Litigation

Constitutional Limits on Punitive Damages: An Evaluation of the Role of Economic Theory in Prescribing Constitutional Constraints on Punitive Damage Awards

*by Dorothy Henderson Shapiro**

Over the last fifteen years, the Supreme Court has formulated new constitutional principles to constrain punitive damages awards imposed by state courts, invoking its authority under the Due Process Clause of the Fourteenth Amendment. This intervention has been controversial from the start, generating dissents from several Justices asserting that the actions of the Court are unwarranted and amount to unjustified judicial activism. Over the ensuing years lower courts and commentators have criticized the Court's prescription of procedural and substantive limitations, finding them to be vague and unnecessarily restrictive of state common law prerogatives. Some observers with an economic orientation have entered the debate, motivated by runaway punitive damage awards in some states. Their core premise is that actual damages alone are sufficient in most tort cases, and that adding punishment on top of compensation creates inefficient incentives to adopt unnecessary precautions against negligent or reckless harm.

Only in instances in which the tort would escape detection is it economically efficient for courts to impose punitive damages. This is an application of deterrence theory, which reflects the probability of a covert injury that is never remedied. Deterrence theory aims at eliminating tortious behavior by eliminating incentives to commit a tort; to achieve appropriate deterrence, injurers should be made to pay only for the amount of harm their conduct generates. As we will see, actual damages result in optimal deterrence except for cases in which the injurer has escaped detection for similar torts, and in these instances, a punitive award would be appropriate.

The Supreme Court does not, however, possess general authority to impose economically efficient standards for the award of punitive damages. As it stated in cases like *BMW v. Gore*,[1] its authority under the Due Process Clause is different and more limited: it sits to review punishments that are "arbitrary" in procedure or amount, and to reject "outlier awards" which cannot reasonably be anticipated by persons accused of torts. Within this limited framework, the Court has intervened in state court cases and reversed punitive damage judgments that have shocked the judicial conscience to the degree that they are deemed to be in violation of the U.S. Constitution. The Court has so far articulated a few constitutional standards on an incremental and tentative basis. Those standards focus chiefly on the concept of reprehensibility and the ratio between actual and punitive damages.

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While economic evaluations of the issues have been very pertinent to punitive damages reform at the state level by common law evolution or statutory amendment, they have had little noticeable impact on the Supreme Court's articulation of constitutional standards and safeguards. It is not obvious how economic analysis fits within the limited legal principles the Supreme Court applies under the Due Process Clause. In addition, the proposals of economists seem very difficult to implement in a practical way, because lay juries must apply the law to complex and disputed facts. Deterrence theory asks jurors to estimate probabilities that cannot be pinpointed and are largely a matter of speculation. Also, there are differences within the published economic literature addressing punitive damage reforms. We will see that in significant ways expert economists disagree among themselves. Given this background, it is perhaps not surprising that the Supreme Court pays little attention to economic teaching in formulating constitutional limitations.

I. MAJOR SUPREME COURT CASES AND THEIR OUTCOMES: THE EVOLUTION OF PUNITIVE DAMAGE RESTRICTIONS

In a 1996 landmark decision, *BMW v. Gore*, the Supreme Court struck down a punitive damage award that it found unacceptable under the Fourteenth Amendment of the Federal Constitution. In his majority opinion, Justice Stevens declined to draw a bright-line limitation or set a cap on punitive damages. He did, however, prescribe three guideposts that he believed should guide the lower courts in their deliberations—"the degree of reprehensibility [of the action], the disparity between the harm or potential harm suffered by the plaintiff and the punitive damages award, and the difference between the punitive remedy and the civil penalties authorized."[2] The Court found that BMW's action[3] was not particularly reprehensible (no reckless disregard for health and safety or evidence of bad faith). The ratio of punitive to actual damages was 500/1, which was suspiciously steep. And the civil penalty sanctioned by the legislature for similar conduct could not exceed $2,000. Thus, the Court concluded that the punishment meted out was "grossly excessive" and violated substantive due process.[4] The Court added, with an element of deliberate vagueness, that these guideposts could be overridden as necessary to deter intentional torts in the future.[5] The dissent, written by Justice Scalia, argued that the identification of a "substantive due process right" against a grossly excessive award is not specified in the U.S. Constitution, and is thus "an unjustified incursion into the province of state governments."[6] Justice Scalia also found fault with the vagueness of the guideposts, calling them a "road to nowhere."[7]

In this case, the Court struggled with the idea of global punishment. Justice Stevens clearly explained that a State may not "impose economic sanctions on violators of its laws with the intent of changing the tortfeasors' lawful conduct in other states,"[8] but later acknowledged that repeated misconduct is more reprehensible, and thus must be taken into consideration.[9] Of special relevance to economic analysis, we see in *BMW v. Gore* an early attempt to delimit the kind of punishment that is necessary to deter conduct that may recur and affect more than one litigant.[10]

In *State Farm Mutual Automobile Insurance Company v. Campbell*,[11] the Court deemed a punitive damages award of $145 million on top of $1 million in actual damages to be unconstitutional, applying the guideposts articulated in *Gore*.[12] The Court once again stated that the purpose of punitive damages is "deterrence and retribution," while actual damages serve to redress a plaintiff's loss.[13] It also refused to articulate a "bright line" ratio that a punitive damage award cannot exceed. Significantly, however, the Court observed that "few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process."[14] Justice Kennedy, writing for the majority, explained that a ratio of 4-1 might be "close to the line of constitutional impropriety," but later noted that greater ratios can comport with due process in cases in which a particularly egregious act results in a small amount of actual damages.

