Punitive Damages: How Much Is Enough?

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Introduction

Punitive damages are an established practice of American common law, traditionally assessed against defendants in civil cases to punish past misconduct and to deter future misconduct. But because they have become more frequent in recent verdicts, they have received increased attention. The major issue today is no longer *whether* defendants should pay punitive damages; it is well-settled that punitive damages are appropriate in certain circumstances, as both a matter of law and policy. Instead, current controversy focuses on what is the appropriate *amount* of punitive damages that should be awarded and how that amount should be calculated.

This article discusses the development of punitive damages, the purposes of such awards, and the factors that must be considered when determining the amount of punitive damages to be awarded. Specifically, it focuses on the percentage of a defendant's net worth that can be assessed in awarding punitive damages and what relationship punitive damages must have to the actual damages awarded.

The Development of Punitive Damages

The award of punitive-type damages was common in early legal systems, and was mentioned in religious law as early as the Book of Exodus. Punitive-type damages were provided for in Babylonian law nearly 4000 years ago in the Code of Hammurabi, in the Hittite Laws of about 1400 B.C., in the Hebrew Covenant Code of Mosaic Law of about 1200 B.C.,

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and in the Hindu Code of Manu of about 200 B.C. Owen, *Punitive Damages in Product Liability Litigation*, 74 Mich L Rev 1257, 1262 n17 (1976).

In *Huckle v Money* (KB 1763)95 Eng Rep 768, punitive damages were first recognized under English common law. The court in *Huckle* held that punitive awards not only compensated the plaintiff for harms such as mental suffering, wounded dignity, and injured feelings, but also served the purpose of punishing the defendant for egregious misconduct. See also *Wilkes v Wood* (KB 1763) 98 Eng Rep 489, cited in *Exemplary Damages in the Law of Torts*, 70 Harv L Rev 517, 519 (1957) (hereinafter *"Exemplary Damages"*). Soon afterwards, American courts also recognized punitive damages. In *Genay v Norris* (1784)1 SC 3, 1 Bay 6, the plaintiff was awarded punitive damages because of injuries received after drinking wine adulterated by the defendant as a practical joke. In *Day v Woodworth* (1851)54 US 363, 371, the U.S. Supreme Court said the doctrine of punitive damages had received support from "repeated judicial decisions for more than a century."

By the mid-1800s, as punitive damages increasingly became an established part of American tort law, American courts emphasized the punishment purpose of punitive damages. For example, in *Hawk v Ridgway* (1864) 33 Ill 473, 476, the court stated, "[w]here the wrong is wanton, or it is willful, the jury is authorized to give an amount of damages beyond the actual injury sustained as a punishment, and to preserve the public tranquility." Justice Scalia of the United States Supreme Court noted in a concurring opinion that, "In 1868, therefore, when the Fourteenth Amendment was adopted, punitive damages were undoubtedly an established part of American common law of torts." *Pacific Mut. Life Ins. Co. v Haslip* (1991) 499 US 1, 26, 113 L Ed 2d 1, 25, 111 S Ct 1032.

While the idea of punitive damages was embraced early in our legal system, claims for punitive damages were rarely brought before the middle of this century. Even when claimed, they were often stricken by the court before trial. When punitive damages claims were allowed to proceed, the eventual awards were minimal compared to modern standards. In the United States, the largest reported punitive damage award in the 1800s was $4500 (the equivalent of $72,000 in 1998 dollars). Even in this century, awards well under $100,000 were viewed as extraordinary, and by some, exceedingly excessive. For example, in the 1930s, a punitive award of $50,000 (worth $412,000 in 1998) was considered astounding. Until 1955, the largest punitive damage award in California was $75,000, and in 1979, a San Diego federal jury returned the largest punitive damages award to that day–$14,750,000 in a securities fraud class action. *Harmsen v Smith* (9th Cir 1982) 693 F2d 932, 947.

