however, is the premise that there are goods and services that are public utility necessities and the conclusion that the public interest requires their regulation.

—Rodney Stevenson

See also Common Law; Deregulation; Economies of Scale; Enron Corporation; Federal Communications Commission (FCC); Internet and Computing Legislation; Just Price; Market Failure; Monopolies, Duopolies, and Oligopolies; Public Interest; Regulation and Regulatory Agencies; Telecommunications Act of 1996; WorldCom

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Punitive Damages

What Are Punitive Damages?

They Are Additional to Other Damages

Punitive damages are additional to the compensatory damages a judge or a jury may grant a plaintiff. Special damages are designed to replace "out-of-pocket" costs to the plaintiff. General damages are designed to compensate for the more ephemeral losses—such as pain and suffering; loss of consortium; or loss of care, love, and affection—to the plaintiff. Punitive damages are awarded to punish and make an example of the defendant.

Punitive Damages Cannot Be Insured

Generally, compensatory damages are paid for by an insurance company. Common law and many state laws or regulations prohibited insurance companies from insuring or paying punitive damages. Punitive damages must be paid for by the party against whom they are assessed.

Punitive Damages Are Quasi-Criminal Assessments

Punitive damages serve a similar purpose as criminal penalties—they punish the defendant and serve to make an example of the defendant. However, because civil defendants are not afforded the same due process and procedural protections as their criminal counterparts, the imposition of punitive damages inherently includes the danger of arbitrary and excessive deprivation of property. This problem is exacerbated when the decision maker, usually a jury, has also been presented with the inflammatory evidence necessary to merit the imposition of punitive damages. For an example of bad behavior that can lead to the imposition of punitive damages, read the facts in *State Farm v. Campbell et al.*, 538 U.S. 416 (2003).

Because of their quasi-criminal nature and the potential for abuse or mistake, the threat of punitive damages touches a red hot button for many people, especially the business community. This entry will look at the type of claims that cause courts and juries to award punitive damages, the Supreme Court's theory of ratio of punitive damages to compensatory damages, and some open issues.

One Legislature's Definition

California's Civil Codes § 3294 is an example of how a state's legislature codifies punitive damages. It states, in salient part, the following:

> In an action for the breach of an obligation not arising from contract, where it is proven by clear and convincing evidence that the defendant has been guilty of oppression, fraud, or malice, the plaintiff, in addition to the actual damages, may recover damages for the sake of example and by way of punishing the defendant.

Punitive Damages Generally Require a Tortious Act

The statute requires the alleged offensive act to arise from a tort, not a contract. These are two very different theories of law. A tort is an offense against an individual. A breach of contract is where a party is alleged to have broken its contractual obligation. This definitional difference can be dangerously simplistic and tricky.

One area of law where these two legal theories blend involves the duty of parties to exercise "good faith and fair dealing" in a contract. If one of the parties had larceny in his or her heart when entering into a contract and used some device to take advantage of the other party (or parties) to the contract, the aggrieved party could claim that the offensive party lacked the requisite "good faith." In a lawsuit, the aggrieved party would allege a "breach of the covenant to deal fairly and in good faith." Although this breach arises in a *contract* setting, the breach of this duty has been routinely defined as a *tort.* Therefore, in the case of California's statute on punitive damages, while there can be no punitive damages for the breach of the *contract*, there can be punitive damages for the *tort.* So the aggrieved party can claim punitive damages for the breach of the duty to deal fairly and in good faith but not for the breach of the contract.

The Standard of Proof for Punitive Damages Is Higher

Constitutional Standard: Probable Cause

The lowest level of proof is "probable cause." This is the level referred to by the Constitution in the Fifth Amendment, which allows the state to get a warrant. It is the level by which a law enforcement officer can stop a citizen and then instigate an investigation or interrogation. Probable cause has a very low evidentiary threshold.

Civil Standard: Preponderance

The next highest level of proof is a "preponderance," which is the standard of proof in a civil action. The simile often used to demonstrate this level of proof is to imagine the Lady of Justice's scales. If they should tilt ever so slightly one way or the other, the heavier side has been said to have the preponderance of the evidence.

Criminal Standard: Beyond a Reasonable Doubt

The highest level of proof is "beyond a reasonable doubt." This is the level reserved for criminal cases. The burden is on the state to prove that the accused is guilty "beyond a reasonable doubt." The higher burden is an attempt to offset the extraordinary range of resources the state has to prosecute the accused.