Finally, the Court in *State Farm* suggested that there is a danger of abuse in punitive awards because they may be meted out in an extravagant manner to strike at a defendant simply because of its size or wealth, without regard to the legal rationale for a punitive award. The majority opinion explained: "The wealth of a defendant cannot justify an otherwise unconstitutional punitive damages award."[15] This issue has received some attention from law and economics commentators, most of whom conclude that corporate wealth should not influence the size of the punitive damage award.[16]

In both *Gore* and *State Farm*, the Court emphasized that punitive sanctions should not be imposed on behavior deemed lawful in other states, and that evidence of alleged misdeeds in other states should not be used to influence the jury's decision. In *Philip Morris v. Williams*,[17] the Court went a step further and held that due process precludes punitive damages awarded for harm to non-parties (parties not involved in the litigation). The Court explained that juries should not be allowed to speculate about harm to non-parties because the defendant could not mount a defense to claims of that sort based on facts and circumstances not truly before the court, and this would violate the defendant's due process rights. The Supreme Court also emphasized that "permitting such punishment would add a near standardless dimension to the punitive damages equation and magnify the fundamental due process concerns of this Court's pertinent cases—arbitrariness, uncertainty, and lack of notice."[18]

In this opinion, the majority addressed an important unresolved question when it ruled evidence of harm to nonparties out of bounds. It distinguished sharply between considering harm to nonparties in general terms as it may bear on reprehensibility, which it would allow, and considering harm to nonparties as direct evidence of the amount of damages to impose, which it would not allow. A jury instruction is now required on this elusive issue, in compliance with *Williams*. The Court declared that the state courts may no longer authorize a procedure "that creates an unreasonable and unnecessary risk of any such confusion occurring," such as this one, calling the risk of misunderstanding "a significant one."[19]

In the latest case to be decided involving punitive damages restrictions, *Exxon Shipping Company v. Barker*,[20] the Court hinted that in the future it will consider adopting a 1:1 test (limiting the punitive award to the amount of actual damages) as a constitutional matter, assuming actual damages are substantial.[21] Prior decisions, in which the Court explained that certain restrictions should apply in certain cases, have not had the limiting effect that the Court hoped. The Supreme Court expressed concern that the lower courts have treated the high Court's flexible, multi-factor standard as no standard at all. The Court in *Exxon* explained that "the real problem is the stark unpredictability of punitive awards."[22] In this opinion, Justice Souter evaluated several ideas that might restore substantive and procedural fairness to the assignment of punitive damages. He rejected the idea of a specific dollar cap because there is no "standard" tort or contract injury. But Justice Souter, writing for the majority, believed that a strict ratio or maximum multiple is a promising alternative. Along these lines, he noted that the median ratio of punitive to compensatory awards found in a series of studies was less than 1:1,[23] meaning that the compensatory award exceeded the punitive award in most cases. Justice Souter explained that, "In a well functioning system, awards at or below the median would roughly express jurors' sense of reasonable penalties in cases like this one that have no earmarks of exceptional blameworthiness. Accordingly, the Court finds that a 1:1 ratio is a fair upper limit in such maritime cases."[24] Although this case dealt with federal maritime law,[25] there are many hints in the opinion that the Court is now considering extending this reasoning to all state court cases evaluated under the Due Process Clause.

In each of these extensive Supreme Court opinions, economic theory is conspicuous by its absence. The Justices occasionally mention the ideas proposed by economists, but in most cases ignore their theories altogether. I will give examples of this trend in later sections of this paper. In order to see what is missing, it is important to understand the economic theory of punitive damages as it stands today.

II. ECONOMIC THEORY OF PUNITIVE DAMAGES

Robert Cooter, professor of law and economics at Boalt Law School at the University of California Berkeley, once wrote, "Litigating a tort dispute involving punitive damages, much like navigating the Straits of Magellan, runs the risk of incurring grave losses from colliding with unseen objects."[26] Some economists have addressed the issue of punitive damages, trying to suggest a system that would achieve legal certainty in uncharted territory. The consequences of miscasting the governing legal rules are grave, say these scholars. By erring on the side of too great a punishment, the Court runs the risk of over-deterrence, which would have harmful effects for innovators and would raise product prices, thus harming

American consumers and industries. On the other hand, too little punishment would result in under-deterrence, which would invite repeat offenses by parties who found it cost-effective to continue unlawful behavior. (It has been widely asserted by economics scholars that punitive damages should only be awarded in cases that involve intentional torts, although in practice in state courts today punitive damages are awarded based on asserted "reckless" behavior, which often shades into "gross negligence").