Even after punitive damages were accepted early in American tort law, they were the subject of heated debate and skepticism regarding their remedial purpose. Concern was focused on whether damages should or could be awarded for noncompensatory reasons. Owen, *Punitive Damages in Product Liability Litigation*, 74 Mich L Rev 1257, 1263 n22 (1976). In *Fay v Parker* (1873) 53 NH 342, the court said, "[t]he

idea [of punitive damages] is wrong. It is a monstrous heresy. It is an unsightly and unhealthy excrescence, deforming the symmetry of the body of the law." 53 NH at 382. By 1935, however, all states, other than Louisiana, Massachusetts, Nebraska, and Washington, had adopted some form of punitive damages remedy if the defendant's behavior was malicious, willful, wanton, oppressive, or outrageous. Owen, *supra.*

Purposes of Punitive Damages

Today, California courts have found that punitive damages serve the dual purposes of punishing the defendant and deterring similar conduct in the future. See, *e.g.*, *Michelson v Hamada* (1994)29 CA4th 1566, 1593, 36 CR2d 343; *Las Palmas Assocs. v Las Palmas Center Assocs.* (1991)235 CA3d 1220, 1243, 1 CR2d 301 ("punitive damages are not awarded for the purpose of rewarding the plaintiff, but to punish the defendant"); *Kaye v Mount La Jolla Homeowners Ass'n* (1988)204 CA3d 1476, 1493, 252 CR 67; *Dyna-Med, Inc. v FEHC* (1987) 43 C3d 1379, 1387, 341 CR 67 (punitive damages "serve but one purpose–to punish and through punishment, to deter"); *Castaic Clay Mfg. Co. v Dedes* (1987)195 CA3d 444, 450, 240 CR 652; *Neal v Farmers Ins. Exch.* (1978)21 C3d 910, 928 n13, 148 CR 389. Accordingly, punitive damages should not be greater than the amount necessary to accomplish these goals. *Weeks v Baker & McKenzie* (1998)63 CA4th 1128, 1166, 74 CR2d 510; *Michelson v Hamada* (1994)29 CA4th 1566, 1593, 36 CR2d 343; *Neal v Farmers Ins. Exch.* (1978)21 C3d 910, 928 n13, 148 CR 389 ("the function of punitive damages is not served by an award which, in light of the defendant's wealth and the gravity of the particular act, exceeds the level necessary to properly punish and deter").

The deterrence justification for punitive damages is motivated by two objectives: (1) to deter the specific defendant in the case from repeating or continuing his, her, or its offensive behavior and (2) to deter, generally, other potential parties from committing similar offenses. See Restatement (Second) of Torts §908. This rationale of deterrence is especially strong in cases in which other measures of civil damages, and the unlikely prospect of criminal prosecution, are together insufficient to prevent an individual or entity from engaging in a wrongful act. Indeed, absent the fear of punitive damages, a defendant may have little incentive to discontinue the unlawful or harmful conduct.

Punitive damages are not intended to compensate the plaintiff. *Dyna-Med, Inc. v FEHC* (1987) 43 C3d 1379, 1387, 341 CR 67; *Newport v Facts Concerts, Inc.* (1981) 453 US 247, 266, 69 L Ed 2d 616, 631, 101 S Ct 2748. The reality, however, is that the plaintiff is the party who receives the punitive damage award. Originally, this was done because such awards made up for intangible harms, but with the increase in other recoverable damages, such justification is less potent. Some argue that the plaintiff should receive punitive damages because of the large amounts of time, money, and effort expended to obtain these verdicts. The goal of the law, however, is to make plaintiffs whole, not to reward them for zealous litigation. Generally, the plaintiff receives the award "because there is no one else to receive it." *Shepherd Components, Inc. v Brice Petrides-Donohue & Assocs., Inc.* (Iowa 1991) 473 NW2d 612, 619.

Yet this raises the issue of whether some plaintiffs receive windfalls while others receive nothing. For example, in *BMW, Inc. v Gore* (Ala 1994)646 So2d 619, a man sued because the brand new car he purchased had been partially repainted to cover damage caused while it was being shipped to the dealer. The jury awarded him $4 million in punitive damages. The Alabama Supreme Court later reduced the punitive damages to a more "constitutionally reasonable" $2 million, noting that in a case virtually identical to plaintiff's, another had received no punitive damages. 646 So2d at 626. The U.S. Supreme Court later held that even $2 million was "grossly excessive." *BMW, Inc. v Gore* (1996) 517 US 559, 134 L Ed 2d 809, 825, 116 S Ct 1589.