Punitive Damages Standard: Clear and Convincing

Between preponderance and beyond a reasonable doubt lies a level of burden of proof called "clear and convincing." It is beyond the 51/49% of preponderance and below the "beyond a reasonable doubt" standard. Clear and convincing is a compromise that considers the quasi-criminal nature of punitive damages. Courts have historically upheld this standard as reflecting society's and the court's disfavor of punitive damages.

Clear and convincing is the *legal* barrier a plaintiff must cross to prove his or her case. However, in the courtroom, even when a plaintiff meets his or her burden of proving the claim for punitive damages by clear and convincing evidence, juries find it hard to award punitive damages in all but the most egregious cases. Furthermore, appellate courts uphold punitive damages in only the most serious circumstances.

The Purpose of Punitive Damages

As California's statute states, punitive damages are used to make an example and punish the alleged offender. As mentioned above, the imposition of punitive damages assumes the mantle of quasi-criminal punishment. One of the questions plaguing the imposition of

punitive damages is, "What does punishment, *sufficient* punishment, look like?"

Suppose a person of modest means chooses a certain behavior, such as using marijuana. What kind of punishment would cause such a person to change his or her behavior? Would a "warning" cause him or her to stop using marijuana? Probably not. How about a $25 fine? Again, probably not. A $250 fine? It might get his or her attention, especially if it were imposed regularly, every time he or she used the drug. Now, how about seizure of all his or her property, a 10-year sentence in a federal jail, and a $250,000 fine? Chances are high this draconian step would cause the miscreant to change his or her behavior.

This is the principle behind punitive damages. Punitive damages should be sufficient to punish and make an example of the defendant, in consideration of the defendant's wealth and ability to pay the damages. The elusive issue is what is just enough but not too much.

Suppose a manufacturer creates a product, develops the product, tests the prototypes, markets the product, and sells the product. Before the product has been placed into the stream of commerce but after the manufacturer has spent hundreds of millions of dollars on the initial development and testing, the manufacturer discovers that the product is defective. Management determines to near certainty that in a common-use scenario, the product uniformly fails catastrophically, with predictable results of serious injury or death to the user. Rather than pulling the product, as Johnson & Johnson did during the Tylenol problem of the 1980s, this manufacturer makes a simple cost-benefit analysis to determine how to proceed.

To a statistical certainty, the catastrophic failure will result in 180 deaths by burning, 180 serious injuries attributed to burning, and 2,100 burned vehicles. The unit cost is $200,000 per death, which was a published U.S. government figure for the value of human life at the time, $67,000 per injury, and $700 property damage per vehicle. The total benefit of doing nothing can be computed by the formula $180 \times (\$200{,}000) + 180 \times (\$67{,}000) + 2{,}100 \times (\$700)$ for a result of $49,500,000. This figure assumes that all persons sue and recover.

Then, the risk management section crunches the numbers and further analyses the cost. They find that 12,500,000 vehicles were sold. The unit repair cost is $11.00. The total cost formula is $12{,}500{,}000 \times \$11.00$ for a result of $137,000,000. The manufacturer decides that it is cheaper to deal with the deaths, injuries, and property damage than to make the repairs. It is decided not to recall the product and to deal with the cases as they appear. The figures used in this hypothetical problem were actual numbers taken from the Ford Motor Company interoffice memo titled "Fatalities Associated With Crash Induced Fuel Leakage and Fires" by E. S. Grush and C. S. Saunby, which was used in conjunction with the Ford Pinto litigation in the 1960s and 1970s.

After a series of configurations resulting in the predicted deaths and injuries, how should society get the company's attention? The company has made a clear decision to sell a product it knew to be defective. It chose to put people at risk after doing its own risk-benefit study. This is a scenario that might merit the imposition of punitive damages. Assuming that a plaintiff can show, by clear and convincing evidence, that the manufacturer knew of the problem, it might be very appropriate to award punitive damages to punish and make an example of the errant manufacturer.

In *Time* magazine, March 10, 2006, there was an article that discussed the *Exxon Valdez* oil disaster. Sixteen years after the accident, Exxon is still disputing the punitive damages award. The attorney of one of the victims was quoted as saying, "Only punitive damages will give Exxon the incentive to prevent future oil spills. The industry's perception is that all they have to worry about is the immediate out-of-pocket costs and they can just pollute and pay."

Some Unresolved Issues

Multiple Plaintiffs and Class Action Cases

One of the unresolved issues involves multiple plaintiffs, such as in a class action case. If one plaintiff were to recover a large punitive damage award, what about the other plaintiffs? If the behavior was considered reprehensible in the first case to trial, what mitigates the behavior in the subsequent cases? On the other hand, if the punitive damage award was sufficient enough to punish and make an example of the manufacturer in the first case, then other punitive damages would be definitionally unfair because the original imposition was supposed to be sufficient to "punish and make an example of" the defendant. On the other hand, is it not unfair to give a large award, seemingly a windfall, to only one of a number of injured plaintiffs?

