

### § 12.03 Punitive Damages

Punitive damages are based not on any concept of compensation to the injured victim, but rather on notions of punishment for and deterrence of intentional, malicious, wanton or reckless infliction of damages. Punitive damages may be awarded for the purpose of punishing or making an example of the defendant based largely on the nature of the defendant's conduct and the defendant's wealth.

Five jurisdictions—Louisiana, Massachusetts, Nebraska, New Hampshire and Washington—prohibit punitive damages, in whole or in part. Four other jurisdictions—Connecticut, Georgia, Michigan and Texas—use the term “punitive damages,” but their law as applied treats such damages, at least in part, as compensatory in nature. The remaining jurisdictions provide for punitive damages either by statute and/or decisional law.<sup>1</sup>

#### [1]—Constitutionality

##### [a]—Due Process.

The concept of punitive damages is controversial and has been subject to several federal constitutional challenges based largely on procedural and substantive due process. The Supreme Court has made it clear that punitive damage awards are subject to due process requirements, and accordingly, it is advisable for any product liability defendant to include constitutional defenses. In 1996, in an unprecedented decision, the United States Supreme Court upheld a constitutional challenge to a jury's award of punitive damages.<sup>2</sup>

For the first time, the Supreme Court voided a state court's award of punitive damages as excessive in breach of the Due Process Clause. In a five to four decision, the Court held that a \$2 million Alabama punitive damages award against the automobile manufacturer BMW was “grossly excessive.” BMW's misconduct had been failing to disclose that it repainted a new \$40,000 car, which was found to have reduced its value by \$4,000.

The Court has made clear that there is no precise threshold that needs to be crossed to determine whether a punitive damage award is constitutionally acceptable.<sup>3</sup> When an award can be deemed as “grossly excessive” in relation to the legitimate state interests in

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<sup>1</sup> See Ghiardi and Kircher, *Punitive Damages Law and Practice*, § 4 (1986) for a summary of states' positions on punitive damages.

<sup>2</sup> *BMW of North America, Inc. v. Gore*, 517 U.S. 559, 116 S.Ct. 1589, 134 L.Ed.2d. 809 (1996).

<sup>3</sup> *Id.*, 517 U.S. at 582. See also *TXO Production Corp v. Alliance Resources Corp.*, 509 US 443, 458, 125 L. Ed. 2d 366, 113 S.Ct. 2711 (1993).

punishment and deterrence, however, it is a violation of the Due Process Clause of the Fourteenth Amendment.<sup>4</sup>The Court created “three guideposts” to ascertain if an award is unconstitutionally excessive: the degree of reprehensibility, the ratio of the punitive damages to the actual harm inflicted on the plaintiff, and the criminal and civil penalties that could be imposed for comparable misconduct.<sup>5</sup>

Prior to the Supreme Court’s *BMW* decision, the Eighth Circuit had held that a punitive damages award in a labor case was excessive and, therefore, violated constitutional due process rights.<sup>6</sup> That court found that the 250,000-to-1 ratio of punitive to actual damages was excessive. However, in the *BMW* case the Supreme Court specifically rejected a simple mathematical formula or ratio cut-off, even though the ratio of punitive to actual damages is one factor to be considered.<sup>7</sup>In 2001, the Supreme Court held that courts of appeals should apply a *de novo* standard of review when passing on district courts’ determinations of the constitutionality of punitive damages awards.<sup>8</sup> The Supreme Court has also held that a state statute that substantially prohibited judicial review of a punitive damages award violated the due process clause of the Fourteenth Amendment because it undermined judicial review as a safeguard against arbitrary awards.<sup>9</sup>

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<sup>4</sup> *BMW of North America, Inc., v. Gore*, N. 2 *supra*, 517 U.S. at 568.

<sup>5</sup> *Id.*, 517 U.S. at 574-584.

<sup>6</sup> *Pulla v. Amoco Oil, Co.*, 72 F.3d 648 (8th Cir. 1995).