Determining How Much Is Enough

Unlike compensatory damages, punitive damages are not recoverable as a matter of right. *McAllister v South Coast Air Quality Management Dist.* (1986)183 CA3d 653, 659, 228 CR 351. The amount of the punitive damages award is left to the jury's discretion (*Coats v Construction & Gen. Laborers Local No. 185* (1971)15 CA3d 908, 916, 93 CR 639), and is determined by considering the character of the defendant's misconduct, the nature and extent of the plaintiff's injury, and the wealth of the defendant.

Jury Instructions

To determine the amount of punitive damages to award, the Book of Approved Jury Instructions (BAJI) states that the jury should consider:

(1) The reprehensibility of the conduct of the defendant.

(2) The amount of punitive damages which will have a deterrent effect on the defendant in the light of *defendant's financial condition.*

BAJI §14.71. [Emphasis added.] In addition, a defendant can ask that the jury be instructed to consider:

(3) That the punitive damages must bear a reasonable relation to the injury, harm, or damage actually suffered by the plaintiff.

BAJI §14.71. These proposed jury instructions include both subjective and objective components. The first factor–the reprehensibility of defendant's conduct–is subjective in nature. The other two–defendant's financial condition and the relationship to actual damages–are objective measurements. The two objective components are discussed below.

Punitive Damages Based on Defendant's Financial Condition

PUNITIVE DAMAGES: HOW MUCH IS ENOUGH?

The defendant's wealth is an important part of the punitive damages equation. In *Las Palmas Assocs. v Las Palmas Center Assocs.* (1991)235 CA3d 1220, 1243, 1 CR2d 301, the court stated:

While in the ordinary action for damages information regarding the adversary's financial status is *inadmissible*, this is not so in an action for punitive damages. . . . The relevancy of such evidence lies in the fact that punitive damages are not awarded for the purpose of rewarding the plaintiff but to punish the defendant. Obviously, the trier of fact cannot measure the punishment without knowledge of defendant's ability to respond to a given award.

A defendant's financial condition has always been relevant to the amount of punitive damages allowed. As the California Supreme Court explained in *Adams v Murakami* (1991)54 C3d 105, 113, 284 CR 318:

After the Norman conquest in 1066, there arose in English law a system of civil sanctions known as "amercements." [citation] Because of the sometimes abusive nature of amercements, the Magna Carta prohibited those that were disproportionate to the offense or that would deprive the wrongdoer of his means of livelihood: "A freeman shall only be amerced for a small offence according to the measure of that offence. And for a great offence he shall be amerced according to the magnitude of the offence, *saving his contentment* [property necessary for a freeman to maintain his position]; And a villein [peasant], in the same way, if he fall under our mercy, shall be amerced *saving his wainnage* [necessary implements of cultivation and husbandry]."

Magna Carta (1215) ch 20. [Italics added.]

Because punitive damages are intended to punish the wrongdoer, a wealthy wrongdoer should face a higher punitive damages award than a less wealthy party. *Neal v Farmers Ins. Exch.* (1978)21 C3d 910, 928, 148 CR 389 ("the function of deterrence . . . will not be served if the wealth of the defendant allows him to absorb the award with little or no discomfort").

In recent years, several courts across the country have acted to put limits on the size of punitive awards. For example, in California, several courts have not allowed punitive damages to exceed 10 percent of the defendant's net worth. *Storage Servs. v Oosterbaan* (1989)214 CA3d 498, 515, 262 CR 689; *Michelson v Hamada* (1994) 29 CA4th 1566, 1596, 36 CR2d 343.

