Penalizing Punitive Damages: Why the Supreme Court Needs a Lesson in Law & Economics

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Abstract: Last fall’s landmark Supreme Court decision addressing punitive damages in the infamous Exxon Valdez oil spill case has brought the issue of punitive awards back into the legal limelight. Modern Supreme Court jurisprudence, most notably BMW, State Farm, Philip Morris, and now Exxon Valdez in 2008, have concluded that such judgments are justified to punish morally reprehensible behavior and to "send a message" to evildoers. However, the Court has increasingly emphasized that the U.S. Constitution’s Due Process Clause presumptively limits punitive awards, drawing an arbitrary line in the sand of no more than ten times actual damages.

This paper critically examines modern punitive damages jurisprudence using a law & economics lens. From that standpoint, there is no justifiable basis for tort law’s requirement of morally reprehensible or intentional conduct before punitive damages may be awarded. Indeed, punitives should be imposed (nay, must for deterrence purposes) even in the absence of egregious behavior when a defendant has escaped liability previously, either intentionally or serendipitously. In this manner, the punitive award “makes up” for the occasions in which the defendant avoided liability and failed to compensate victims for harm caused. On the other hand, sound economic analysis dictates that imposing enormous punitive damages simply because a tortfeasor’s behavior was morally offensive can inadvertently lead to overdeterrence, prices up beyond optimal, quantity of goods purchased far below optimal, and a significant reduction in overall social welfare. In sum, the Supreme Court must drastically revise its approach to punitive damages jurisprudence: such awards should not be arbitrarily based on a gut reaction to how “reprehensibly” we feel a defendant acted. Rather, punitive damages should be granted only where tortfeasors have the potential to escape liability for their actions, and they should be awarded in that case even if the defendant in no way meets the modern requirements of egregious behavior necessary. Moreover, the Supreme Court’s arbitrary litmus Due Process test of “ten times compensatory damages” as a ceiling on punitive damages makes zero sense from an economic analysis point of view, and needs to be summarily abolished.

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In the interest of full disclosure, this paper’s author was one of the contributors to an amicus brief before the U.S. Supreme Court in the Exxon Valdez case. See Brief Amici Curiae of Sociologists, Psychologists, and Law and Economics Scholars in Support of Respondents, Exxon Shipping Co. v. Baker, 128 S. Ct. 2605. This brief was unique in that it employed an economics-based argument in favor of punitive damages against Exxon rather than relying on the unprincipled and arbitrary approach taken by past Supreme Court punitive damages cases.
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I. INTRODUCTION

Throughout history, punitive damages have served to punish individuals who engage in morally egregious and reckless behavior. The ancient Code of Hammurabi as well as the powerful Roman Empire viewed punitive damages as a means to express society’s disapproval of certain actions by punishing the defendant well above and beyond a victim’s need for compensation.1 Sadly, our current U.S. Supreme Court sees the issue only slightly differently, holding that punitive damage awards should justly “send a message” to reckless defendants based largely or solely on the moral reprehensibility of their behavior.2

In its defense, the Supreme Court has been concerned about preventing juries from handing down punitive damages awards that are entirely arbitrary.3 Unfortunately, the manner in which the Court has gone about curing this problem has been completely arbitrary in its own right. In the early 1990s, the Court required that a jury be given instructions that provide “reasonable constraints” on its discretion to provide punitive damages.4 Two years later, in TXO Prod. Corp. v. Alliance Res. Corp.,5 a divided Court found that punitive damages awards could not be “grossly excessive,” whatever that phrase might be interpreted to mean.6 Honda v. Oberg7 followed, in which the Court found that judicial review of punitive damage awards was necessary because such oversight provided a check on punitive damage awards that may be the result of bias or prejudice toward the defendant.8 Shifting its analysis to one predicated on the notion that punitive damages are quasi-criminal, the Court held in Cooper Industries, Inc. v. Leatherman Tool Group, Inc.9 that courts of appeals must review punitive awards under a de novo standard.10 The Court justified this opinion by invoking the old adage that “the punishment must fit the crime,” while explicitly referencing the Eighth Amendment’s prohibition on excessive fines and cruel and unusual punishment.11

1 LINDA L. SCHLUETER, PUNITIVE DAMAGES 1-5 (5th ed. 2005). Schlueter provides a detailed summary of the history of punitive damages from their roots in ancient law to the transition into modern U.S. jurisprudence.
2 See, e.g., State Farm Mut. Ins. Co. v. Campbell, 538 U.S. 408, 419 (2003) (“The most important indicium of the reasonableness of a punitive damages award is the degree of reprehensibility of the defendant’s conduct.”) (quoting BMW of North America, Inc. v. Gore, 517 U.S. 559, 575 (1996)). The view that punitive damages should be used to “send a message” to particularly offensive defendants can trace its origins to the century-old case of Lake Shore & M.S. Railway Co. v. Prentice, 147 U.S. 101, 107 (1893), where the Court described such an award as a “way of punishment of the offender, and as a warning to others.”
3 See Exxon Shipping Co. v. Baker, 128 S.Ct. 2605, 2627 (2008) (“[A] penalty should be reasonably predictable in its severity, so that even Justice Holmes’s “bad man” can look ahead with some ability to know what the stakes are in choosing one course of action or another.” See Oliver Wendell Holmes, The Path of the Law, 10 HARV. L. REV. 457, 459 (1897).
6 Id. at 458.
8 Id. at 432.
10 Id. at 443.
11 Id. at 432-34 (“The principle that the punishment should fit the crime is deeply rooted and frequently repeated in common-law jurisprudence.” (citing BMW of North America, Inc. v. Gore, 517
Unfortunately, the Court’s solutions in each case never solved the ultimate problem: *jury awards that aim to put a price tag on the defendant’s level of moral reprehensibility are inherently arbitrary*. Under modern traditional Supreme Court jurisprudence, there is simply no way to consistently or fairly put a dollar value on society’s disapproval of certain “reprehensible” behaviors. Justice Scalia, criticizing the majority opinion in *BMW of North America, Inc. v. Gore* (which presumptively limited punitive damages to no more than ten times actual harm), stated that the Court “has constructed a framework that does not genuinely constrain, that does not inform state legislatures and lower courts – that does nothing at all except confer an artificial air of doctrinal analysis upon its essentially ad hoc determination that this particular award of punitive damages was not ‘fair.’”

Moreover, current jurisprudence, which examines a defendant’s financial condition before assessing punitive damages, results in disparate and unequal treatment because the damage award is not based on an individual’s actual conduct, but instead on an individual’s position. Justice O’Connor in her *TXO* dissent specifically expressed this fear, explaining that “[c]ourts long have recognized that jurors may view large corporations with great disfavor.” Unfortunately, this concern has more than materialized in recent Supreme Court decisions.

Against this backdrop, the oft-criticized law and economics movement provides a principled, workable solution by viewing punitive damages as a means of creating socially optimal deterrence and levels of care, rather than as a tool for imposing punishment for morally reprehensible actions. The ultimate goal of modern tort law jurisprudence should be to make injurers internalize the full costs of all their actions so
that they will take the proper level of care – not too much, not too little, but just right.\textsuperscript{20} Jurors will have no reason to take into account a defendant’s wealth,\textsuperscript{21} but would instead be asked to focus on what amount of money would incentivize the defendant, or other similarly situated parties, to act in a socially optimal manner in the future. Such an analysis would avoid arbitrary determinations of how offensive the particular defendant’s behavior was, but rather would focus on whether she had a chance of escaping liability that justified the award of punitive damages.\textsuperscript{22} Indeed, punitives should be imposed (nay, \textit{must} for deterrence purposes) even in the absence of egregious behavior when a defendant has escaped liability previously, either intentionally or serendipitously. Conversely, sound economic analysis dictates that imposing punitive damages simply because a tortfeasor’s behavior was morally offensive can inadvertently lead to overdeterrence, prices up beyond optimal, quantity of goods purchased far below optimal, and a significant reduction in overall social welfare.

\section*{II. \textbf{Traditional Punitive Damages Law}}

\subsection*{A. Historical Origins}

Punitive damages can trace their historical origins as far back as Hammurabi’s Code in 2000 B.C.\textsuperscript{23} As their name suggests, they have been used to punish wrongdoers for the reprehensibility of their conduct. Under ancient Roman law, punitive damages were imposed where “the essence of the delict [offense] was not loss but insult, and therefore, the money payment must usually have represented not compensation in the ordinary sense, but rather solace for injured feelings or affronted dignity. [Hence], the action had . . . the . . . characteristics of a penal action.”\textsuperscript{24} Punitive damages were an attempt to express society’s distaste for an offense rather than to actually compensate victims.