<sup>7</sup> *BMW of North America, Inc. v. Gore*, N. 2 *supra*, 517 U.S. at 582-583. See also: *Fifth Circuit: Deffenbaugh-Williams v. Wal-Mart Stores, Inc.*, 156 F.3d 581, 598 (5th Cir. 1998), *remanded on other grounds* 182 F.3d 333 (1999) (finding a 5.26:1 ratio of punitive damages to compensatory damages excessive in a race discrimination case, based in part on the fact that the \$100,000 punitive damages award was on the high-end for cases dealing with § 1981 (of the Civil Rights Act of 1866, 42 U.S.C. § 1981) claims in the Fifth Circuit, and ordering remittitur to \$75,000).

*Ninth Circuit: Neibel v. Trans World Assurance Co.*, 108 F.3d 1123, 1132 (9th Cir. 1997) (finding a 6:1 ratio of punitive damages to compensatory damages permissible under *BMW, supra*, where defendant’s reprehensible tortious behavior “led to the financial ruin of many of the plaintiffs”).

*Tenth Circuit: Hamilton v. NCNB Texas National Bank*, 122 F.3d 854, 861-862 (10th Cir. 1997) (finding a 27:1 ratio of punitive damages to compensatory damages constitutionally excessive in an economic injury case and ordering remittitur of punitive damages to an amount representing six times the actual damages suffered by plaintiffs).

<sup>8</sup> *Cooper Industries, Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424, 121 S.Ct. 1678, 149 L.Ed.2d 674 (2001).

<sup>9</sup> *Honda Motor Co. v. Oberg*, 512 U.S. 415, 114 S.Ct. 2331, 129 L.Ed.2d 336 (1994).

Later in 2001, the Ninth Circuit found a \$5 billion punitive damages award against Exxon Corporation to be excessive.<sup>10</sup> The case involved an action for compensatory and punitive damages to a Commercial Fishing Class, a Native Class, and a Landowner Class affected by the 1989 Exxon Valdez oil spill. The Ninth Circuit vacated the punitive damages award and remanded the issue to the district court after providing analysis of the award's constitutionality in light of the "three guideposts" of *BMW of North America, Inc. v. Gore* and in light of *Cooper Industries, Inc. v. Leatherman Tool Group, Inc.*

In 2003, the Supreme Court placed further constraints on punitive damages by way of limiting the admissibility of evidence. Because a state does not have a valid interest in punishing a defendant for acts occurring outside the state (whether or not lawful where they occurred), and because a defendant's acts may not serve as the basis for punitive damages unless those acts are similar to those that harmed the defendant, the Court held that it was error for the forum courts to consider conduct occurring outside the forum state not having a nexus with the specific harm suffered by the plaintiff. The Court also held that evidence of the wrongdoer's financial means was not relevant to the assessment of reprehensibility for the purpose of determining punitive damages, and that only rarely should the ratio of punitive damages to compensatory damages exceed single digits.<sup>11</sup>

The trend toward limiting punitive damage awards continued, as a Florida Court of Appeal reversed what had been a startling decision regarding punitive damages in tobacco litigation.<sup>12</sup> In the first smokers' case to be certified as a class action anywhere in the country, the trial court had entered final judgment awarding \$12.7 million in compensatory damages to three individual plaintiffs, and \$145 billion in punitive damages to a class of Florida smokers. The Court of Appeal reversed the class certification, holding that smokers' claims were uniquely individualized, and therefore, could not satisfy the "predominance" and "superiority" requirements for a class action. Among other things, the court held that choice of law problems presented an insurmountable obstacle to the smokers' class action even though the class was limited to residents of Florida, inasmuch as more than 65%

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<sup>10</sup> In re the Exxon Valdez, Nos. 97-35191, 97-35192, 97-35193, 97-35235, 2001 U.S. App. LEXIS 24029 (9th Cir. Nov. 7, 2001).