In a recent case, *Weeks v Baker & McKenzie*, *supra*, the court acknowledged the 10-percent threshold, but allowed $225,000 in punitive damages even though it "slightly" exceeded 10 percent of the defendant's net worth of $2 million. 63 CA4th at 1167. This amount was found permissible because there was "no evidence that payment of that sum will bankrupt him or cause him undue hardship as to render his punishment unreasonably disproportionate to his ability to pay." 63 CA4th at 1167.

PUNITIVE DAMAGES: HOW MUCH IS ENOUGH?

While mandated percentage "limits" on a punitive damage award have drawn criticism, awards in excess of these limits have also drawn objection. Again, using California as an example, courts have generally found punitive damages greater than 15 percent of a defendant's net worth to be excessive. *Little v Stuyvesant Life Ins. Co.* (1977)67 CA3d 451, 469, 136 CR 653; see also *Michelson v Hamada* (1994)29 CA4th 1566, 1595, 36 CR2d 343 (award equal to 28 percent of defendant's net worth is excessive). Awards greater than 30 percent of a defendant's net worth are often rejected as excessive. *Merlo v Standard Life & Acc. Ins. Co.* (1976) 59 CA3d 5, 18, 130 CR 416 (punitive damages equal to 30 percent of defendant's net worth are excessive); *Zhadan v Downtown L.A. Motors* (1976)66 CA3d 481, 500, 136 CR 132 (punitive damages equal to one-third of defendant's net worth are excessive).

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If a defendant's financial condition is a key factor in determining the amount of punitive damages, is it also true that such information *must* be considered before such an award can be rendered? Before 1991, California courts routinely upheld punitive damage awards even when there was no evidence of the defendant's worth. See, *e.g.*, *Fenlon v Brock* (1989)216 CA3d 1174, 1179, 265 CR 324; *Dumas v Stocker* (1989) 213 CA3d 1262, 1269, 262 CR 311; *Greenfield v Spectrum Inv. Corp.* (1985)174 CA3d 111, 124, 219 CR 305; *Fletcher v Western Nat'l Life Ins. Co.* (1970)10 CA3d 376, 404, 89 CR 78; *Hanley v Lund* (1963) 218 CA2d 633, 645, 32 CR 733.

In 1991, however, the California Supreme Court decided *Adams v Murakami* (1991) 54 C3d 105, 284 CR 318, holding that "[a] reviewing court cannot make a fully informed determination of whether an award of punitive damages is excessive unless the record contains evidence of the defendant's financial condition." 54 C3d at 110. Yet, even after the decision in *Adams*, courts have continued to find that evidence of "net worth" is not essential to upholding a punitive damages award. For example, in *Cummings Med. Corp. v Occupational Med. Corp.* (1992) 10 CA4th 1291, 1298, 13 CR2d 585, the court held that the punitive damage award could be based on the *profitability* of defendant's misconduct. The court noted that (10 CA4th at 1299):

[a]lthough appellate courts have sometimes used the terms "wealth," "financial condition" and "net worth" interchangeably [citations], clearly these terms are not synonymous. And, while "net worth" is probably the financial measurement most often used in setting the amount of punitive damages, no court has held that it is the *only* permissible measurement.
[Emphasis in original.]

When a plaintiff alleges federal law causes of action, financial information need not be presented until after the jury determines that punitive damages should be awarded. *Barber v Rancho Mortgage & Inv. Corp.* (1994) 26 CA4th 1819, 1842 n26, 32 CR2d 906. Thus, the *Adams* rule was not applied in *Chavez v Keat* (1995) 34 CA4th 1406, 41 CR2d 72. The court explained that "the view adopted in California by *Adams* is

not universally held," and is not applicable to federal causes of action being heard in state court because it is substantive in nature. 34 CA4th at 1410; see also *Barber v Rancho Mortgage & Inv. Corp.*, *supra* (proof of financial condition is a matter of substantive law, so federal standards apply when plaintiff has brought federal cause of action in state court).

