $1 million and $25 million respectively. The Utah Supreme Court reinstated the $145 punitive damage award. The Supreme Court reversed. It applied the Gore factors, and concluded that "this case is neither close nor difficult." Central to the Supreme Court's reversal was the fact that the case "was used as a platform to expose, and punish, the perceived deficiencies of State Farm's operations throughout the country." The Court noted, as it had in Gore, that much of this out of state conduct was legal where it occurred. More importantly, most of the conduct for which punitive damages were awarded bore no relation to the Campbell's harm.

> Due Process does not permit courts, in the calculation of punitive damages, to adjudicate the merits of other parties' hypothetical claims against a defendant under the guise of the reprehensibility analysis, but we have no doubt the Utah Supreme Court did that here. *** Punishment on these bases creates the possibility of multiple punitive damages award for the same conduct; for in the usual case nonparties are not bound by the judgment some other plaintiff obtains.[13]

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Apparently, the plaintiffs were unable to point to other cases in Utah where State Farm had accept a good faith settlement offer within policy limits and then refused to pay the excess liability imposed by a jury.[14]

The Court turned next to the second Gore factor, and concluded that the Utah Supreme Court ratio of 145 to 1 was excessive.

> The compensatory award in this case was substantial; the Campbells were awarded $1 million for a year and a half of emotional distress. This was complete compensation. The harm arose from a transaction in the economic realm, not from some physical assault or trauma; there were no physical injuries; and State Farm paid the excess verdict before the complaint was filed, so the Campbells suffered only minor economic injuries for the 18 month period in which State Farm refused to resolve the claim against them.[15]

Once again, the Court noted that the constitutional line between permissible and impermissibly large awards is not marked by a simple mathematical formula. It refused to create such a formula in this case.

> Our jurisprudence and the principles it has now established demonstrate, however, that, in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process. In Haslip, in upholding a punitive damages award, we concluded that an award of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety. 499 U.S., at 23-24. We cited that 4- to-1 ratio again in Gore. 517 U.S., at 581. The Court further referenced a long legislative history, dating back over 700 years and going forward to today, providing for sanctions of double, treble, or quadruple damages to deter and punish. Id., at 581, and n. 33. While these ratios are not binding, they are instructive. They demonstrate what should be obvious: Single-digit multipliers are more likely to comport with due process, while still achieving the State's goals of deterrence and retribution, than awards with ratios in range of 500 to 1, id., at 582, or, in this case, of 145 to 1.
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> Nonetheless, because there are no rigid benchmarks that a punitive damages award may not surpass, ratios greater than those we have previously upheld may comport with due process where "a particularly egregious act has resulted in only a small amount of economic damages." See also ibid. (positing that a higher ratio might be necessary where "the injury is hard to detect or the monetary value of noneconomic harm might have been difficult to determine"). The converse is also true, however. When compensatory damages are substantial, then a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee. The precise award in any case, of course, must be based upon the facts and circumstances of the defendant's conduct and the harm to the plaintiff.[16]

The third Gore guidepost also weighed against the size of the award.

The most relevant civil sanction under Utah law was a $10,000 fine for an act of fraud.

On April 23, 2004, upon remand from the Supreme Court, the Utah Supreme Court reduced the punitive damage award to a little over $9 million.[17] It will be interesting to see if the United States Supreme Court allows this award to stand in light of its comment that in cases where compensatory damages are "substantial" a ratio of even 1 to 1 might reach the outer limit of due process and its labeling of the $1 million dollar award as "substantial."

In my opinion, the most important aspect of the Campbell opinion is not the ratio discussion, but the evidentiary ruling that punitive damages should be based on the particular case at hand. Obviously, the Court is most concerned with the possibility for multiple punitive damages. Conceptually, this is a very difficult issue although as an practical matter it is very hard to know if it is a frequent problem.[18] Another important aspect of this case and the Gore case before it is the fact that the Supreme Court has consistently downplayed the "reprehensibility" of any conduct that results only in economic loss and emotional distress. This point of view may make it more difficult to obtain large punitive damage awards in many consumer cases.