The "Ratio"

The issue of the ratio of punitive damages to compensatory damages has been before the U.S. Supreme

Court twice in the last decade. The first case was *BMW of North America, Inc. v. Gore*, 517 U.S. 559 (1996), and the second was *State Farm Mutual Automobile Insurance Co. v. Campbell et al.*, 538 U.S. 416 (2003). In *Gore*, the Supreme Court overturned a $2,000,000 punitive damages award that accompanied a $4,000 compensatory award. In *Campbell*, the Court reversed a $145,000,000 punitive damages award where the compensatory damages were $1,000,000.

The Supreme Court, in *Gore* and *Campbell,* refused to give a specific formula or ratio. However, in both cases, the Court said, "In practice, few awards exceeding a single digit ratio between punitive and compensatory damages will satisfy due process." The Court found that single-digit multipliers satisfied both the due process issues presented by the Fourteenth Amendment to the Constitution and the state's need for punishment and deterrence. In *Gore*, the ratio was 500 to 1, and in *Campbell*, the ratio was 145 to 1.

However, to a company such as BMW or State Farm, if the aberrant behavior was very profitable, would the imposition of insignificant punitive damages really be a deterrence? For example, in *BMW*, the company was punished for failing to disclose that they were selling vehicles damaged in the manufacturing process as new vehicles. If the Court's guidance for a ratio was 9 to 1 and the damage was $4,000, the maximum punitive damage would be $36,000. Considering that the vehicle sale price was more than double the maximum amount that could be awarded for punitive damages, would the 9-to-1 ratio be enough to cause the defendant to refrain from the practice of selling vehicles damaged at the factory as new cars?

Popular Prejudices

Over a decade ago, an article in the June 17, 1996, *Wall Street Journal* discussed punitive damages from a business perspective. The authors addressed some of the commonly held misunderstandings regarding punitive damages. They said,

> Here is the latest stunning development about runaway punitive-damage awards: They may not be as common as you think. . . . Punitive awards are generally modest, and meted out in only the most extreme circumstances. . . . According to the study, most punitive awards aren't random, as critics have argued, but instead are closely tailored to the amount of compensatory damages, such as medical expenses and lost wages. Punitive damages are designed to punish and deter bad conduct. . . . The study found a much closer relationship between punitive and compensatory damages in most cases. Where compensatory damages were $10,000, punitives averaged around $10,860. Where compensatory damages were $100,000, punitives averaged around $65,720. And where compensatory damages were $1 million, punitives averaged $397,810.

This is just one example of the public's common misunderstanding of the nature and purpose of punitive damages. More important, it also gives an indication of the depth of passions around the subject. Is this prejudice a function of excellent manipulation of the media by savvy manufacturers or artificial hype brought to the public by the media?

What seems to be accurate is that in most cases, when the public hears the real facts of a case where punitive damages are awarded, they usually have no problem. Once the public hears why a jury gave punitive damages, the reasons predicated on the evidence proven in the trial, the average citizen is supportive. However, when only partial facts are given, many people look at these awards askance.

An example is *Liebeck v. McDonald's Corp*, the (in)famous "hot coffee" case. Many people have a very strong feeling that this case was just ridiculous. However, when they are quizzed to give the facts, invariably they give the wrong facts. When they are told the facts the jury heard, even the most obstinate persons usually feel that they have been duped by the media. Perhaps the more important question is who gave the "story" to the media and why they omitted the essential facts.

Conclusion

The issue of punitive damages touches social and legal hot buttons. However, such damages serve a valid social purpose. Punitive damages are designed to be punitive, to punish and make an example of a wrongdoer. Without punitive damages, society has no other viable means of holding large corporate entities accountable for intentional wrongdoing. One of the current important questions is what constitutes enough punishment. What is enough money to "punish and make an example" yet not so much as to violate an entity's right to due process under the law? The intertwining of civil and criminal law is what makes punitive damages so volatile and yet so effective. As long as punitive damages remain an alternative, they

may serve a greater purpose, that of deterring despicable behavior.

—Michael B. Rainey

See also Commutative Theory of Justice; Compensatory Damages; Dalkon Shield; Enron Corporation; *Exxon Valdez*; Firestone Tires; Ford Pinto; Global Crossing; Johns-Manville; Price-Fixing; Tyco International

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