<sup>11</sup> *State Farm Mutual Automobile Insurance Co. v. Campbell*, \_\_\_ U.S. \_\_\_, 123 S.Ct. 1513, 155 L.Ed.2d 585 (2003).

<sup>12</sup> *Liggett Group Inc. v. Engle*, No. 3D00-3400, 2003 Fla. App. LEXIS 7500 (Fla. App., May 21, 2003).

of current and former smokers in Florida had moved to that state after they became regular smokers.

Concerning punitive damages, the Court of Appeal reversed as well, holding that the trial court had erred in awarding payment of class-wide punitive damages without the necessary findings of liability and compensatory damages for each of the class members. Where actual damage is an element of the underlying cause of action, an award of compensatory damages is a prerequisite to an award of punitive damages, and the only determinations of liability that had been made were to the three individual plaintiffs in the case. Thus, in all cases, compensatory damages must be tried before punitive damages, and “defendants [are]entitled to a jury determination, on an individualized basis, as to whether and to what extent each particular class member is entitled to receive punitive damages. One class member’s circumstances cannot serve as a proxy for another’s.” The trial court’s award violated the law because it allowed the trial of three individuals’ claims to establish entitlement to punitive damages with respect to an entire class.

Moreover, the Court of Appeal held that the punitive damages were excessive. The defendants’ combined net worth was no more than \$8.3 billion. No case had ever awarded punitive damages based upon multiples of net worth. A defendant’s financial capacity is a crucial factor in determining punitive damages, and the amount awarded cannot be so great as to result in bankruptcy. The court also noted that prejudicial error had been committed by, among other things, the plaintiffs’ counsel’s continued arguments that defendants could pay the award over time. The court held that to be improper, stating that “a defendant’s ability to pay a punitive award is to be measured as of the time of trial.”

### **[b]—Commerce Clause**

The Supreme Court also held that punitive damages awards are subject to Commerce Clause as well as due process constraints.<sup>13</sup> Penalties in the form of judicially imposed punitive damages may not be awarded with the intent of changing the tortfeasor’s lawful conduct in other states.<sup>14</sup> Economic penalties may be supported

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<sup>13</sup> *BMW of North America, Inc., v. Gore*, 517 U.S. 559, 116 S.Ct. 1589, 1597, 134 L.Ed.2d 809, (1996).

<sup>14</sup> *Id.*, 517 U.S. 559, 116 S.Ct. at 1597, 134 L.Ed.2d 809.

only by a state's interest in protecting its own consumers and its own economy.<sup>15</sup>

### [c]—Products Liability Implications

The Supreme Court's decision invalidating an award of punitive damages was based on a fraud claim, and therefore did not directly address product liability issues. Nevertheless, the decision should have a profound impact on the product liability field. There is no reason why the Court's "three guideposts" should not be applied to test the constitutionality of punitive damage awards in product liability cases. Indeed, that process has begun.<sup>16</sup>

### [2]—Other Limitations

There are many other limitations on punitive damages in the various states arising under both common law and statute. The variations are too numerous to describe in detail, but a few examples will suffice. Typically, punitive damages are not recoverable in actions for wrongful death.<sup>17</sup> Under Pennsylvania law, absent fraud, punitivedamages

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<sup>15</sup> *Id.* But *cf.* *Smith v. Ingersoll-Rand Co.*, 214 F.3d 1235, 1253 (10th Cir. 2000) ("BMW does not, however, create an absolute bar to jury consideration of similar incidents simply because they occurred outside the jurisdiction in which the jury sits. The BMW court points out that out-of-state acts are clearly admissible 'to show the degree of reprehensibility of a defendant's conduct [quoting *BMW of North America Inc. v. Gore*, N. 8 *supra*, 517 U.S. at 574 n.21].'").