Legal treatises and the previously cited Supreme Court opinions consistently state that the purpose of punitive damages is "punishment and deterrence." In *Williams*, the Court acknowledged this basic proposition only to abandon the deterrence aspect and focus on the idea of punishment alone throughout the remainder of the opinion. It seems as though the Court has neglected to take into account the proper role of optimal deterrence in punitive damages law. Economists, aware of this somewhat confusing legal definition, articulate the purpose of punitive damages in different but related ways, and all focus on deterrence with little mention of punishment. Economists are able to justify punitive damages from a deterrence point of view because the incentives to conform to the law are insufficient without them.

The only time that the violation of a legal standard is profitable, according to Cooter, is when enforcement error reduces the injurer's expected liability. This is the central point in Cooter's "rule of the reciprocal," a formula that accounts for situations in which violators will avoid paying full compensatory damages because not all victims will bring suit in a court of law. He writes, "in general, the punitive multiple should equal the reciprocal of the *enforcement error* for the sake of deterrence,"[27] The major forms of enforcement error include a victim's failure to assert claims that they are legally entitled to recover and "under compensation" of successful plaintiffs. Deterrence theory does not aim to make the victim whole, but rather to punish the injurer for the amount of harm for which he or she is responsible and to encourage economically sensible precautions.

Economists Mitchell Polinsky and Steven Shavell have continued the discussion of the appropriate role of punitive damages.[28] Like Cooter, they believe that the goal of punitive damages is to achieve optimal deterrence so that parties take efficient precaution against harm. Polinsky and Shavell explain: "to achieve appropriate deterrence, injurers should be made to pay for the harm their conduct generates, not less, not more."[29] Thus, the only time punitive damages can be justified at all, according to Polinsky and Shavell, is when injurers can escape liability for harms for which they are responsible. "If they do," write Polinsky and Shavell, "the level of liability imposed on them when they are found liable needs to exceed compensatory damages so that, on average, they will pay for the harm that they cause."[30] Thus, the authors offer an economic justification for the efficient allocation of punitive damages.

Polinsky and Shavell expand on Cooter's initial point that not every illegal action will be detected and reported. Polinsky and Shavell set forth an equation that can be used to calculate the appropriate amount of total damages: if an injurer has been found liable, total damages should equal the harm caused multiplied by the reciprocal of the probability of being found liable. They explain, "we believe that courts and juries often will be able to obtain enough information about the likelihood of escaping liability to apply the theory reasonably well."[31] Despite this assertion, evidence to the contrary has been amassed by critics of the Polinsky and Shavell economic model, as I explain at the end of this essay.

The proposition that punitive damages should be based solely on deterrence of behavior that is not caught by the compensatory damages web is supported by eminent legal scholars such as Yale Law School Professor George Priest. But Priest broadens the set of possible rationales for punitive damage awards, explaining that punitive awards may be needed to remedy defects in compensatory damage awards, "such as juries awarding damages that are too low in some dimension or some set of injuries going undetected or perhaps being too insignificant individually to justify litigation."[32]

III. WHY IS ECONOMIC ANALYSIS MISSING FROM THE SUPREME COURT'S OPINIONS?

It can be seen from the above that many economists concur in the idea of optimal deterrence. They propose detailed theories and even mathematical formulas that they hope will aid the courts in formulating a systematic and exact method for calculating the appropriate amount of punitive damages. It surely must be disconcerting to these scholars that the Supreme Court has ignored the economic analysis proposed, and contradicted large portions of economic thinking.

In *Browning Ferris v. Kelco*,[33] the defendant attempted to argue that excessive damages awards were invalid under the Excessive Fines Clause of the Eighth Amendment. This was the first time that punitive awards received constitutional scrutiny, and in the end the Court (per Justice Blackmun) rejected that argument. In her dissenting opinion, Justice O'Conner dismissed the economic theory that both sides had employed in their arguments, noting, "the Constitution does not incorporate the views of the Law and Economics School," nor does it "require the States to subscribe to any particular economic theory."[34] Neither the majority opinion nor Justice O'Conner in dissent accepted a link between constitutional law and economic theory.