The Campbell case probably is not the last Supreme Court pronouncement in this area. I hope this brief review will produce a discussion of the current and future status of punitive damages. .

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1. Valerie P. Hans and Stephanie Albertson, Empirical Research and Civil Jury Reform, 78 NOTRE DAME L. REV. 1497 (2003).
2. Theodore Eisenberg, neil LaFountain, Brian Ostrom, David Rottman and Martin Wells, Juries, Judges, and Punitive Damages: An Empirical Study, 87 CORNELL L. REV. 743 (2002) report similar results from a 1996 study.
3. Joni Hersch and W. Kip Viscusi, Punitive Damages: How Judges and Juries Perform, 33 J. LEGAL STUD. 1 (2004). ($1.8 million for jury trials and $550 thousand for bench trials); Jennifer K. Robbennolt, Determining Punitive Damages: Empirical Insights and Implications for Reform, 50 BUFF. L. REV. 103 (2002) ($730,000); Richard W. Murphy, Punitive Damages, Explanatory Verdicts, and the Hard Look, 76 WASH. L. REV. 995 (2001) ($534,000)
4. See Theodore Eisenberg, Neil LaFountain, Brian Ostrum, David Rottman & Martin T. Wells, Juries, Judges, and Punitive Damages: An Empirical Study, 87 CORNELL L. REV. 743, 777-78 & n.123 (2002); Neil Vidmar & Mary R. Rose, Punitive Damages by Juries in Florida: In Terrorem and in Reality, 38 HARV. J. ON LEGIS. 487, 503-08 (2001); Michael L. Rustad, Unraveling Punitive Damages: Current Data and Further Inquiry, 1998 WIS. L. REV. 15, 40-44 (1998); Marc Galanter, Real World Torts: An Antidote to Anecdote, 55 Md. L. Rev. 1093, 1115-16 (1996).
5. Erik Moller et al., Rand Institute for Civil Justice, PUNITIVE DAMAGES IN FINANCIAL INJURY JURY VERDICTS 44 (1997).
6. Neil Vidmar and Mary R. Rose, Punitive Damages by Juries in Florida: In Terrorem and in Reality, 38 HARV. J. ON LEGIS. 487 (2001).
7. The next largest award was $77 million.
8. Apparently, this ratio would violate Florida caps. Fla. Ann. Stat. § 768.73 limits punitive damages to the greater of 3 times compensatory damages or $500,000 in most cases. However, where the fact finder determines that the defendant's conduct was motivated "solely by unreasonable financial gain and determines that the unreasonably dangerous nature of the conduct, together with the high likelihood of injury resulting from the conduct, was actually known by the managing agent, director, officer, or other person responsible for making policy decisions on behalf of the defendant" the cap is the greater of 4 times compensatory damages or $2 million.
9. John Y. Gotanda, Punitive Damages: A Comparative Analysis, 42 COLUM. J. TRANSNATIONAL L. 391, 421 (2004). In this category he lists Nebraska, Washington, Louisiana, New Hampshire, and Massachusetts.
10. William A. Lovett, Exxon Valdiz, Punitive Damages, and Tort Reform, 38 TORT TRIAL & INS. PRAC. L.J. 1071, 1107 (2003) In this latter category, he lists Alabama, Alaska, Colorado, Florida, Illinois, Indiana, Kansas, Nevada, New Jersey, North Carolina, South Dakota, Oklahoma, and Texas.
11. 499 U.S. at 18.
12. 517 U.S. at 574.
13. 538 U.S. at 410.
14. Of course, in most jurisdictions in these circumstance an insured is required, either by statute or by legal opinion, to pay judgments in excess of policy limits.
15. 538 U.S. at 426.
16. 538 U.S. at 425.
17. Campbell v. State Farm, — P.3d —, 2004 WL 869188.
18. For a useful state court opinion dealing with this issue, see Owens-Corning Fiberglas Corp. v. Malone, 972 S.W.2d 35 (Tex. 1998).