<sup>16</sup> *Second Circuit*: *Silivanch v. Celebrity Cruises, Inc.*, 95 Civ. 0374, 2001 U.S. Dist. LEXIS 15578, \*38-40 (S.D.N.Y. Sept. 28, 2001) (applying the Supreme Court's guideposts in a product liability case involving spa filters).

*Ninth Circuit*: *McEuin v. Crown Equipment Corp.*, No. 97-365-HA, 2001 U.S. Dist. LEXIS 8285, \*3-4 (D. Or. June 4, 2001) (applying the Supreme Court's guideposts in a product liability case involving forklifts).

*Tenth Circuit*: *Smith v. Ingersoll-Rand Co.*, 214 F.3d 1235, 1253 (10th Cir. 2000) (applying the Supreme Court's guideposts in a product liability case involving milling machines).

<sup>17</sup> *Restatement (Second) of Torts*, § 908 comment a.

cannot be awarded for breach of warranty.<sup>18</sup> In some jurisdictions, punitive damages cannot be awarded on a derivative claim, such as loss of consortium. In one asbestos case, the distributor-installer was not liable for punitive damages because the users were its own employees and the tort claims were barred by the Workers' Compensation Act.<sup>19</sup> Some courts have held that punitive damages must bear a reasonable relationship to the plaintiff's actual damages. In a few instances, maximum amounts have been set on punitive damage awards.<sup>20</sup>

Under the rubric of "tort reform," a number of states have begun to revamp their system of punitive damages. For example, Oregon allows only 40 percent of a punitive damages award to be paid to the winning party, and that party's attorney may receive no more than 20 percent of the award—the remaining 60 percent is paid to the Criminal Injuries Compensation Account.<sup>21</sup> North Carolina has capped punitive damages at three times the amount of compensatory damages or \$250,000, whichever is greater.<sup>22</sup>

### [3]—Burden of Proof

To recover punitive damages, the plaintiff must first meet the burden of proof as to all elements of the underlying claim.<sup>23</sup> Then the plaintiff must prove that the defendant acted with aggravated fault, such as intentional or reckless disregard of the safety of the injured plaintiff or the public, or both. Although the burden of proof in the underlying claim is the "preponderance" standard, punitive damages are often subject to the higher standard of "clear and convincing"

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<sup>18</sup> *English v. Mentor Corp.*, 67 F.3d 477 (3rd Cir. 1995).

<sup>19</sup> *AC and S v. Godwin*, 667 A.2d 116 (Md 1995).

<sup>20</sup> See generally: *The American Law of Products Liability* 3d § 60:61-60:65 (1987); Annotation, "Allowance of Punitive Damages in Products Liability Cases," 13 A.L.R. 4th 52.

<sup>21</sup> Or. Rev. Stat. § 18.540 (1995). See generally Larsen, Annotation, "Validity, Construction, and Application of Statutes Requiring that Percentage of Punitive Damages Awards Be Paid Directly to State or Court-Administered Fund," 16 ALR5th 129, for a list of jurisdictions that have punitive damages awards funds. See also *BMW of North America, Inc. v. Gore*, 517 U.S. 559, 616-618, 116 S.Ct. 1589, 134 L.Ed.2d 809 (1996) (appendix to dissent of Ginsburg, J.).

<sup>22</sup> N.C. Gen. Stat. § ID-25 (1995). See generally: *The American Law of Products Liability* 3d § 60:61-60:65 (1987). See also Annotation, "Allowance of Punitive Damages in Products Liability Cases," 13 A.L.R.4th 52, for a list of jurisdictions in which maximum amounts have been set on punitive damage awards. See also *Cooper Industries, Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424, 121 S.Ct. 1678, 1683 n.6, 149 L.Ed.2d 674 (2001).