In later opinions, the Justices mention prominent economists by name, but still refuse to put their precepts into practice. In his concurring opinion in *BMW v. Gore*, Justice Breyer mentions Professors Shavell and Cooter and summarizes his understanding of their standard for punitive damages. Justice Breyer correctly interprets the economic theories introduced by Shavell. He notes:

> Some economists… have argued for a standard that would deter illegal activity causing solely economic harm through the use of punitive damages awards that, as a whole, would take from a wrongdoer the total cost of the harm caused…. My understanding of the intuitive essence of some of these theories, which I put in crude form (leaving out various qualifications), is that they could permit juries to calculate punitive damages by making a rough estimate of global harm, dividing that estimate by a similarly rough estimate of the number of successful lawsuits that would likely be

> brought, and adding generous attorney's fees and other costs. Smaller damages would not sufficiently discourage firms from engaging in the harmful conduct, while larger damages would 'over-deter' by leading potential defendants to spend more to prevent the activity that causes the economic harm, say, through employee training, than the cost of the harm itself.[35]

He concludes by explaining that the record contained nothing that might suggest that the Alabama Supreme Court applied any economic theory that might explain the high punitive award. He then rejects "reference to a constraining 'economic' theory, which might have counseled a more deferential review" by the Court.

After Justice Breyer's summation of economic theory, Shavell and Cooter disappear from the remainder of the *BMW v. Gore* opinion. In *State Farm*, Justice Kennedy summarizes some of the arguments for the plaintiffs, including "the fact that State Farm will only be punished in one out of every 50,000 cases as a matter of statistical probability."[36] In dismissing this argument, Kennedy joins this economically legitimate argument with another; he writes, "Here, the argument that State Farm will be punished in only the rare case, coupled with the reference to its assets, had little to do with the actual harm sustained by the Campbells. The wealth of a defendant cannot justify an otherwise unconstitutional punitive damages award."[37] The Court deals with the corporate wealth argument, while pushing the detectability issue into the background, claiming that it lacks proximity to the victim. This misapprehends the economic substance of deterrence theory. The Court requires the jury to focus on total harm caused, and not the amount needed to effectively deter future misdeeds. The Court's analysis pulls the issue in a different direction than the economists would like to go.

Finally, in *Exxon*, Justice Souter mentions Shavell and Polinsky's detection theory without coming to grips with it. Justice Souter spends several pages debating the pros and cons of limiting punitive damages in a specific way (something the Court had explicitly declined to do just fifteen years previously). In doing so he writes, "Heavier punitive awards have been thought to be justifiable when wrongdoing is hard to detect (increasing chances of getting away with it),"[38] and then cites snippets from two other Supreme Court opinions. This is the last we hear of Shavell, as Justice Souter moves forward and leaves this trace of economic theory in the dust.

Despite the variety of articles written by economists on the subject of punitive damages in the last twenty years, economic theory has been largely brushed aside by the Supreme Court, notwithstanding the Court's obvious desire to fashion a more exacting rationale intended to limit punitive damages to promote certainty and predictability. It remains to be seen whether economic analysis can be fitted within the requirements of constitutional law, and whether it can operate in a practical manner to serve as the purposes the Supreme Court seeks to accomplish.

IV. MAJOR CONTRADICTIONS BETWEEN SUPREME COURT OPINIONS AND ECONOMIC THEORY

The *BMW v. Gore* guideposts ask the courts first and foremost to consider "reprehensibility" and "the ratio between punitive and actual damages," considerations not grounded in economic thinking. In fact, Shavell and Polinsky explicitly caution against using "reprehensibility" as a litmus test. They write, "That a defendant's conduct can be described as reprehensible is in itself irrelevant. Rather, the focus in determining punitive damages should be on the injurer's chance of escaping liability."[39] Cooter explains that punitive damages are appropriate to curb "gross faults" only because the perpetrator will most likely need a serious sanction in order to influence his incentives, not because the faults are especially egregious. But the Court has not made this distinction. The *Gore* opinion explains: "The most important indicium of the reasonableness of a punitive damages award is the degree of reprehensibility of the defendant's conduct."[40] It is true that using reprehensibility as a gauge does not equate to throwing economic analysis out the window. But by adopting a system that allows jury outrage to trump careful evaluation of deterrence, the Court is opening a Pandora's box of runaway jury decisions.

One problem with allowing "reprehensibility" to be a main criterion for evaluating punitive damages is that no universal moral code exists that would guide jury discretion. In evaluating the reprehensibility of a tortious action, the Supreme Court has provided a vague outline:

> [T]he Court must consider whether the harm was physical rather than economic, the tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others, the conduct involved repeated actions or was an isolated incident, and the harm resulted from intentional malice, trickery, or deceit, or mere accident.[41]

All of these factors serve as proxies for especially egregious behavior. But the unpredictability problem stems from more than the characterization of a reprehensible act. Perhaps a particular jury may feel that an action is really bad, and perhaps they will unanimously feel a strong sense of outrage toward the perpetrator, and believe that he should be punished. But it is impossible to translate this feeling into a dollar amount that is predictable and consistent. Cass Sunstein and other prominent legal scholars conducted hundreds of controlled experiments in order to study this phenomenon. Their conclusion: "people have a hard time in arriving at consistent, predictable judgments when using the scale of dollars—even when their moral judgments are both consistent and predictable."[42] In addition, they found that juries are extremely vulnerable to lawyer suggestion when dealing with punitive damage instructions; evidently, it is not too difficult to convince a jury that someone's behavior is especially egregious when the right rhetorical skills are employed.