The modern concept of punitive damages first arose in England in the case of \textit{Wilkes v. Wood}.\textsuperscript{25} In 1762, John Wilkes published a pamphlet that was allegedly libelous against the King.\textsuperscript{26} In response, Wilkes’ house was searched and his property seized.\textsuperscript{27} The Court of Common Pleas granted Wilkes’ request for punitive damages in his case against the King because compensatory damages were deemed too small to deter the wrongdoer from causing such harm again.\textsuperscript{28} English courts have since also

\begin{thebibliography}{9}
\bibitem{20} Polinsky & Shavell, \textit{supra} note 19, at 873, 877-900 (discussing optimal damages for deterrence purposes when the defendant is found liable with certainty, when the defendant can sometimes escape liability, and the relationship between punitive damages and the basic economic theory of deterrence).
\bibitem{21} Polinsky & Shavell, \textit{supra} note 19, at 910-14.
\bibitem{22} Legendary Seventh Circuit Judge Richard Posner was the first person to reference the factor of escaping liability as a justification for the imposition of punitive damages. \textit{See RICHARD POSNER, ECONOMIC ANALYSIS OF LAW} 77-78 (1st ed. 1972). \textit{See also} Dorsey D. Ellis, Jr., \textit{Fairness and Efficiency in the Law of Punitive Damages}, 56 S. Cal. L. Rev. 1, 25-26 (1982).
\bibitem{23} Schlueter, \textit{supra} note 1, at 1.
\bibitem{24} BARRY NICHOLAS, \textit{AN INTRODUCTION TO ROMAN LAW} 212, 217 (1977), \textit{cited in} Schlueter \textit{supra} note 1, at 4.
\bibitem{25} 98 Eng. Rep. 489 (1763).
\bibitem{26} \textit{Id.} at 490.
\bibitem{27} \textit{Id.} at 489-91.
\bibitem{28} \textit{Id.} at 498-99.
\end{thebibliography}
utilized punitive damages to compensate for nonpecuniary losses such as harm to one’s image.\textsuperscript{29}

In the United States, there was some confusion over the purpose of punitive damages when they were initially introduced into our legal system.\textsuperscript{30} At times they were used as extra-compensatory damages to account for the trial fees incurred by successful litigants,\textsuperscript{31} whereas in others they focused on the more traditional goals of punishment and deterrence.\textsuperscript{32} Over a century ago, in \textit{Lake Shore & M.S. Railway Co. v. Prentice},\textsuperscript{33} the Supreme Court described punitive damages as “being awarded, not by way of compensation to the sufferer, but by way of punishment of the offender, and as a warning to others.”\textsuperscript{34} More recently, the Court restated this view, explaining that punitive damages “are not compensation for injury. Instead, they are private fines levied by civil juries to punish reprehensible conduct and deter its future occurrence.”\textsuperscript{35}

\section*{B. Modern Supreme Court Jurisprudence}

\textbf{i. Haslip: Seven Factors to Guide the Jury}

Modern Supreme Court rulings on punitive damages have largely focused on this issue through the lens of the Due Process Clause of the Fourteenth Amendment – i.e., is the sanction so “arbitrary” or “grossly excessive” so as to deprive the defendant of its constitutional right to due process under the law.\textsuperscript{36} In 1991, the Court decided \textit{Pacific Mutual Life Insurance Co. v. Haslip},\textsuperscript{37} a case involving an insurance agent’s fraudulent failure to renew her client’s health insurance policy.\textsuperscript{38} The jury returned a verdict of $1,040,000,\textsuperscript{39} of which at least $840,000 was classified as punitive damages.\textsuperscript{40} The

\textsuperscript{29}See Benson v. Frederick, 3 Burr. 1845, 97 E.R. 1130 (1766) (damage award that was greater than the physical harm was upheld because the injury was unreasonable and the victim “was scandalized and disgraced”).

\textsuperscript{30}See SCHLUETER, supra note 1, at 15-16.

\textsuperscript{31}See, e.g., Boston Mfg. Co. v. Fiske, 2 Mason 119, 3 F. Cas. 957 (1820) (jury could include extra costs such as trial fees in a damages award even though they were not allowable in the compensatory damages award).

\textsuperscript{32}See, e.g., Day v. Woodworth, 54 U.S. 363, 371 (1851) (“a jury may inflict what are called exemplary, punitive, or vindictive damages upon a defendant, having in view the enormity of his offence rather than the measure of compensation to the plaintiff.”).

\textsuperscript{33}147 U.S. 101 (1893).

\textsuperscript{34}Id. at 107.

\textsuperscript{35}Gertz v. Robert Welch, Inc., 418 U.S. 323, 350 (1974). In \textit{Gertz}, Justice Powell refused to allow punitive damages in a libel case where liability was “not based on a showing of knowledge of falsity or reckless disregard for the truth.” Id. at 349. Justice Powell essentially argued that punitive damages could not be assessed under the negligence standard at play in the case because no punishment beyond payment of compensatory damages was necessary. Id. at 350.


\textsuperscript{38}Id. at 4-6.

\textsuperscript{39}Id. at 6.

\textsuperscript{40}Id. at 6 n. 2.
Court focused its analysis on whether the jury’s discretion in determining the award was subject to “reasonable constraints” so as not to be entirely arbitrary. Citing the Alabama Supreme Court’s review with approval, Justice Blackmun reiterated seven factors under which a jury should evaluate its punitive damages award. A factfinder was to consider:

(a) 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;
(b) the degree of reprehensibility of the defendant’s conduct, the duration of that conduct, the defendant’s awareness, any concealment, and the existence and frequency of similar past conduct;
(c) the profitability to the defendant of the wrongful conduct and the desirability of removing that profit and of having the defendant also sustain a loss;
(d) the “financial position” of the defendant;
(e) all the costs of litigation;
(f) the imposition of criminal sanctions on the defendant for its conduct, these to be taken in mitigation; and
(g) the existence of other civil awards against the defendant for the same conduct, these also to be taken in mitigation.

The Court determined that the objective criteria given to the jury (including defendant’s “degree of reprehensibility” and “financial position”) satisfied due process concerns and therefore upheld the punitive damages award. Justice Scalia concurred in the judgment, but expressed his belief that the Constitution itself placed no explicit constraints on punitive damages awards. Justice Scalia defended this position by noting that punitive damages were “undoubtedly an established part of the American common law of torts” when the Fourteenth Amendment was passed. No special procedures were thought necessary at the time of the passage of the Fourteenth Amendment, so the Court should not impose its own version of “reasonable constraints” on the jury’s discretion to award punitive damages.

In her dissenting opinion, Justice O’Connor eloquently described the key element – arbitrariness – that has ultimately led to such inconsistent and confused Supreme Court rulings on the subject. Justice O’Connor believed that the Court needed to impose stronger constraints on a jury’s discretion to avoid such unpredictable punitive damages awards. While Justice O’Connor did not question the legitimacy of punitive damages in general, she stated boldly, “I see a strong need to provide juries with standards to constrain their discretion so that they may exercise their power wisely, not capriciously.

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41 Id. at 20 (“As long as the [jury’s] discretion is exercised within reasonable constraints, due process is satisfied.”).
42 Id. at 21-22.
43 Id.
44 Id. at 23-24.
45 Id. at 24-25.
46 Id. at 26.
47 Id. at 26-28.
48 Id. at 42-43 (emphasis added).
or maliciously. The Constitution requires as much.”

She added that “[v]ague references to ‘the character and the degree of the wrong’ and the ‘necessity of preventing similar wrong’ do not assist a jury in making a reasoned decision; they are too amorphous.”

Justice O’Connor’s solution was to require that states adopt precise methods to constrain juries in their imposition of punitive damages and to fix the amounts awarded. She did not offer such a specific method, but believed that states should be allowed to experiment with and define their own methods.

Justice O’Connor’s dissent highlighted a crucial flaw in the Supreme Court’s punitive damages jurisprudence: namely, how can punitive damages awards avoid being arbitrary when they are based on inherently subjective factors like the defendant’s “the degree of reprehensibility?”

Up to this point in our judicial history, the Court was employing a procedural due process rationale to unsuccessfully address this core question.

ii. **TXO: Punitive Damages Must Not be “Grossly Excessive”**

In *TXO Production Corp. v. Alliance Resources Corp.*, a divided Supreme Court attempted to further constrain punitive damages awards, invoking constitutional substantive due process protections in addition to purely procedural ones. In explaining this doctrinal shift, Justice Stevens opined that “the Due Process Clause of the Fourteenth Amendment imposes substantive limits ‘beyond which penalties may not go’” – therefore, under his TXO test, such awards may not be “grossly excessive.”

Despite this alleged concern, the Court ultimately upheld a punitive damages award in TXO that was 526 times greater than compensatory damages in the case because the defendants’ actions could have led to substantial loss for the plaintiffs and because their behavior was “part of a larger pattern of fraud, trickery, and deceit.”

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49 Id. at 43.
50 Id. at 48.
51 Id. at 63.
52 Id. at 63-64. Justice O’Connor has long been known as an ardent supporter of entrusting controversial topics to the “laboratory of the states.” For example, in upholding New York’s ban on physician-assisted suicide, she nevertheless held that other states could legalize and regulate the practice if they so chose, opening the door to Oregon’s Death With Dignity Act. See Vacco v. Quill, 521 U.S. 793 (1997). On this latter topic, see also Steve P. Calandrillo, *Corralling Kevorkian: Regulating Physician-Assisted Suicide in America*, 7 VA. J. SOC. POL’Y & L. 41 (1999).
53 509 U.S. 443 (1993). The case concerned a dispute over title related to a joint venture in an oil and gas development project. The jury awarded the lessor of the property $19,000 in compensatory damages and an astounding $10 million in punitive damages. The Supreme Court of West Virginia affirmed the award, and the U.S. Supreme Court found that the punitive judgment in the case was not so “grossly excessive” as to violate substantive due process protections. Id. at 463.
55 TXO Prod. Corp., 509 U.S. at 453-54 (citing Seaboard Air Line R. Co. v. Seegers, 207 U.S. 73, 78, 28 S.Ct. 28 (1907)).
56 Id. at 454.
57 Id. at 462. One year after the TXO case, the Court added to the protections afforded defendants in *Honda v. Oberg*, holding that judicial review of punitive damage awards was necessary because such oversight provided a check on awards that were the result of bias or prejudice toward the defendant. 512 U.S. 415, 432 (1994).
Perhaps cognizant of Justice O’Connor’s fears in Haslip, Justice Kennedy stated in his TXO concurrence that the Court’s review of punitive damages should focus not on some abstract concept like whether an award is “grossly excessive,” but rather should focus on the jury’s actual reasons for its award. The due process protection is not based on a specific dollar amount or ratio, but rather avoidance of “arbitrary or irrational deprivations of property.” Justice Kennedy pointed out that the jury could rationally have made its award based on evidence of the defendant’s “deliberate, wrongful conduct” to meet the State’s goals of punishment and deterrence.

iii. BMW: Three Guideposts

The next significant opportunity for the Court to refine limits on punitive damages came in BMW of North America, Inc. v. Gore, a seminal case in which the jury initially awarded $4,000 in compensatory damages and $4 million in punitive damages to the defrauded owner of a BMW vehicle. The case was based on BMW’s practice of repainting slightly damaged cars and selling them as new without disclosing the damage to buyers. Deciding it was finally time to set out a clear standard for reviewing punitive damage awards, the BMW Court famously laid out “three guideposts” for analysis:

1. the degree of reprehensibility of a defendant’s conduct;
2. the disparity between the harm or potential harm suffered by plaintiff and the punitive damages award (i.e., the “ratio” analysis); and
3. the difference between the punitive damages awarded and the civil penalties authorized or imposed in comparable cases.