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The issue of what constitutes "net worth" also raises the thorny issue of what is the true financial condition of the defendant, because numbers can often be easily manipulated. *Michelson v Hamada* (1994) 29 CA4th 1566, 1592, 36 CR2d 343. In *Michelson*, the defendant produced a financial statement showing that his net worth was almost $4,400,000 in 1988. Yet a second financial statement purportedly showed that the defendant's net worth had mysteriously declined to just over $2,080,000 in 1989. Because of numerous inconsistencies between the financial statements, the trial court considered the 1989 financial statement "patently crooked." On appeal, the court also used the higher net worth found in the 1988 financial statement to determine what percentage of the defendant's net worth the punitive damage award should be applied against. Absent glaring errors such as those in *Michelson*, however, parties must be wary of and question estimates of net worth based on the data provided.

The Relationship Between Actual Damages and Punitive Damages Actually Suffered by the Plaintiff

The other indication of whether punitive damages are reasonable is the relationship to the actual harm caused. Courts have long held that punitive damages must bear a "reasonable relationship" to actual damages. *BMW, Inc. v Gore* (1996) 517 US 559,134 L Ed 2d 809, 829, 116 S Ct 1589. There is no magic ratio, however, between the maximum permissible punitive damages and compensatory damages, and juries have wide discretion when deciding whether punitive damages should be awarded. *Wetherbee v United Ins. Co.* (1971)18 CA3d 266, 271, 95 CR 678; *Cotes v Construction & Gen. Laborers* (1971) 15 CA3d 908, 916, 98 CR 639.

In *Pacific Mut. Life Ins. Co. v Haslip* (1991) 499 US 1, 22, 113 L Ed 2d 1, 22, 111 S Ct 1032, the U.S. Supreme Court found that punitive damages of four times the amount of actual damages were "close to the line" of being excessive, yet were still constitutional. However, *Haslip* still left open the question of where the outer limit of reasonableness regarding punitive damages lies.

Some insight on this issue is provided in the Supreme Court decision in *TXO Prod. Corp. v Alliance Resources* (1993) 509 US 443, 125 L Ed 2d 366, 113 S Ct 2711, in which the Court broadened its view of what ratio between actual and punitive damages is permissible. The Court upheld a $10-million punitive damage award that accompanied an actual damage award of only $19,000–a ratio of 526 to 1. Quoting *Haslip*, the Court declared that, "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 [a] general concer[n] of reasonableness . . . properly enter[s] into the constitutional calculus. " 509 US at 458, 125 L Ed 2d at 379.

In arriving at its decision in *TXO*, the Court focused on "whether there is a reasonable relationship between the punitive damages award and *the harm likely to result* from the defendant's conduct as well as the harm that actually has occurred." 509 US at 460, 125 L Ed 2d at 380. [Emphasis in original.] The Court concluded that the high punitive damage award was reasonable because TXO's actions could have caused millions of dollars of damages to other victims. 509 US at 460, 125 L Ed 2d at 380.

More recently, the Supreme Court decided *BMW, Inc. v Gore* (1996) 517 US 559, 134 L Ed 2d 809, 116 S Ct 1589. In that case, Dr. Gore bought a new BMW automobile for just over $40,000. Nine months later, a car detailer noticed that parts of the car had been repainted. At the time, BMW had a policy that it would not sell as "new" any car with predelivery damage that totals more than 3 percent of the car's suggested retail price. The cost to repaint the BMW at issue was about $600, which was only about 1.5 percent of the suggested retail price. Thus, the repainting was not disclosed when Dr. Gore bought the car.

Dr. Gore sued BMW, claiming that BMW's failure to disclose that the car had been repainted constituted the suppression of a material fact. He claimed that his actual damages were $4000, based on the testimony of a former BMW dealer who said a repainted BMW was worth about 10 percent less than a car without the repairs. Dr. Gore also asked for $4 million in punitive damages. He arrived at this figure by multiplying the $4000 in actual damages he suffered by 1000, the approximate number of "new" cars BMW sold with undisclosed repairs.