It is obvious why a focus on reprehensibility is unsettling to economists. But the second guideline enunciated in the *Gore* opinion seeks to limit the ratio between punitive and compensatory damages and may have a closer link to economic concerns. As mentioned above, the latest *Exxon* opinion hints

that a decisive "bright-line" one-to-one ratio may be the next limit placed on punitive damages. Seen through the Shavell and Polinsky lens, this means that the tortfeasor has at least a 50% chance of detection. Although the ratio cap serves the basic purpose of creating a concrete limit on excessive punitive damage awards, it does not allow for flexibility to apply economic analysis. Instead, Justice Souter explains in *Exxon* that, "an acceptable standard can be found in the studies showing the median ratio of punitive to compensatory awards… in a well functioning system, awards at or below the median would roughly express juror's sense of reasonable penalties in cases like this one that have no earmarks of exceptional blameworthiness."[43] Justice Souter offers a statistical theory, but economic theory is absent. The only exception that is allowed bows to the vague reprehensibility standard once again.

In "An Economic Evaluation of Punitive Damages," David Friedman remarks,

> If the common law does not follow the rule we think is economically efficient, that may be evidence that our economic analysis is wrong. It also may be evidence that something has gone wrong with the common law, or that whatever forces push it toward economic efficiency apply in only some areas and not others.[44]

Perhaps a third explanation for this discrepancy is that there is no practical way to implement the principles of deterrence theory that the economists advocate. The Supreme Court is struggling with strong economic and constitutional pressures, which cut in different directions. As a result, the current state of punitive damages law is understandably a hodgepodge of ambiguous formulations which serve no clear purpose other than "cutting back on awards" that strike the judicial conscience as excessive in particular circumstances. Lower courts, as a result, have little practical guidance.

V. RECOMMENDATION FOR POLICY

How can economic theory be reconciled with constitutional law in the field of punitive damages? As several of the Justices have noted, the Due Process Clause does not enshrine any particular economic theory as the law of the land, whether it is the theory of Mr. Herbert Spencer or that of Professor Shavell. States are entitled to have their own policies on punitive damages, both wise and unwise. In our federal system, individual states serve as laboratories to experiment with different economic policies. They learn from each other. And state legislatures supervise the handiwork of common law courts, including tort reform statutes. Congress too has the power to place limits on punitive damages. It is arguably undemocratic for the Supreme Court to intervene in this process and lay down its own, national standards, particularly standards that have proven to be so vague and controversial.

But there is a powerful constitutional concern at work in the field of punitive damages. If awards are freakish and unpredictable, the defendant has no fair notice of the magnitude of potentially crushing punishments. And if astronomical awards are imposed in response to jury outrage over "reprehensibility," inflamed by the rhetoric of lawyers, the award in the end may serve no legitimate purpose—punishment that exceeds the outer limits of substantive due process.

As previously noted, the Supreme Court is groping toward greater limitations, inching its way toward a 1-to-1 ratio limit. It sees greatest hope in adopting a mechanical litmus test of this kind. Such a standard can be understood by defendants and applied readily by state courts and juries. It is preferred to an open-ended "reprehensibility" analysis, which invites unlimited inflation in an award based on overblown indignation or even prejudice against a large, out-of-state defendant brought before the bar of a local court. One trouble with the 1-to-1 standard, however, is that it may not allow optimal deterrence to be achieved. The award might underdeter by failing to punish misconduct occurring in secrecy that could reoccur absent a large punitive award. And in cases involving a large compensatory damage awards, it might not effectively limit an excessive punitive award.[45]

The key to future reform lies in separating deterrence theory from the idea of punishment and making it the focus of punitive awards. Vague limitations by the Court have not been successful in combating excessive awards of punitive damages. Thus, the Court is right in moving toward a "bright-line" limit. But there has been too much focus in the Court's opinions on the retributive aspect of punitive damages, and too little focus on changing incentives by forcing injurers to internalize costs. Juries should be instructed in a way that removes their focus from the total harm generated by the injurer and sustained by the victims and instead focuses on ways to deter tortious behavior.

Is a 1:1 ratio cap appropriate? The predictability secured by a concrete limit has its pitfalls. Although a ratio cap would be a helpful guide in most situations, there are a few in which such an inflexible limit could have adverse results. As previously mentioned, if actual damages are quite small, a higher multiplier may be necessary to result in effective deterrence. There would be little incentive for a party to bring a suit in which actual damages are minimal, even if the behavior was especially egregious and warranted some kind of punishment. In these cases, the judicial system would not be able to deter wrongdoing as effectively, and worse, would deprive private parties of incentive to pursue wrongdoers, which is a basic function of tort law.