The first factor explicitly required a court to examine the degree of reprehensibility of a defendant’s conduct, stating it was “perhaps the most important indicium of the reasonableness of a punitive damages award.” The Court justified its emphasis on this prong by explaining simply that “some wrongs are more blameworthy than others” and thus may support a larger award. In its review of the specific facts of the case, the Court examined whether the harm was purely economic and whether the defendant’s actions demonstrated a “reckless disregard for the health and safety of

59 Id. at 467.
60 Id. at 469. In another concurrence, Justice Scalia reiterated his position that the Constitution requires only reasonable procedural protections and places no “reasonable” limit on the amount of punitive damages. Id. at 471 (Scalia, J., concurring).
62 Id. at 565. The $4 million punitive judgment was later reduced by the Alabama Supreme Court to $2 million, but even that reduction still faced constitutional challenge before the U.S. Supreme Court. Id. at 567.
63 Id. at 562.
64 Id. at 575-85.
65 Id. at 575.
66 Id. at 576.
others.”67 Further, it added that the degree of reprehensibility guidepost may also allow for more severe penalties based on a repeated pattern of bad conduct.68

The second BMW factor dictated that punitive damages must bear a “reasonable relationship” to compensatory damages.69 Justice Stevens explained this comparative ratio analysis, pointing out that the Haslip Court had found a relationship of four to one to be close to the constitutional limit,70 and that the Court in TXO “suggested that the relevant ratio was not more than 10 to 1.”71 The BMW Court rejected the adoption of an absolute mathematical ratio, however, again focusing the inquiry on whether an award was “reasonable.”72 Depending on the other BMW factors, a low compensatory damages award may support a higher ratio if “a particularly egregious act has resulted in only a small amount of economic damages.”73

The third BMW guidepost required a reviewing court to compare the punitive damages award with the relevant civil or criminal penalties for comparable misconduct.74 The goal of this final factor was to use what the legislature had already determined to be a “fair” punishment in assessing society’s distaste for certain conduct.75 Because the Court believed a lesser penalty could have had a similar deterrent effect (a questionable proposition in this author’s opinion; see infra Part III), the large punitive award in BMW was held to be unjustified and unconstitutional.76

iv. Cooper v. Leatherman: Searching Scrutiny of Punitive Awards

In 2001, the Supreme Court added teeth to the BMW standard in the case of Cooper Industries, Inc. v. Leatherman Tool Group, Inc.77 The litigation concerned a dispute between competing tool manufacturers, but the relevant legal issue was whether the Ninth Circuit erred by applying an “abuse-of-discretion” standard to the district court’s consideration of the punitive damages award.78 The Supreme Court held that searching scrutiny must be given to any such punitive verdicts, stating that courts of appeal should apply a de novo standard when reviewing district court determinations of the constitutionality of punitive damages.79 A less demanding abuse-of-discretion standard of review does not pass constitutional muster.

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67 Id.
68 Id. at 577.
69 Id. at 580.
72 Id.
73 Id. at 582.
74 Id. at 583.
75 See id.
76 Id. at 584.
78 Id. at 426. A jury had found the petitioner guilty of unfair competition and awarded respondent $50,000 in compensatory damages and an additional $4.5 million in punitive damages. The district court held that the punitive award did not violate the Constitution, and the Ninth Circuit affirmed while applying a relatively lenient “abuse of discretion” standard to the district court’s determination.
79 Id. at 436-37.
v. State Farm: Defendant’s Reprehensibility is Key; Presumptive Single-Digit Ratio

Not long thereafter, the Supreme Court once again took up the issue of punitive damages in *State Farm Mutual Automobile Insurance Co. v. Campbell*, hoping to clarify the relative importance of the BMW guideposts. State Farm had been sued by the Campbells for bad faith, fraud and intentional infliction of emotional distress arising out of an insurance dispute. Plaintiffs prevailed on the merits, and in the compensatory and punitive damages phase of the trial, they successfully introduced evidence that pertained to State Farm’s business practices in numerous states but which bore no relation to the type of claims underlying the Campbells’ complaint. A Utah jury considering this information returned a $2.6 million compensatory damages judgment topped off by an astounding $145 million in punitives. Not surprisingly, State Farm countered with a substantive due process objection. The Utah Supreme Court stood firm, holding that the punitive award was justified because of State Farm’s “massive wealth,” and because of the fact that State Farm could conceal its conduct so that it would only be punished one out of every 50,000 cases.

The U.S. Supreme Court nevertheless struck down the punitive award against State Farm, finding it to be “grossly excessive” under the BMW guideposts, and could therefore serve no legitimate state purpose. Finding the case “neither close nor difficult,” the Court clarified that BMW factor number one – defendant’s degree of reprehensibility – was the most important indicator of a punitive damages award’s reasonableness.

After laying out these principles and acknowledging that State Farm’s conduct was reprehensible, the Court nonetheless easily determined that the award was

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81 *Id.*
82 *Id.* at 408-09, 412. The trial court subsequently reduced the compensatory portion to $1 million and the punitive remedy to $25 million, but the Utah Supreme Court reinstated the full $145 million award after applying the BMW factors.
83 *Id.* at 415-16.
84 See *id.* at 417-18.
85 *Id.* at 409.
86 *Id.* at 409 (citing BMW of North America, Inc. v. Gore, 517 U.S. 576-77). The Court opined that it “should be presumed that a plaintiff has been made whole by compensatory damages, so punitive damages should be awarded only if the defendant’s culpability is so reprehensible to warrant the imposition of further sanctions to achieve punishment or deterrence.” *Id.*
unjustified since it was based in large part on State Farm’s conduct nationwide.\(^{87}\) Justice Kennedy’s focus was primarily on the fact that each state had independent sovereignty to evaluate and punish conduct occurring within its own borders, but can go no further than that without violating the strictures of due process.\(^{88}\)

In addition, the State Farm Court strongly reinforced the BMW ratio analysis, holding notably that “few awards exceeding a single-digit ratio between punitive and compensatory damages…will satisfy due process.”\(^{89}\) Once again the Court stopped just short of establishing an absolute bright-line rule, but reasoned that single-digit ratios were more likely to survive due process analysis while still achieving a state’s legitimate goal of deterrence and retribution.\(^{90}\)

vi. Philip Morris: Juries Cannot Consider Harm to Nonparties

Next, in 2007, the Court again addressed the propriety of punitive damages in *Philip Morris USA v. Williams*,\(^{91}\) this time explicitly focusing on the question of whether a jury could consider harm to nonparties in assessing punitive awards.\(^{92}\) A jury granted the widow of a longtime smoker $821,000 in compensatory damages stemming from the tobacco company’s wrongful behavior, and a whopping $79.5 million in punitive damages.\(^{93}\) Writing for the Court, Justice Breyer struck down the punitive damage award as a violation of constitutional due process,\(^{94}\) stating that the 14th Amendment requires a defendant to have “an opportunity to present every available defense” before he may be punished.\(^{95}\) The Court reasoned that allowing awards based on harm to nonparties would amount to a taking of defendant’s property because she would have “no opportunity to defend against the charge.”\(^{96}\) Additionally, awards based on harm to nonparties would add a “near standardless dimension” because the number of plaintiffs and the extent of harm could not be established with any certainty.\(^{97}\)

Perhaps realizing that its holding would not adequately deter wrongdoers, however,\(^{98}\) the Court stated that a jury could consider harm to nonparties when deciding

\(^{87}\) Id. at 420-22.
\(^{88}\) Id.
\(^{89}\) Id. at 425 (emphasis added).
\(^{90}\) Id.
\(^{91}\) 549 U.S. 346 (2007). The Court remanded this case to the Oregon Supreme Court for reconsideration based on its holding. Id. at 357-58. The Oregon Supreme Court responded by once again upholding the punitive damages award, this time on independent state grounds. Williams v. Philip Morris, Inc., 344 Or. 45, 48, 176 P.3d 1255 (2008). The Supreme Court granted certiorari to rehear the case, but dismissed it as improperly granted. Philip Morris USA, Inc. v. Williams, 128 S. Ct. 2904 (2008); Philip Morris USA, Inc. v. Williams, 129 S. Ct. 1436 (2009).
\(^{92}\) Philip Morris USA, 549 U.S at 349.
\(^{93}\) Id. at 350.
\(^{94}\) Id. at 349.
\(^{95}\) Id. at 353 (citing Lindsey v. Normet, 405 U.S. 56, 66 (1972)).
\(^{96}\) Id.
\(^{97}\) Id. at 354.
\(^{98}\) See infra, Part III, discussing the law & economics notion that the deterrence goal of punitive damages demands that society should force defendants to pay for the times they escaped liability, including for harms defendants caused to nonparties who decided it was not worth their time or money to sue, or to nonparties who never even realized that they were harmed by defendants’ actions.
the reprehensibility of a defendant’s conduct. Justice Breyer made valiant efforts to explain this confusing distinction:

[T]he Due Process Clause prohibits a State’s inflicting punishment for harm caused to strangers to the litigation. At the same time we recognize that conduct that risks harm to many is likely more reprehensible than conduct that risks harm to only a few. And a jury consequently may take this fact into account in determining reprehensibility.