<sup>23</sup> See *Restatement (Second) of Torts*, § 908 comment c.

evidence.<sup>24</sup> At least one state requires proof beyond a reasonable doubt before punitive damages may be awarded.<sup>25</sup>

#### [4]—Obtaining Evidence of Punitive Damages

In the product liability field, there are two factual patterns which are the cause of most punitive damage awards. First, the award of punitive damages has often been premised on the manufacturing defendant's concealment or disregard of scientific information implicating the product in serious health or safety problems.<sup>26</sup> The second common scenario resulting in an award of punitive damages is the defendant's knowledge of prior problems with the product.<sup>27</sup> In one case, evidence of only one prior incident coupled with field tests suggesting similar problems sufficed to permit a claim for punitive damages to be submitted to the jury.<sup>28</sup> Proving punitive damages generally requires proving the requisite egregious conduct and proving that defendant's wealth is sufficient to withstand an award yet suffer the appropriate deterrence.

#### [a]—Proof of Conduct

A prime punitive damages witness is a disgruntled or other former employee of the defendant who is willing to testify. The plaintiff's lawyers should use every legitimate source possible to find such former employees, who can often provide dynamic testimony. Such efforts would obviously include discovery designed to uncover the names of knowledgeable former employees, but also informal investigative methods as well. The plaintiff's attorney should bear in mind, however, that certain states place limitations on *ex parte* interviews of

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<sup>24</sup> See *The American Law of Product Liability* 3d, § 60.87, n. 31 for a list of statutes and cases adopting the clear and convincing standard. See also *Rodriguez v. Suzuki Motor Corp.* 936 S.W.2d 104 (Mo. 1996).

<sup>25</sup> Colo. Rev. Stat. § 13-25-127(2).

<sup>26</sup> See, e.g.:

*Eighth Circuit: Kociemba v. J.D. Searle & Co.*, 707 F. Supp. 1517 (D. Minn. 1989) (involving intrauterine devices).

*Ninth Circuit: Ingram v. Acands, Inc.*, 977 F.2d 1332 (9th Cir. 1992) (under Oregon law, award of punitive damages against asbestos manufacturer was supported by evidence that asbestos manufacturer had known of health risk of asbestos since 1930's, that manufacturer was advised that its product was capable of causing asbestosis, and that manufacturer failed to place warnings on product packages after learning of danger of asbestos).

<sup>27</sup> *Cf. BMW of North America, Inc. v. Gore*, 517 U.S. 559, 584-585, 116 S.Ct. 1589, 134 L.Ed.2d 809 (1996) ("In the absence of a history of noncompliance with known statutory requirements, there is no basis for assuming that a more modest sanction would not have been sufficient to motivate full compliance . . .").

<sup>28</sup> *Airco, Inc. v. Simmons First National Bank*, 638 S.W.2d 660 (Ark. 1982).

employees of parties to litigation, particularly if that party was a member of the party's "control group."<sup>29</sup>

For the plaintiff, proving the requisite "aggravated fault" will often require a combination of experts and circumstantial evidence. Continuing employees of the defendant company who are deposed may also provide evidence that, for example, certain safety tests were either not conducted or yielded adverse results which were disregarded. Defendant's internal documents are often a very fertile source of discovery which may serve as a basis for punitive damages. Internal memoranda that raise safety concerns which have not been addressed are highly damaging. Often the most damaging evidence of all is evidence that serious product hazards were evaluated solely on economic terms, and were uncorrected only to save money.

Expert witnesses may be able to testify that a particular risk was discoverable with appropriate testing or review. Even further, an expert may be able to testify that failures to address or discover certain risks were attributable to recklessness or indifference to consumer safety.

From a defendant's perspective, a punitive damages claim requires proof of its "good conduct," i.e., that it did not act wantonly or recklessly. Defendants should move to bifurcate the trial so as to separate the compensatory and punitive phases of a case. One important piece of evidence from a defendant's perspective in a punitive damages case is a lack of prior problems or complaints with the product. Evidence of the defendant's behavior after learning of a defect may be an important factor in mitigating culpability. When the defendant is aware of a defect, evidence of a recall campaign or other remedial efforts may be proof of "good conduct."<sup>30</sup> Defendants may also consider their own version of the "day in the life" video often used by plaintiffs in severe injury cases. Defendant's "day in the life" film should seek to place faces and personalities on the employees concerned with product safety to show that defendant is not an impersonal, monolithic entity, but a business made up of people whose job it is to care about the safety of their products.