Justice Scalia mentions in his *Gore* dissent that the Fourteenth Amendment's Due Process Clause should not be seen as a guarantee against "unfairness." He explains, "What the Fourteenth Amendment's procedural guarantee assures is an opportunity to contest the reasonableness of a damages judgment in state court; but there is no federal guarantee a damages award actually *be* reasonable."[46] This textualist argument does not allow for the evolution of due process law, and certainly does not suggest any implied constitutional limit on punitive damage awards. But this legal view does sometimes mesh with economic theory in certain cases: for example, if an injurer had only been made to pay for harm generated in one of a hundred cases, Justice Scalia would not oppose a punitive award one hundred times greater than the actual.[47] But Justice Scalia would also tolerate economically inefficient awards more substantial than necessary to achieve deterrence.

It is true that for most cases, a 1-to-1 cap would have the beneficial effect of limiting runaway punitive awards and preventing gross over-deterrence that economists caution against. But a rule that makes economic sense would allow for

exceptions to the 1:1 rule in specific situations.[48] A case that would allow for a larger punitive award would not be judged based on reprehensibility. Instead, the jury would be given simple but specific instructions: is the tortious act easily detectable,[49] or is it likely to have occurred over time without disclosure?[50] Is the compensatory award quite small? A brief summary of basic deterrence theory may be appropriate, highlighting the risks of under- and over-deterrence for the jury's consideration. However, these exceptions would be rare: serious injuries are usually detectable by victims, and individual victims of egregious torts can be counted on to bring their own suits.

Why have a rule at all, only to allow exceptions? The advantages of a concrete limit are significant and result in a punitive damages framework that is predictable, which is necessitated by the Constitution. Also, civil liability critics have a point when they argue that massive awards defeat consideration of the merits. If massive awards are threatened, no one can run the risk of defending themselves on the merits. Settlement outside of court becomes the only feasible option, which deprives the defendant of opportunity to defend him or herself.

A mathematical formula like that advocated by the economic theorists has many advantages. However, it remains to be seen whether the economic calculus suggested is implementable in the real world. Although deterrence theory seems simple enough, Cass Sunstein's studies found that most jurors are not attentive to the judge's instructions: individuals averaged 5% correct on a test of memory for comprehension of the instructions (although the studies found that the more discussion a jury devoted to the judge's instructions, the less likely they were to award punitive damages).[51] The outrage and punishment factor is much more appealing to the average juror than predictions about concealment and discovery, especially when enhanced by the rhetoric of an accomplished lawyer. And the formula advocated by Shavell and Polinsky asks the jury to estimate probabilities of detection that can never be known as certain. In addition, the idea of total harm, which makes theoretical sense, is almost impossible to calculate (especially when the jury is barred from using evidence not brought by parties before the court, as was decided in *Philip Morris*). It is also impossible to place accurate monetary values on subjective losses, such as human life, which is almost always undervalued.[52] The only way to determine appropriate punitive damages in these situations is to make a speculative guess about "subjective probability." Due to these difficulties, I find that there is currently not a principled basis for implementing the precepts of deterrence theory. We are left where we started: the judicial system needs clear rules and predictability, but the facts hypothesized by economists are difficult to measure, especially when a jury is making the calculations.[53] Until economists resolve this practical issue, abstract theories involving deterrence will be ignored by the courts in favor of more concrete solutions.

At the present, the courts' best solution is to graft the principles of deterrence theory upon the current trend in Supreme Court jurisprudence. Thus, awards of punitive damages that exceed a 1:1 ratio should be allowed to stand only in cases of a high probability of a lack of detection, or in cases in which actual damages are next to nothing. The jury should not be allowed to speculate on such matters, and it should be the plaintiff's burden of proof on the need for an extra enhancement in the ratio to reflect concealment. But because of these exceptions, the ratio cap would not stand as an absolute rule, but rather as a guidepost in order to limit unpredictable outlier jury awards.

Of course, as the Supreme Court's opinions demonstrate, it is ultimately the job of the judiciary, including the trial judge and all reviewing appellate courts, to make sure that a jury award of punitive damages is justified. The 1:1 ratio for cases involving substantial amounts of actual damages, enlarged only in instances that involve a clear risk of concealment, should be easy for reviewing courts to apply and thereby achieve the Supreme Court's due process goal of promoting certainty and predictability in the punitive damages field. The "outlier" cases (cases involving especially high ratios of punitive to compensatory damages) that have caused the Supreme Court such concern in the past two decades can be dealt with efficiently in this manner.

By capping the permissible ratio, the Court would promote certainty in the law and avoid excessive litigation due to the misunderstanding of the constitutional requirements. For example, there would be fewer cases like *Phillip Morris v. Williams*,[54] that have gone to the Supreme Court several times because lower courts misperceived the Supreme Court's message on the permissibility of punitive damages. The additional predictability and legal efficiency resulting from this ratio cap would benefit society generally, even when discounted by occasional instances of under-deterrence due to reduced legal flexibility. Application of due process law may not achieve optimal deterrence in every case, but parties can predict a consistent level of punishment when their conduct warrants deterrence. Consistency and predictability are benefits not only to the efficient administration of justice in the courts and fairness to those subjected to punishment, but also to settlement negotiations and the formulation of insurance rates. Large economic penalties, imposed unpredictably, prevent parties from arriving at reasonable settlements in civil cases and make liability insurance more costly and sometimes wholly unobtainable.[55]

Endnotes

1 517 U.S. 559 (1996).