Rather than solving the difficulty in applying such a double standard, the Court merely held that states may not use procedures that “create an unreasonable and unnecessary risk” of juries punishing defendants for harm to nonparties.

vii. Exxon Valdez: Punitive Damages Jurisprudence Meets Maritime Law

Coming to the case upon which this paper takes a special interest, the Supreme Court most recently confronted its tortured punitive damage jurisprudence in 2008 in the aftermath of the infamous Exxon Valdez oil spill. The tragedy spawned one of the most epic class-action lawsuits in history, spanning an unbelievable twenty years of bitter litigation that involved tens of thousands of devastated plaintiffs and almost incomprehensible environmental devastation. This time the Court faced the additional wrinkle of operating under maritime law as it wrestled with the proper scope of punitive damage awards. In 1989, the Exxon Valdez supertanker ran aground off the coast of Alaska, spilling eleven millions of gallons of oil into Prince William Sound. The ship’s captain, Joseph Hazelwood, was drunk at the time of the accident and a jury determined that Exxon recklessly failed to address Captain Hazelwood’s history of alcoholism. Exxon settled its claims with the United States and the State of Alaska for spill cleanup, agreeing to pay substantial fines in the millions of dollars and far more than that to restore natural resources. Plaintiffs in the remaining litigation were commercial fishermen, native Alaskans, and landowners who sought compensation for actual harm caused by the spill – for price diminishment in their fisheries, reduced value

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99 Philip Morris USA v. Williams, 549 U.S. 346, 357 (2007). Professor Chemerinsky pointed out the confusion that would result from the Court’s holding, stating that “[t]rial judges are likely to struggle for years with formulating jury instructions that simultaneously tell the jury to consider and not consider harm to people other than the plaintiffs.” Erwin Chemerinsky, More Questions About Punitive Damages, 43 TRIAL 72, 72 (May 2007).
100 Philip Morris USA, 549 U.S. at 357.
101 Id.
103 See Gabrielle Nomura, Exxon Valdez Ruling Sinks Fisherman’s Hopes: Lawsuits Offers Too Little, Too Late for Those Whose Dreams Floated on Tainted Waters, BELLINGHAM BUSINESS J., Aug. 1, 2008 (providing a brief history of the sad affair, and chronicling the toll it has taken on countless fisherman in Alaska).
104 Exxon Shipping Co., 128 S. Ct. at 2611.
105 Id. at 2613.
106 Id.
of their fishing vessels and permits, harm to the general tourist trade, and for debilitating emotional distress and pain and suffering injuries.\textsuperscript{107} The jury awarded $287 million in compensatory damages, which after settlements and other payments reached approximately $500 million, and a staggering $5 billion in punitive damages against Exxon.\textsuperscript{108} After decades of subsequent painful litigation challenging the constitutionality of the award, this $5 billion punitive remedy was reduced to $4.5 billion, $4 billion and then to $2.5 billion by 2006.\textsuperscript{109} Finally, in 2008, the Supreme Court threw out the vast majority of the remaining punitive damage judgment, reducing it to just $507.5 million, or one-tenth the original verdict.\textsuperscript{110}

Justice Souter, writing for the Court, significantly relied primarily on maritime law rather than on due process to reject the punitive damages award,\textsuperscript{111} and generally ignored the fact that maritime law barred many elements of actual harm from being compensated for in the first place.\textsuperscript{112} Like prior Supreme Court jurisprudence, however, much of the majority opinion focused on the problem of remedying unpredictability in imposing punitive damages in order to bring such awards in line with procedural due process concerns against arbitrary judgments.\textsuperscript{113} Since punitive damages express society’s disapproval over the moral quality of a defendant’s conduct, Justice Souter was understandably worried about determining a consistent measure of society’s need for retribution.\textsuperscript{114} Citing numerous quantitative studies, Justice Souter determined that the median ratio is generally 1:1 between compensatory and punitive damages awards.\textsuperscript{115}

\textsuperscript{107} Id.
\textsuperscript{108} Id. at 2614.
\textsuperscript{109} See In re Exxon Valdez, 472 F.3d 600, 625 (9th Cir. 2006) (per curiam).
\textsuperscript{110} Exxon Shipping Co., 128 S. Ct. at 2633-34.
\textsuperscript{111} Id. at 2626.
\textsuperscript{112} See Brief Amici Curiae of Sociologists, Psychologists, and Law and Economics Scholars in Support of Respondents, Exxon Shipping Co. v. Baker, 128 S. Ct. 2605 (No. 07-219), 2008 WL 275482 (hereinafter “Brief Amici Curiae of Law & Economic Scholars”). Plaintiffs had alleged that many economic harms, including lost value to fishing vessels and permits, as well as emotional harms, had gone uncompensated under the idiosyncrasies of maritime law.

In the interest of full disclosure, this paper’s author was one of the contributors to and signatories of this amicus brief, employing an economics-based argument in favor of punitive damages against Exxon rather than relying on the unprincipled and arbitrary approach taken by past Supreme Court punitive damages cases. Despite this argument, Justice Souter stated that the Court “take[s] for granted the District Court’s calculation of the total relevant compensatory damages at $507.5 million,” without examining Plaintiffs claims that many elements of actually harm were precluded from this figure. Exxon Shipping Co., 128 S. Ct. at 2634.

\textsuperscript{113} Exxon Shipping Co., 128 S. Ct. at 2629. Stanford law professor Jeffrey Fisher has recently argued that in light of the Exxon Valdez case, the Court’s fears today are in fact largely procedural, not substantive, in nature. See Jeffrey L. Fisher, The Exxon Valdez and Regularizing Punishment, 26 ALASKA L. REV. 1 (2009). Professor Fisher suggests that what the Court is really attempting to accomplish is the “regularization of punishment” in order to avoid wide disparities in sanctions for similarly harmful acts. Id. at 5. He concludes that the courts should therefore defer to legislatures (and the standards they craft) in regulating the appropriate size of punitive damages awards. Id. at 25.

\textsuperscript{114} Exxon Shipping Co., 128 S. Ct. at 2620-21.

\textsuperscript{115} Id. at 2624-25. Interestingly, despite Justice Souter’s wide ranging survey of empirical statistical evidence, the authors of one of the studies he relied upon have written a paper disputing Justice Souter’s interpretation of their own work. See Theodore Eisenberg, Michael Heise, and Martin T. Wells, Variability in Punitive Damages: An Empirical Assessment of the U.S. Supreme Court’s Decision in Exxon Shipping Co. v. Baker, CORNELL LAW SCHOOL LEGAL STUDIES RESEARCH PAPER
Accordingly, the Court held that a ratio of 1:1 should “roughly express jurors’ sense of reasonable penalties in [maritime] cases with no earmarks of exceptional blameworthiness within the punishable spectrum.”116 Despite this outcome, some legal scholars and academics had hoped the Court would utilize punitive damages as a means to address the uncompensated harms resulting from unique limits under maritime law.117 Specifically, maritime law does not allow victims to recover for consequential economic damages (such as price declines in fishing vessels, permits, and tourist revenues), or for pain and suffering damages, leaving the plaintiffs in the case to bear much of the harm themselves.118 Justice Souter dismissed the attempt to use punitive damages as extra-compensatory, insisting that “punitives are aimed not at compensation but principally at retribution and deterring harmful conduct.”119 In doing so, the Court completely ignored the reality that its holding could have exactly the opposite effect of that it intended. If a defendant escapes liability for a portion of the harm it causes (due to the quirks of maritime law for example), then it will necessarily have a diluted incentive to take proper care, foiling society’s deterrence objective.120

III. A PRINCIPLED ECONOMIC APPROACH TO SETTING PUNITIVE DAMAGES – OR, WHY THE SUPREME COURT NEEDS A LESSON IN LAW & ECONOMICS

Employing a law and economics lens provides a dramatically different and far more principled approach to punitive damage jurisprudence than that adopted by our own Supreme Court. Instead of engendering debates in each case over irresolvable factors like “reasonableness” and “moral reprehensibility,” an economic approach views the assessment of punitive damages from a private and social deterrence perspective.121 Punishment for punishment-sake is not the proper goal because inconsistency and unfairness are guaranteed by pursuing such a course. Rather, legal rules (including

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116 Exxon Shipping Co., 128 S. Ct. at 2633.
117 See Brief Amici Curiae of Law and Economics Scholars, supra note 112. See also Exxon Shipping Co., 128 S. Ct. at 2636-37 (Stevens, J., concurring in part and dissenting in part).
118 See Exxon Shipping Co. v. Airport Depot Diner, Inc. 120 F.3d 166, 167 n. 3 (9th Cir. 1997) (hereinafter Exxon 1) (plaintiffs could not recover for “emotional distress damages, price diminishment in fisheries that were not oiled, diminished value of limited entry fishing permits or fishing vessels absent a sale of the permit or vessel, . . . [and] diminution of market value owing to fear or stigma.”).
119 Exxon Shipping Co., 128 S.Ct. at 2621.
120 Brief Amici Curiae of Law & Economics Scholars, supra note 112, at 19-26; Polinsky & Shavell, supra note 19, at 887-96.
121 See Polinsky & Shavell, supra note 19, at 870-77; Cooter, Punitive Damages for Deterrence: When and How Much?, 40 ALA. L. REV. 1143, 1149-66 (1989); Chapman & Trebilcock, supra note 19.
PENALIZING PUNITIVE DAMAGES (CALANDRILLO)

punitive damage awards) should seek to appropriately deter socially undesirable acts and maximize overall social welfare.

A. The Dichotomy Between the Traditional versus Economic Approach to Law: A Simple Example

Let us take a simple example to highlight the dichotomy between the traditional versus economic approach to the law. Imagine an automobile factory produces pollution that causes a harm of $1 million to nearby residents. Let’s further assume that the factory can install a smoke arrestor at a cost of $2 million. Should the factory make the purchase – i.e., is it socially optimal to use our legal system to require it to do so? Obviously not, since the cost of preventing the harm outweighs the resulting damage. However, if the factory faced a punitive damage award of $5 million for intentionally or recklessly failing to install the smoke arrestor, it may very well indeed make the decision to purchase one. Simply put, indiscriminate punitive damage awards have the potential to create perverse second-order consequences, as Justice O’Connor feared decades ago. The company may choose to go out of business, decrease production, or pass on the cost of the punitive award in the form of higher prices to all customers.