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<sup>29</sup> Compare *Fair Automotive Repair, Inc. v. Car-X Service Systems, Inc.*, 471 N.E.2d 554 (Ill. App. 1984) (adopting "control group" test) with *Continental Insurance Company v. The Superior Court of Los Angeles County*, 32 Cal. App.4th 94, 37 Cal. Rptr.2d 843 (Cal. App. 1995) (communications with previous employees are not prohibited regardless of the status of their previous employment).

<sup>30</sup> See *Alexander v. Morning Pride Manufacturing, Inc.*, 913 F.Supp. 362 (E.D. Pa. 1995) (evidence of fire protective gear manufacturer's communications with the Fire Department and firefighters union was properly admitted in the punitive damages phase of the trial because it was relevant to culpability). But see, *Holmes v. Wegman Oil Co.*, 492 N.W.2d 107 (S.D. 1992), in which the court refused to hold that evidence of a recall campaign would prohibit punitive damages as a matter of law.

**[b]—Proof of Financial Condition of Defendant**

The Supreme Court has specifically permitted the defendant's wealth to be a consideration in a punitive damages case.<sup>31</sup> Most states allow such proof, and some states take the position that financial ability to pay is essential to an award of punitive damages.<sup>32</sup> On the other hand, in at least one state, evidence of wealth of a punitive damages defendant is statutorily prohibited.<sup>33</sup>

While plaintiffs will want to prove that defendants have substantial wealth, defendants should seek to exclude or limit all evidence of financial condition. Bifurcation is particularly important on this issue because proof of a defendant's wealth introduced into a liability trial is highly likely to infect the jury's view of liability. If a defendant is a subsidiary, a strong argument can be made that it is prejudicial to admit evidence of the financial condition of the parent.<sup>34</sup> A defendant can also argue that financial analysis should be limited to the specific aspect of defendant's operations involved in the punitive damage award.<sup>35</sup>

Corporate financial statements are a primary source of information. Often, a plaintiff's expert will contend that a defendant's net worth exceeds the value reported because assets, such as goodwill, are undervalued in the defendant's financial statements. A defendant should challenge a plaintiff's financial analysis. A plaintiff's analysis may ignore liquidity problems or fail to fully account for the impact of punitive damages awards. Evidence of all negative effects of a punitive damages award should be presented. The entire cost of a punitive damages award includes additional interest expenses, increased insurance costs, loss of sales due to negative public reaction, and potential bankruptcy.<sup>36</sup>

If the damages award affects a defendant's financial viability, it will negatively impact employees, shareholders, and enterprises that work with the defendant. A defendant should present evidence of this negative impact. A defendant can also mitigate a plaintiff's evidence of the defendant's reprehensibility by presenting evidence of the positive effects of the defendant's behavior. For example, detailed financial statements can demonstrate defendant's expenditures on consumer safety and product quality as well as spending for community programs.<sup>37</sup>

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<sup>31</sup> Pacific Mutual Insurance Co. v. Haslip, 499 U.S.1, 21-22, 111 S.Ct. 1032, 113 L.Ed.2d 1 (1991).

<sup>32</sup> See, e.g., Herman v. Sunshine Chemical Specialties, 608 A.2d 978 (N.J. 1992).

<sup>33</sup> Col. Rev. Stat. § 13-21-102(6).

<sup>34</sup> See, e.g., HCA Health Services of Midwest, Inc. v. National Bank of Commerce, 745 S.W.2d 120 (Ark. 1988).

<sup>35</sup> See Zaumeyer, "The Economics of Punitive Damages," For The Defense, June 2001.

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*