2 *Id.* at 575.

3 The case against BMW involved BMW's failure to disclose that the automobile sold to Gore had been repainted after being damaged prior to delivery.

4 *Gore*, 517 U.S. at 586.

5 For example, after outlining the ratio guidepost, Justice Stevens explained,

> Low awards of compensatory damages may properly support a higher ratio than high compensatory awards, if, for example, a particularly egregious act has resulted in only a small amount of economic damages. A higher ratio may also be justified in cases in which the injury is hard to detect or the monetary value of noneconomic harm might have been difficult to determine. It is appropriate, therefore, to reiterate our rejection of a categorical approach.

Id. at 582.

6 *Id.* at 599 (Scalia, J., dissenting).

7 *Id.* at 605.

8 *Id.* at 573 (majority opinion).

9 This difficulty was directly addressed less than ten years later in *Phillip Morris v. Williams,* 549 U.S. 346 (2007), as we will see.

10 But the Court pointed out that a state court class action could not attempt to punish conduct that may be lawful "in other jurisdictions." *Gore*, 517 U.S. at 573.

11 538 U.S. 408 (2003).

12 Once again, Justice Scalia filed a dissenting opinion emphasizing his view that "the Due Process Clause provides no substantive protections against 'excessive' or 'unreasonable' awards of punitive damages," and that "the punitive damages jurisprudence which has sprung forth from *BMW v. Gore* is insusceptible of principled application." *Id.* at 429 (Scalia, J., dissenting). Justice Thomas and Justice Ginsberg wrote concurring opinions.

13 *Id.* at 409 (majority opinion).

14 *Id.* at 425.

15 *Id.* at 427.

16 *See* E. Donald Elliot, "Why Punitive Damages Don't Deter Corporate Conduct Misconduct Effectively" 40 Alabama L. Rev. 1053 (1989); Andrew Frey, "Corporate Wealth: The 800-Pound Gorilla that Sabotages Fair Adjunction of Punitive Damages" *Litigation* (2004); Peter Huber, *Liability: The Legal Revolution and Its Consequences* (1988).

17 549 U.S. 346 (2007).

18 *Id.* at 349.

19 *Id.* at 355.

20 128 S.Ct. 2605 (2008).

21 The Court left open the possibility of a large punitive award when actual damages are very small.

22 *Exxon*, 128 S.Ct. at 2610.

23 *See* Eisenberg & Heise "Juries, Judges, and Punitive Damages: An Empirical Study," 269 (reporting median ratios of 0.62:1 in jury trials and 0.66:1 in bench trials using Bureau of Justice Statistics data from 1992, 1996, and 2001); Vidmar & Rose, "Punitive Damages by Juries in Florida," 38 Harv. J. Legis. 487, 492 (2001) (studying civil cases in Florida state courts between 1989 and 1998 and finding a median of 0.67:1).

24 *Exxon*, 128 S.Ct. at 2611.

25 It is true that maritime law could evolve in a different direction from federal due process law. But the significant aspect of this maritime decision is that it cites and relies on due process case law repeatedly. In a footnote, Justice Souter pointedly comments, "Indeed, any argument for more generous punitive damages would call into question the maritime applicability of the constitutional limit on punitive damages as now understood." *Id.* at 2633. This footnote suggests that the Court intends to rely on these same principles in the due process context.

26 Robert Cooter, "Economic Analysis of Punitive Damages," 56 S. Cal. L. Rev. 79 (1982-83).

27 Robert Cooter, "Punitive Damages for Deterrence: When and How Much?," 40 Alabama L. Rev. 1148 (1989).

28 Mitchell Polinsky & Steven Shavell, "Punitive Damages: An Economic Analysis," 111 Harv. L. Rev. 868 (1997-1998).

29 *Id.* at 873.

30 *Id.* at 875.

31 *Id.*

32 George Priest, "Punitive Damage Reform: The Case of Alabama," 56 La. L. Rev. 825, 831 (1995-1996).

33 492 U.S. 257 (1989).

34 *Id.* at 300-301 (O'Connor, J., dissenting).

35 BMW v. Gore, 517 U.S. 559, 593 (1996) (Breyer, J., concurring).

36 State Farm Mutual Automobile Insurance Company v. Campbell, 538 U.S. 408, 426 (2003).

37 *Id.* at 427.

38 Exxon Shipping Company v. Barker, 128 S.Ct. 2605, 2622 (2008).

39 Polinsky & Shavell, *supra* note 29, at 906.

40 *Gore*, 517 U.S. at 559.