As a second example, consider a company that ships oil. The company can choose to single-hull, double-hull, or triple-hull its boats in the interest of safety. In considering the appropriate level of care to be taken, let us imagine that the direct cost of production of an oil-based product is $20. Further, assume that the harm from an oil-spill accident would be $100, and that the probability of an accident \((p)\) varies with the level of care taken. Let’s consider the optimal level of care that the firm should take in the table below:

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122 This analysis assumes that the factory is unable to bargain with nearby residents to gain the right to pollute. The seminal Coase theorem dictates that the parties will bargain around the legal rule whenever a mutually beneficial agreement is possible, assuming no transaction costs prevent the negotiation. Thus, in a world without transaction costs, the factory would pay the neighbors $1 million (or slightly more) to gain the right to pollute even if the governing gave neighbors the legal entitlement to clean air. See STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW, 83-84 (2004).

123 See Haslip, 499 U.S. at 42-43 (O’Connor, J., dissenting). Justice O’Connor opened her dissent boldly:

Punitive damages are a powerful weapon. Imposed wisely and with restraint, they have the potential to advance legitimate state interests. Imposed indiscriminately, they have a devastating potential for harm. Regrettably, common-law procedures for awarding punitive damages fall into the latter category. States routinely authorize civil juries to impose punitive damages without providing them any meaningful instructions on how to do so. Rarely is a jury told anything more specific than “do what you think is best.” (citing Browning-Ferris Indus. of Vt., Inc. v. Kelco Disposal, Inc., 492 U.S. 257, 281 (Brennan, J., concurring).

124 In this example, optimal care would be medium (i.e., double hull tankers), and the resulting full “price” of the product incorporating care and expected accidents would be $27.
If it chooses to single-hull its boats, the company can lower prices, but will significantly increase the likelihood of catastrophic accidents, so the total social costs are quite high ($30). If the company chooses to triple-hull its boats, it reduces the likelihood of accidents, but increases its costs of care dramatically, which leads to higher prices and lower levels of activity. Because the double-hull tanker balances both cost and safety, it might indeed prove to be the best option from society’s perspective even if it presents slightly greater risk of oil spills than a triple hull tanker would (because total social costs are lowest at $27). Hence, lawmakers should adopt rules or regulations that incentivize the firm to take this moderate level of care – not too high and not too low.

However, if we assume that the firm might face punitive damages of ten times the amount of harm (i.e., $1,000) if it causes an accident, let us reconsider the firm’s cost-benefit calculus:

<table>
<thead>
<tr>
<th>Level of Care</th>
<th>Cost of Care</th>
<th>Accident Probability</th>
<th>Expected Accident Losses</th>
<th>Total Social Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>none (single hull)</td>
<td>0</td>
<td>10%</td>
<td>.10 x 100 = 10</td>
<td>0 + 20 + 110 = 130</td>
</tr>
<tr>
<td>*medium care (double hull)</td>
<td>4</td>
<td>3%</td>
<td>.03 x 100 = 3</td>
<td>4 + 3 + 20 = 27*</td>
</tr>
<tr>
<td>very high care (triple hull)</td>
<td>10</td>
<td>2%</td>
<td>.02 x 100 = 2</td>
<td>10 + 2 + 20 = 32*</td>
</tr>
</tbody>
</table>

Thus, a firm facing a potential $1,000 punitive damage judgment would rationally choose to take very high care, for that minimizes the total costs it expects to face. This outcome is perverse from society’s perspective, however, as it leads to dramatically increased prices. The firm would now have to charge $52 to cover the expected punitive liability (even though the full social cost when firms employ optimal medium care is just $27).125

Some traditional jurists might respond, “well, what’s the problem with forcing the firm to triple hull its tankers in the interest of safety and raising price to $52?” Unfortunately, there is a serious problem with that logic. To see its flaws more clearly, let’s now examine how unwarranted punitive damage liability impacts customer welfare. Imagine a world of four potential customers whose utility from using the oil-based product is as follows:

Conversely, setting damages below actual harm caused will allow the firm off the hook for a portion of the injuries it creates, and it might therefore rationally choose to only single-hull its tankers to avoid significant safety expenses. Clearly then, if damages are arbitrarily set too high or too low, we will witness a suboptimal result from an economic deterrence perspective.

125 Conversely, setting damages below actual harm caused will allow the firm off the hook for a portion of the injuries it creates, and it might therefore rationally choose to only single-hull its tankers to avoid significant safety expenses. Clearly then, if damages are arbitrarily set too high or too low, we will witness a suboptimal result from an economic deterrence perspective.
Who purchases this oil-based product now? Only A does, because B and C cannot afford a pricetag of $52. However, it is clear from this simple example that it is socially optimal for A, B, and C to all buy the product in a perfect world, since they all value it at greater than its full social cost of $27. Significantly, indiscriminate punitive damage awards have the potential to prevent people whose utility from a product exceeds its full social cost from being able to gain access to the product. This outcome is due to the unfortunate fact that firms will be incentivized to take excess care to try to avoid the unnecessarily high punitive damage judgment, leading to substantial price increases and quantity decreases.126

i. Impacts of the Ill-Considered Traditional Legal Approach

a. Philip Morris Hypothetical

To demonstrate a real-world application of the economic theory laid out above, consider the Philip Morris case once again. Because the Court refused to make Philip Morris pay for the harms it caused to nonparties to the litigation,127 Philip Morris was (and still may be) partially underdeterred from creating harm to consumers. Let’s assume that Philip Morris caused $10 worth of harm to ten different actors by producing dangerous tobacco products, but only one party found it worth the time and expense to actually sue for compensation. If that was indeed the case, then Philip Morris caused total social harm of $100, but only was held to pay for $10 of this harm because the Supreme Court explicitly prohibited any consideration of harm to nonparties in assessing the punitive damage award.128 Philip Morris – or any other similarly situated tortfeasor – would therefore rationally continue its behavior as long as it gained a benefit of more than $10, rather than the socially optimal result of making Philip Morris consider (and answer for) all of the social costs it was imposing on the public.129

Alternatively, if the Supreme Court had upheld an enormous punitive damages award without employing this type of economic thinking (e.g., perhaps because the defendant had extraordinarily deep pockets or was particularly reprehensible in its behavior), Philip Morris may have been overdeterred. Using the same oversimplified hypothetical as above, if a jury assessed a punitive damage award of $1,000 when actual

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126 See Polinsky & Shavell, supra note 19, at 877-900.
127 Philip Morris USA, Inc. v. Williams, 549 U.S. 346, 349 (2007) (holding that punitive damages awards based in part on jury’s desire to punish defendant for harming nonparties amounts to a taking of property from defendant without due process of law).
128 Id.
129 See generally Polinsky & Shavell, supra note 19, at 887-96 (detailing firms’ diluted incentive to take care if they can escape liability some portion of the time they create harm).
total harm was only $100, then Philip Morris would likely take extraordinary efforts to avoid paying these damages. If Philip Morris (or consumers) gained $120 of value from its activity, then net social welfare would increase by $20 by keeping the company in operation (i.e., $120 benefit minus $100 harm). If Philip Morris faced a $1,000 punitive damages award, however, it would no longer choose to engage in this line of business at all and social welfare would correspondingly decline.\textsuperscript{130}

b. Judgment-Proof Independent Contractors

A final problematic impact of ill-considered punitive damage awards is that companies which potentially face such judgments will have a perverse incentive to contract out their dangerous shipping activities to judgment-proof independent contractors who care not a whit about taking precautions because they lack the financial resources to pay any damages that they might inflict.\textsuperscript{131} In the event its low level of care produces a catastrophic accident (and results in a punitive damage award), the independent contractor can simply hand over its low level of cash on hand, declare bankruptcy, and walk away from the financial impact of the judgment.\textsuperscript{132}

In fact, huge oil conglomerates now engage in this practice precisely because of the fear of the initial punitive damages award in Exxon. For example, oil giant Shell was recently criticized by Justice Ruth Bader Ginsburg for attempting to avoid liability for cleanup costs at a Superfund site near Bakersfield, California, arguing that the damage created by spilling its product was caused by an independent third party.\textsuperscript{133} In addition, in 2002, one such independent contractor sailing the oil tanker Prestige sank off the coast of Spain, killing more than 250,000 seabirds, affecting 30,000 jobs, and costing in excess of $2 billion to clean up.\textsuperscript{134} The ship was owned by a Greek company, registered in Liberia, carrying a Bahaman flag, and chartered by a Russian oil-trading company.\textsuperscript{135} Not surprisingly, the ship was an ancient single-hull tanker constructed in 1974 that should never have been chartered in the first place. One can clearly see that the traditional legal approach has so far produced unwanted and perverse consequences that must be fixed before greater harm results.

\textsuperscript{130} \textit{Id.} While it might be difficult for the reader to humor this hypothetical considering the devastating harm created by tobacco products, it must indeed be the case that smokers gain some net utility from using a product that they know significantly decreases their life expectancy by raising their cancer and heart disease risk.

\textsuperscript{131} See Polinsky & Shavell, supra note 19, at 942-45. Firms facing potentially large punitive damage awards have an incentive to use independent contractors because any resulting liability from accidents falls on the contractor instead of the firm. If the contractor is “judgment proof” – i.e., capitalized below the level of the harm it might produce – it can take suboptimal care without the fear of facing huge liability.

\textsuperscript{132} \textit{Id.}


\textsuperscript{134} See Dale Fuchs, A Seeping Tanker Turns Spain’s Beaches into an Oily Sandbox, N.Y. TIMES, Aug. 31, 2003.