The jury awarded Dr. Gore exactly what he requested–$4000 in compensatory damages and $4 million in punitive damages. On appeal, the Alabama Supreme Court held that the *amount* of the punitive damages award was not excessive, but that the method of calculating it was impermissible. It held that the jury improperly calculated punitive damages by multiplying Dr. Gore's damages by the number of similar sales in other jurisdictions. Although Dr. Gore argued that the large punitive damages award was necessary to force BMW to change its practices, "by attempting to alter BMW's nationwide policy, Alabama would be infringing on the policy choices of other States." 134 L Ed 2d at 824. The Alabama Supreme Court reduced the punitive damages to $2 million, although it did not explain why this amount was constitutionally reasonable while the $4 million award was not. *BMW, Inc. v Gore* (Ala 1994) 646 So2d 619, 629.

The $2 million punitive damage award represented a 500 to 1 ratio between the punitive and actual damages. On appeal, the Supreme Court called this ratio "breathtaking" and "grossly excessive" on due process grounds, and remanded the case for further proceedings consistent with its opinion. While the Supreme Court has repeatedly found that there is no "bright line" ratio where punitive damages become excessive, it has not shed much light on what the outer limits of reasonableness would be. We know from *Haslip* that punitive damages totaling four times the actual damages is clearly permissible, and *TXO*

extended the line to a ratio of almost ten to one. *BMW*, however, held that a ratio of 500 to 1 is unconstitutional.

Some guidance regarding this vast gray area is provided by the California courts. In *Neal v Farmers Ins. Exch.* (1978) 21 C3d 910, 929, 148 CR 389, the California Supreme Court upheld punitive damages that were 74 times the amount of compensatory damages ($10,000 in compensatory damages and $740,000 in punitive damages). Most recently, a California appellate court reaffirmed that a ratio of 70 is permissible. *Weeks v Baker & McKenzie* (1998)63 CA4th 1128, 1166, 74 CR2d 510.

California courts, however, will disallow punitive damages, even with a ratio less than one times the actual damages, when the punitive damages would equal a large percentage of the defendant's net worth. For example, in *Storage Servs. v Oosterbaan* (1989) 214 CA3d498, 262 CR 689, the actual damages totaled $1,044,250. Punitive damages of $75,000 were assessed against one of the defendants that equaled just over 7 percent of the actual damages awarded. Yet, the court held that the punitive damages were "excessive" because the defendant's net worth was only $150,000 to $200,000. 214 CA3d at 514.

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Another twist to the analysis is the doctrine that there should be an award of actual damages to support an award of punitive damages. As stated by the California Supreme Court, "actual damages must be found as a predicate for exemplary damages." *Mother Cobb's Chicken T., Inc. v Fox* (1937)10 C2d 203, 205, 73 P2d 1185. See also *Cheung v Daley* (1995)35 CA4th 1673, 1677, 42 CR2d 164; *Kizer v County of San Mateo* (1991) 53 C3d 139, 147, 279 CR 318. In *Clark v McClurg* (1932) 215 C 279, 9 P2d 505, however, an award of $5000 in punitive damages was upheld when the jury *left blank* the space for actual damages.

In *Cheung*, defendant was accused of fraudulently transferring real property to evade satisfaction of a nuisance judgment against him. The jury found that plaintiff was entitled to compensatory damages in the amount of $0. The jury further found that by making the fraudulent transfers, defendant had acted with fraud, oppression, or malice, and awarded punitive damages. On appeal, the court concluded that "the rule of *Mother Cobb's Chicken* -- that an award of exemplary damages must be accompanied by an award of compensatory damages–is still sound. That rule cannot be deemed satisfied where the jury has made an express determination not to award compensatory damages." 35 CA4th at 1677.

Conclusion

The appropriate measure of punitive damages is a subject that will be closely watched in the next decade. With the clamor for reform of punitive damages, legislatures are being inundated with lobbyists peddling bills to reduce or eliminate these damages. Courts are likewise being pulled by arguments of due process, unlawful takings, and excessive fines under the various clauses of both the federal and state constitutions.

PUNITIVE DAMAGES: HOW MUCH IS ENOUGH?

While the fate of such damages will be decided by either the legislature or the courts, at some point limits may only act to erode the confidence of the public in our legal system by abandoning the only remaining civil process that penalizes a party for acting with fraud, oppression, or malice against another.