41 *Id.* at 568.

42 Cass R. Sunstein et al., *Punitive Damages: How Juries Decide*, 29 (2002).

43 *Exxon*, 128 S.Ct. at 2611.

44 David Friedman, "An Economic Evaluation of Punitive Damages," 40 Alabama L. Rev. 1125, [page number?] (1990).

45 *Exxon* is a good example of this. In most cases, like *Exxon*, economists would call for no punitive damages at all (there was virtually no chance that Exxon could escape liability), finding that accurately calculated compensatory damages served deterrence purposes appropriately. The cap on punitive damages had the useful function of reducing the award, but in this case where the actual award was substantial, there remained a lot of latitude for unnecessary punishment: the final punitive award was two billion dollars. This, by our economic analysis, could result in unnecessary deterrence (perhaps forcing the company to hire several seamen to steer the ship at the same time, a proverbial unwise strategy). Thus, the risk of over-deterrence still remains even with a multiplier cap on punitive damage awards.

46 *Gore*, 517 U.S. at 598 (Scalia, J., dissenting).

47 This is not to say Justice Scalia explicitly advocates economic theory in his dissent, nor does he support large and unconstrained punitive awards. Later, he paradoxically faults the Court for constructing a framework "that does not genuinely constrain." *Id.* at 606.

48 These exceptions to the general 1:1 ratio rule, of course, are easy to defend on constitutional grounds. They leave more room for the states to impose enhanced punishment, if state policy so provides. Arguably, goals of optimal deterrence and state sovereignty are served by recognizing these narrow exceptions to the bright line limitation.

49 To obtain an enhancement in the damages award based on concealment, the plaintiff need not adduce evidence of other persons who were deceived or secretly injured by the tortious conduct. The Supreme Court's decision in *Phillip Morris v. Williams* makes clear that juries are not entitled to speculate about the merits of cases not before the court. Some civil wrongs, however, are covert by their nature. For example, in *BMW v. Gore*, the hidden refinishing activities could have escaped detection entirely, as shown by the facts of the particular case before the Court. This would warrant an enhanced award based on concealment. Some antitrust violations, such as price fixing conspiracies, are covert and may escape detection,

50 Judge Posner and William Landes have suggested that punitive damages may be expanded in cases that involve actual damages that are hard to calculate. William M. Landes & Richard A. Posner, *The Economic Structure of Tort Law* 161 (1987). That is a rationale sometimes applied in antitrust cases, where treble damages are allowed. But in that context Congress has made the necessary judgment. Judge Posner's proposal does not appear to be a rule that juries could administer systematically. The vagueness of such a standard would also create serious problems for appellate judges, moving the law in the exact opposite direction from that intended by the Supreme Court. Actual damages can be proven based on reasonable estimates, and do not require scientific precision. This gives claimants sufficient latitude to make their "best case" to the jury, aided with expert testimony as appropriate. I would not confuse this field of law further with the exception suggested by Judge Posner.

51 Sunstein et al., *supra* note 42, at 23.

52 William Landes and Judge Posner discuss the undervaluation of human life in wrongful death cases:

> The limitation of damages to survivors' pecuniary loss is very peculiar. It implicitly assumes—if, as we generally believe to be the case, tort law seeks to internalize the costs of accidents—that the average person derives no utility from living. He does not work for himself, he works

> solely for his family. This cannot be right, and it results in a systematic underestimation of damages in wrongful death cases.

Landes & Posner, *supra* note 50, at 161.

53 Although perhaps unfortunate, it appears that a clear ratio cap rule, with a few narrow exceptions, is the only way to prevent runaway awards that violate Due Process. David Friedman addresses the clumsiness of the punitive damages system, noting that "one of the most important factors determining the form of efficient law" is the

> fact that courts are a very poor way of finding the correct answer to a difficult question. If you wish to diagnose an illness, design a computer, or discover a new scientific law, you do not do it by picking a dozen people at random, forming them into a committee, and demanding that they give you an answer. Given the limitations of courts, it is sensible to try to avoid, so far as possible, asking them to do difficult things.

Friedman, *supra* note 44, at 1138.

In his *Gore* dissent, Justice Scalia evaluates the consequences of elevating "fairness in punishment" as an aspect of substantive due process, writing "by today's logic, every dispute as to evidentiary sufficiency in a state civil suit poses a question of constitutional moment, subject to review in this Court." BMW v. Gore, 517 U.S. 559, 606 (1996). It would follow that asking the courts to make calculations outside of their ability would violate due process; the jury almost certainly lacks the means of determining exact probabilities, running the risk of imposing an unfair penalty. The 1-to-1 rule, however imperfect, offers an easily implementable and consistent solution to the problem of excessive "outlier" awards.

54 549 U.S. 346 (2007).

55 *See* Priest, *supra* note 32; George Priest, "The Current Insurance Crisis and Modern Tort Law," 96 Yale L.J. 1521 (1986-1987).