\textsuperscript{135} See Emma Daly, Off Galicia, Spill Spreads Devastation and Doubt, N.Y. TIMES, Nov. 21, 2002.
B. Optimal Deterrence: When and How Should Punitive Damages be Awarded?

Thus, the sensible goal of an economic approach to punitive damages is to properly deter wrongdoers – by setting damages equal to actual harm assuming that defendants are always caught. At the same time, juries must also be vigilant to avoid indiscriminately handing out excessive punitive damage awards, not merely because of the Supreme Court’s due process concerns, but rather, due to fear of potentially creating devastating negative second-order effects: overdeterrence, decreased productivity, increased cost, decreased consumption and a decline in overall social welfare.

Does this mean that law and economists are categorically opposed to awarding punitive damages in all cases? Absolutely not, but the justification for such awards has little to do with moral reprehensibility and everything to do with creating optimal incentives towards socially appropriate levels of care. For example, if a defendant escapes suit 50% of the time, then total damages in the case actually litigated should be set at twice actual harm to adequately deter defendant’s wrongful conduct. If defendant escapes liability 99% of the time it causes harm, then total damages should be set at 100 times actual harm in order to incentivize the defendant to take care – and due process is not at all violated by doing so!

Thus, punitive damages should – nay, must – be imposed for deterrence purposes whenever a defendant has a chance to escape liability, even in the absence of morally egregious behavior. A principled economic approach to punitive awards dictates that they should be calculated by multiplying the actual harm in the instant case by the inverse of the probability that the defendant escaped liability if he is not caught when he ought to be.

C. Avoidance of Liability

But why do we assume that defendants are evading liability on occasion? A defendant’s avoidance of legal consequences might be due to his intentional concealment of a wrongful act, or even to sheer serendipity. Take, for example, an automobile company that intentionally disguises the fact that it is repainting its cars to look like they are new (as in BMW), or a company that conceals information about a product defect from consumers. Less sinisterly, one might imagine a factory that emits low-level pollution which is difficult for victims to detect. In either case, the firm is likely to avoid being sued in all of the cases in which it creates harm because of the difficulty victims face in seeing it. Punitive damage awards must step in to fill this void in compensating victims when the defendant actually does indeed find itself caught.

136 See Polinsky & Shavell, supra note 19, at 878-87 (discussing optimal level of damages when defendants are found liable with certainty).
137 Id. at 870-77.
138 Id. at 887-96.
139 Id.
140 Id. at 889. Polinsky & Shavell offer an algebraic formula as well: If H is the harm and p is the probability of being caught, then the injurer should pay a total of: H x (1/p) – i.e., H/p – when he is found liable. In this manner, the injurer’s expected damages will be p x (H/p) = H. Id. at 889, n. 48.
Without doing so, defendants will systematically face diluted incentives to take socially optimal levels of care.

i. Application: Motel 6 Bedbugs Case (Judge Posner)

Moreover, even in examples where victims know they have been harmed, there are many situations in which the magnitude of the damage is small enough that it is not worth the victim’s time to litigate. For example, in *Mathias v. Accor Economy Lodging, Inc.*, defendants were operators of a Motel 6 chain in Chicago and plaintiffs sued after suffering bedbug bites during a stay. The jury awarded a mere $5,000 in compensatory damages, but a substantial $186,000 verdict in the form of punitive damages to each of the two plaintiffs. Relying on the Supreme Court’s misguided *BMW* and *State Farm* reasoning, defendants argued vigorously that punitive damages could not exceed $20,000. Specifically, the defendants pointed directly to language in *State Farm* suggesting that “few awards [of punitive damages] exceeding a single-digit ratio between punitive and compensatory damages . . . will satisfy due process,” and the further arbitrary statement that “four times the amount of compensatory damages might be close to the line of constitutional impropriety.”

Fortunately, Judge Posner rejected this bright-line argument, opting instead for a law and economics analysis of the punitive damages award. Posner opined persuasively that substantial punitive damages were in fact necessary to create adequate deterrence because many individuals harmed by Motel 6’s actions suffered such minor injuries that they would rationally choose not to sue and bear the costs of litigation. The punitive damages award in *Mathias* therefore: serve[d] the additional purpose of limiting the defendant’s ability to profit from its fraud by escaping detection and (private) prosecution. If a tortfeasor is ‘caught’ only half the time he commits torts, then when he is caught he should be punished twice as heavily in order to make up for the times he gets away.

D. Summary of the Economic Approach to Punitive Damages

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141 347 F.3d 672 (7th Cir. 2003).
142 Id. at 673. Journalist Jan Greenberg described the facts more vividly: “A day after Burl and Desiree Mathias arrived in Chicago for a packaging trade show, they found themselves itching to get away – at least from their downtown hotel overrun with bedbugs. After a night in the Motel 6 on East Ontario Street, the brother and sister awoke to find itchy bumps all over their bodies, and the next evening they found the culprit: legions of insects scurrying about in their beds. Hotel management wasn’t surprised by their horrified complaints, because it had been renting out rooms infested with bedbugs for months to unsuspecting customers.” Jan Crawford Greenburg, *Big Award in Bug Case Stirs Debate*, Nov. 24, 2003, available at http://www.savefarscape.com/forums/archive/index.php/t-17909.html.
143 *Mathias*, 347 F.3d at 674.
144 Id. at 675-76.
146 *Mathias*, 347 F.3d at 676 (quoting *State Farm*, 538 U.S. at 425).
147 Id.
148 Id. at 677.
149 Id. (emphasis added).
Thus, law and economists view punitive damage awards as an opportunity to create optimal deterrence by “making up” for the occasions where the defendant has previously avoided liability (for whatever reason), and failed to compensate for the full harm caused. Moreover, it should be emphasized here that no degree of morally offensive behavior is required before a punitive award is justified in the above scenarios. A “morally innocent” tortfeasor who allowed bedbugs to bite customers should still be asked to compensate victims in all of the occasions in which it escaped liability, or else it will face diluted incentives to take adequate care in the future.

On the other hand, sound economic analysis dictates that imposing punitive damages well beyond actual harm simply because a tortfeasor’s behavior was morally reprehensible can inadvertently lead to overdeterrence, prices up beyond optimal, quantity of goods purchased far below optimal, and a significant reduction in overall social welfare. Consider once again the oil-shipping company example discussed above. If punitive damages are assessed far above actual harm because of a drunken ship captain’s morally reprehensible behavior, then the company will do everything it can to avoid confronting those damages in the future. The company may choose to triple hull its ships, which would dramatically increase oil prices, leaving consumers to bear the resulting costs. Alternatively, the deep-pocket firm will hire judgment-proof independent contractors to engage in work that runs the risk of punitive damages because undercapitalized companies need not worry about their level of care or corresponding liability exposure. Clearly, the traditional legal approach to punitive damage awards can produce socially perverse consequences that need to be fixed before even greater harm materializes.

IV. A REEXAMINATION OF THE SUPREME COURT’S MISGUIDED APPROACH TO PUNITIVE DAMAGES

Given the principled economic analysis of punitive damages law presented above, the flaws in the Supreme Court’s approach quickly become apparent. In its early punitive damage jurisprudence, the Court shied away from drawing a hard line, choosing instead to focus on procedures it hoped would avoid arbitrary results. In Haslip, the Court held that a jury’s discretion with respect to the amount of punitive damages must be subject to “reasonable constraints.”

Because the jury was given seven specific factors to consider, the Court upheld the award.

In TXO, the Court added that punitive damages may not be “grossly excessive,” but upheld a significantly large award because of the potential loss to the plaintiff if TXO’s wrongful acts had been successful in creating greater harm.

By the time of the BMW case, the Supreme Court realized it needed to lay down more specific guidelines to govern its due process analysis. The Court famously laid out three “guideposts”: (1) the degree of defendant’s reprehensibility, (2) the ratio between

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151 Id. at 21-22.
152 Id. at 22. The Court also suggested that a ratio of four times compensatory damages “may be close to the line” beyond which punitive damages could not go. Id. at 23.
154 Id. at 463.
compensatory and punitive damages, and (3) the comparison of the punitive award to civil penalties in similar cases. 155 Justice Stevens pointed out in his ratio analysis that, while there was no specific bright-line, 156 punitive damages awards generally could not exceed ten times compensatory damages. 157 In doing so, the Court hoped that this would lead to more predictable results and stem the tide of litigation. 158

Unfortunately, BMW only opened the floodgates to debate and controversy regarding its guideposts and limitations. In 2003, the Court granted certiorari in the State Farm case in order to “clarify” that the moral reprehensibility of the defendant was the most crucial of the BMW guideposts. 159 The Court further explored the allowable ratio of compensatory to punitive damages, reiterating that awards ten times above actual harm would be considered constitutionally suspect. 160 Despite these refinements, the Court offered no principled guidance to juries as to how to place a non-arbitrary monetary figure on reprehensibility, or any sensible explanation for why an award nine times beyond actual harm was presumptively sound whereas one that was ten times larger was not. Ironically, the State Farm Court believed that its ruling would lead to increased predictability because “the point of due process – [and] of the law in general – is to allow citizens to order their behavior.” 161

Worse than that, the Supreme Court in State Farm and then in Philip Morris also prohibited juries from taking into consideration any of the harm to the myriad parties not present in the litigation. 162 In so doing, the Court effectively allowed each defendant to avoid paying for the vast majority of the harm it had caused. 163 There is little doubt that such a verdict will inevitably dilute the deterrent impact on other similarly situated tortfeasors. Why take socially optimal care if you are only required to pay for a portion of the harm you actually cause?

Finally, the recent Exxon Valdez decision only served to prove the point that the Supreme Court’s punitive damage jurisprudence was a tortured mess. Hoping to once and forever put punitive damages law to a well-settled rest, the Court limited punitive damages in maritime cases to an amount equal to compensatory damages. 164 Ignoring

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156 Id. at 582.
157 Id.
158 Id. at 574 (“constitutional jurisprudence dictate[s] that a person receive fair notice not only of the conduct that will subject him to punishment, but also of the severity of the penalty that a State may impose”) (internal citations omitted).
160 Id. at 424-28.
161 Id. at 418 (citing Pacific Mutual Life Ins. Co. v. Haslip, 499 U.S. 1, 59 (O’Connor, J. dissenting)).
163 Of course, the Supreme Court’s rationale in barring consideration of harm to nonparties was that doing so would violate defendant’s due process rights to confront its accusers. Philip Morris, 549 U.S. at 353-54 (“[A] defendant threatened with punishment for injuring a nonparty victim has no opportunity to defend against the charge”); see also State Farm, 538 U.S. at 423 (“Due process does not permit courts, in the calculation of punitive damages, to adjudicate the merits of other parties’ hypothetical claims against a defendant under the guise of the reprehensibility analysis”). While that makes sense, there was no balancing of that factor against the competing principle that defendants should compensate all victims that it harmed, or else would necessarily face diluted incentives to avoid injuring them again in the future.
the reality that Exxon was escaping a substantial portion of liability for the harm it had caused to the Alaskan communities and businesses who were not “physically oiled” by the spill, the Court instead arbitrarily determined that the jury’s outrage could adequately be expressed by punitive damages set exactly equal to compensatory damages. Justice Souter declared, “In a well-functioning system, we would expect that awards [of approximately a 1 to 1 ratio between compensatory and punitive damages] would roughly express jurors’ sense of reasonable penalties in cases with no earmarks of exceptional blameworthiness within the punishable spectrum.”

Despite these convoluted attempts at preserving constitutional due process protections, if the Supreme Court truly wishes to eliminate arbitrary and unpredictable punitive damages awards, the Justices must dramatically revise their approach to the entire issue. There is no legally or economically principled justification for a jury to award punitives based on emotional gut reactions to how badly it feels a defendant acted. Rather, principled jurists understand that punitive damages should be awarded only where tortfeasors have the potential to escape liability for their actions. Thus, a defendant whose wrongful behavior is detected only 1% of the time should face a punitive damage award of 99 times actual harm when it is indeed caught (resulting in a total judgment of $1.01 = 100 times harm in the instant case). Likewise, punitive damages should be awarded in that case even if the defendant in no way meets the modern tort requirements of egregious behavior necessary. Given this simple economic analysis, the Supreme Court’s arbitrary due process litmus test of “ten times actual damages” as a constitutional ceiling on punitive damages makes zero sense, and needs to be summarily abolished. It is high time that punitive awards create proper incentives to take socially optimal care – rather than arbitrarily exacerbate society’s deterrence and punishment goals.

V. HOW TO CORRECTLY DEAL WITH SPECIAL CASES LIKE EXXON VALDEZ

The Exxon Valdez case provides a unique example of where a law and economics approach produces a far more predictable and principled result to dealing with punitive damages than traditional jurists have been able to devise.

A. History of the Litigation

Let us revisit and explore the sad history of the case in some depth. On March 24, 1989, the Exxon Valdez oil tanker crashed into Bligh Reef in Prince William Sound, Alaska. The spill devastated the surrounding communities, destroying marine life, the fishing industry, tourism, and society in local towns. In the wake of the spill,
investigators discovered that Captain Hazelwood was drunk at the time of the accident, leaving his post right before the ship was to make a critical turn. Further investigation revealed that Hazelwood was an alcoholic and that Exxon was aware of this fact. In fact, Hazelwood had consumed at least five double vodkas at waterfront bars on the night of the spill, and was known to habitually drink in bars, parking lots, apartments, airports, airplanes, restaurants, hotels, at various ports, and aboard other Exxon tankers.

The spill resulted not just in massive environmental destruction but also triggered an epic twenty-year litigation involving over 32,000 plaintiffs. Exxon settled with the United States for violations of numerous federal statutes, ultimately paying approximately $125 million in fines and restitution. Exxon paid another $900 million in response to a civil action by the United States and Alaska. The company paid an additional $303 million in settlements to fishermen, property owners, and other parties harmed by the spill.

Countless other civil suits remained after these settlements, and ultimately the district court for the District of Alaska certified a mandatory class of those plaintiffs seeking punitive damages. These plaintiffs were commercial fishermen, Native Alaskans, and landowners. The court split the case into three phases: Phase I examined whether Exxon and Captain Hazelwood had been reckless and could therefore be subject to punitive damages; Phase II set the amount of compensatory damages for commercial fisherman and Native Alaskans; and Phase III set the amount of punitive damages. The jury ultimately awarded $287 million in compensatory damages to commercial fishermen, which after settlements and other payments reached approximately $500 million. Native Alaskans, in two settlements, agreed to $22.6 million. But the shocking attention-grabber was the fact that the jury also awarded a stunning $5 billion in punitive damages against Exxon as well, a sum that was then and still is today by far the single largest punitive damages verdict in history.

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170 Exxon Shipping Co., 128 S. Ct. at 2612-13. At the moment in time when the tanker needed to move west to avoid the underwater reef off Bligh Island, Hazelwood inexplicably left the bridge, later claiming he needed to go down to his cabin in order to fill out paperwork. Before doing so, he made matters worse by putting the tanker on autopilot, speeding it up, making the turn more difficult, and making any mistake harder to correct. He decided to put his third mate Joseph Cousins in charge, despite Cousins’ fatigue and lack of training to navigate the dangerous waters. Id.
171 In re the Exxon Valdez, 296 F. Supp. 2d 1071, 1076 (D. Alaska 2004), vacated and remanded by In re Exxon Valdez, 472 F.3d 600 (9th Cir. 2006). Captain Hazelwood had in fact completed a 28-day alcohol treatment program while employed by Exxon, but dropped out of a prescribed follow-up program and stopped going to Alcoholics Anonymous Meetings. See Exxon Shipping Co., 128 S.Ct. at 2612.
172 See id.
173 See id. at 2613.
174 Id.
175 Id.
176 Id.
177 Id.
178 Id.
179 Id.
180 Id.
181 Id. at 2614.
182 Id. at 2614.
Traditional legal jurists justified the initial $5 billion punitive damages award by pointing to Exxon’s reprehensible behavior in allowing a drunk ship captain to pilot such a dangerous vessel.\(^\text{183}\) The fact that Exxon knew about Captain Hazelwood’s history of alcoholism but did little about it evidently did not sit well with the jury, or with most Americans for that matter.\(^\text{184}\) This staggering punitive damages award triggered seemingly endless subsequent litigation. While Exxon admitted wrongdoing and was more than willing to pay the compensatory judgment, it vigorously challenged the constitutionality of the punitive damages portion of the verdict.

On appeal, the Ninth Circuit realized that the award might be constitutionally suspect based on the decisions in *BMW* and *Leatherman*, and therefore remanded for reconsideration.\(^\text{185}\) The district court held firm, however, finding that the award was justified under the three *BMW* guideposts.\(^\text{186}\) It remitted the punitive damages slightly from $5 billion to $4 billion based on plaintiffs’ willingness to accept such a judgment, which also brought the total number in line with the “single-digit ratio analysis” suggested in *BMW*.\(^\text{187}\) Exxon appealed again, but before the parties submitted any briefing, the Supreme Court decided *State Farm*,\(^\text{188}\) prompting the Ninth Circuit to remand without opinion.\(^\text{189}\) On its third analysis of the case, the district court added discussion of the *State Farm* holding, once again determining that the original $5 billion was constitutionally acceptable.\(^\text{190}\) Because the case had been remanded specifically for reduction of the punitive damages award, though, the district court agreed to reduce the award to $4.5 billion, roughly nine times the compensatory award.\(^\text{191}\) On appeal, after considering yet another remand to a defiant district court,\(^\text{192}\) the Ninth Circuit decided to remit the award to $2.5 billion – a legal “splitting of the baby” if you will.\(^\text{193}\) The U.S. Supreme Court subsequently granted certiorari to end the legal wrangling once and for all, and to explicitly address the issue of punitive damages in the maritime context.\(^\text{194}\)

Six of the nine Supreme Court Justices agreed with Exxon that the jury had indeed chosen an arbitrary amount to award as punitive damages,\(^\text{195}\) and concluded that Exxon’s conduct was morally reprehensible in a dollar amount set exactly equal to compensatory damages.\(^\text{196}\) “In a well-functioning system,” Justice Souter opined, “we would expect that awards [of less than or equal to a 1 to 1 ratio between compensatory and punitive damages] would roughly express jurors’ sense of reasonable penalties in cases with no earmarks of exceptional blameworthiness within the punishable

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\(^{183}\) See id. at 2613-14.

\(^{184}\) See *In re Exxon Valdez*, 296 F. Supp. 2d 1071, 1077 ((D. Alaska 2004), vacated and remanded by *In re Exxon Valdez*, 472 F.3d 600 (9th Cir. 2006).

\(^{185}\) *In re Exxon Valdez*, 270 F.3d 1215, 1241 (9th Cir. 2001).


\(^{187}\) Id.

\(^{188}\) 538 U.S. 408 (2003).

\(^{189}\) See *in re Exxon Valdez*, 296 F. Supp. 2d 1071, 1075 (D. Alaska 2004).

\(^{190}\) Id. at 1110.

\(^{191}\) Id.

\(^{192}\) *In re Exxon Valdez*, 472 F.3d 600, 625 (9th Cir. 2006) (per curiam).

\(^{193}\) *In re Exxon Valdez*, 490 F.3d 1066, 1095 (9th Cir. 2007) (per curiam).


\(^{195}\) See id. at 2633-34.

\(^{196}\) See id.
spectrum.” In the middle of 2009, the Ninth Circuit tacked on 5.9% interest from 1996 to the present date to account for the fact that plaintiffs were due this money long ago.

B. Traditional Economic Analysis of Exxon Valdez

One very interesting point worth exploring in the Exxon Valdez case was that many notable law and economic scholars, including intellectual giants Mitch Polinsky and Steven Shavell, were employed as consultants by the defendant oil company to argue that punitive damages were completely unnecessary altogether. Their argument was generally as follows: the chance of an oil conglomerate escaping litigation after dumping millions of barrels of oil across the coast of Alaska are essentially zero. Therefore, all the legal system needs to do to properly incentivize Exxon to take due care is to impose damages in the amount of actual harm. Anything larger than that will overdeter, increase prices, and lead to negative second-order consequences. For example, consumers might wind up paying $5 per gallon of gas, or Exxon and other similarly situated oil conglomerates might begin to hire judgment-proof (and dangerous) independent contractors to ship their oil in order to avoid massive liability exposure.

C. Maritime Law Changes the Equation: Three Categories of Uncompensated Harm

That argument initially possessed appeal to the author of this paper, until he learned of the hugely consequential differences between modern tort law and the well-established maritime law governing the Exxon Valdez disaster. Unfortunately, both traditional legal jurists as well as traditional law and economists largely failed to consider the harms precluded by maritime law for which Exxon effectively escaped liability. The plaintiffs – commercial fishermen, native Alaskans, and landowners – sought compensation for a number of injuries that would have been available under modern tort law but which the idiosyncrasies of well-established maritime law prohibited. These uncompensated harms fell into three categories: (1) economic harm from the spill that was precluded by the landmark 1927 maritime case of Robins Dry Dock, (2) economic harm prohibited by maritime law because the extent of harm was unknown at the time of the spill, and (3) non-economic harm, such as emotional distress and pain and suffering, arising from the spill. As a result, plaintiffs failed to recover for substantial price diminishment in fisheries that were not oiled, diminished value of

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197 Id. at 2633.
199 See Polinsky & Shavell, supra note 19, at 870 n.*, 903-04.
200 Id.
201 Id.
202 See supra Part III.A.1.b. and accompanying text, on the potential for indiscriminately large punitive damage awards to incentivize deep-pocket firms to hire judgment-proof independent contractors to engage in the more risky lines of their business.
203 See Brief Amici Curiae of Law & Economics Scholars, supra note 112, at 3-18.
205 See Brief Amici Curiae of Law & Economics Scholars, supra note 112, at 3-4.
fishing permits and fishing vessels, lost tax revenue, damage to area tourism, and for the significant pain and suffering caused by the disaster. Each of these categories should be explored briefly to assess the magnitude of the uncompensated harm, starting with the preclusionary effect on damages under the courts’ Robins Dry Dock rulings.

i. Robins Dry Dock: Substantial Economic Damages to Fisherman, Fishing Vessels, Permits, and Area Tourism were Largely Excluded

In Robins Dry Dock, charterers of a ship sued the operators of a dry dock after the dock damaged the ship’s propeller, delaying the charterers’ ability to use the ship. The charterers did not own the ship, and the dry dock was working under a contract with the ship’s owners. Justice Holmes, writing for the Court, barred the plaintiffs from recovering against the dry dock because, as charterers and not owners, they were not a party to the dry dock contract. In addition, the plaintiffs could not recover because, while they suffered consequential damages, they suffered no physical injury.

The Robins Dry Dock ruling was generally an attempt to place a policy limitation on the extent of maritime damages, in much the same way as the requirement of proximate causation operates in land-based torts. Land-based torts generally focus on whether harm is foreseeable, or as Professor Dan Dobbs has stated: “The most general and pervasive approach to proximate cause holds that a negligent defendant is liable for all the general kinds of harms he foreseeably risked by his negligent conduct to the class of persons he put at risk by that conduct.” Anything beyond that is excluded from recovery. In maritime-based torts, Robins Dry Dock analogously placed a further restriction on foreseeability, requiring physical damage to a proprietary interest as well. Thus, even though it was completely foreseeable that Exxon’s oil spill would

206 See Exxon Shipping Co. v. Airport Depot Diner, Inc., 120 F.3d 166, 167 n. 3 (9th Cir. 1997); Brief Amici Curiae of Law & Economics Scholars, supra note 112, at 3.
208 Id. at 308-09.
209 Id. (emphasis added).
210 See THOMAS J. SCHOENBAUM, ADMIRALTY AND MARITIME LAW, § 12-7 (4th ed. 2004). Much of the controversy surrounding the Robins Dry Dock rule stems from the issue of whether to apply a rule of negligent interference with contract or more traditional tort doctrines. See, e.g., Kinsman Transit Co. v. City of Buffalo, 388 F.2d 821, 823-24 (2d Cir. 1968) (“we hesitate to accept the ‘negligent interference with contract’ doctrine . . . several cases often cited as illustrations of the application of the . . . doctrine have been convincingly explained in terms of other more common tort principles.”). See id.
211 See Robins Dry Dock, 275 U.S. at 308-09; see also State of Louisiana v. M/V Testbank, 752 F.2d 1019, 1021 (5th Cir. 1985) (en banc) (no recovery of economic losses caused by shipping accident without physical damage to plaintiff’s property, although perhaps injury was foreseeable). Judge Wisdom vigorously disagreed with the M/V Testbank majority in his dissent, opting instead to apply the traditional tort principles of foreseeability and proximate causation because he felt this would lead to more fair and economically reasonable results. See id. at 1029, 1032.

Courts have carved out an extremely limited exception to this general maritime prohibition created by Robins Dry Dock, allowing commercial fisherman to recover economic damages even in the absence of physical harm. See Union Oil Co. v. Oppen, 501 F.2d 558 (9th Cir. 1974). Later courts have struggled to apply the general Robins Dry Dock rule, finding it difficult to determine.
damage the local fishing industry, if those fishermen and vessels were not physically touched by the oil, there was limited recovery available.

Unfortunately for the plaintiffs in Exxon Valdez, the ramifications of Robins Dry Dock were dramatic: substantial components of measurable harm, likely totaling in the hundreds of millions of dollars, were excluded from their compensatory damages judgment.215 Among the items precluded were damages to commercial fishermen in areas not oiled because of the stigma associated with fish from Alaskan waters;216 loss of profits for residents of local towns reliant on the fishing trade, including those who repaired boats, manufactured fishing nets, and provided goods and services to commercial fishermen;217 and loss of profits in the tourism industry.218 Local governments also lost significant tax revenues because of fisheries closures.219 Worst of all, the oil spill caused the value of fishing permits to plummet, a devastating loss to Alaskan fishing communities.220 Because of the uncertainty caused by the oil spill as to the recovery of the fishing grounds, individual permits lost $100,000 to $200,000 in value.221 Fishermen were left with useless equipment and permission to fish in an ecosystem that had been ravaged and emptied – as one victim put it starkly, “they’ve lost everything.”222

ii. Harm that was Unknown at the Time of Trial was Not Recovered

Secondly, the Exxon Valdez oil spill caused additional uncompensated harm in the form of economic damages the extent of which was unknown at the time of trial in 1994.223

when a “physical damage” component should apply and when the questions should simply be one of foreseeability and proximate causation. Compare Kinsman Transit Co., 388 F.3d at 825 (denying recovery where neither plaintiff “suffered any direct or immediate damage for which recovery [was] sought.”), with Union Oil Co. v. Oppen, 501 F.2d 558, 568 (9th Cir. 1974) (permitting recovery for commercial fishermen even in the absence of physical injury because the harm to plaintiffs was foreseeable and imposition of liability would lower the likelihood of future harm). The Ninth Circuit in Union Oil specifically refused to apply the Robins Dry Dock rule because fishermen enjoy a favored position in admiralty such that “their interests [are] entitled to the fullest possible legal protection.” Union Oil Co., 501 F.2d at 567.

See Brief Amici Curiae of Law & Economics Scholars, supra note 112, at 4-6.

See id.; see also Brief Amici Curiae of Law & Economics Scholars, supra note 112 at 4.

See Exxon 1, 120 F.3d at 168 n. 3.


See Brief Amici Curiae of Law & Economics Scholars, supra note 112 at 4-5. The price of fishing permits in Alaska is based entirely on demand, which fell precipitously in the wake of the Exxon Valdez oil spill. Id. (citing Charles Seibert, After the Spill, MEN’S JOURNAL, Apr. 1999).

Id.; see also J. Steven Picou & Cecelia G. Martin, Long-Term Community Impacts of the Exxon Valdez Oil Spill: Patterns of Social Disruption and Psychological Stress Seventeen Years After the Disaster 14 (2007) (final report submitted to National Science Foundation).

See Nomura, supra note 103. One victim, David Mann noted that at least 65% of fisherman plying the waters before the spill are now gone. “They’ve lost everything. And to add insult to injury, after losing business, losing everything and waiting 20 years, they find out it’s worth [almost nothing].”

See Brief Amici Curiae of Law & Economics Scholars, supra note 112 at 6.
When the initial trial took place, scientists dismissed links between the collapse of the Prince William Sound herring fishery and the Exxon Valdez crash, but further research suggested that the fishery collapse occurred immediately after the spill. As a result of this timing, plaintiffs were unable to recover complete damages for harm to the fishery. Over the ensuing two decades, some plaintiffs attempted to reopen consideration of the damages that were unknown at the time of trial, but relatively little has been successfully recovered to date.

### iii. Sociological, Cultural and Emotional Distress Damages were Barred

The third major category of uncompensated harm resulting from the Exxon Valdez oil spill was the purely non-economic harm injury, namely the sociological, cultural and emotional distress damage that accompanied the disaster. Research in the wake of the Exxon Valdez crash has revealed that communities around Prince William Sound were devastated by the spill and its impact on the area’s natural resources. Sociologists have found that, in addition to the physical destruction, disasters can have “significant impacts on mental health functioning” because of the disruption and stress they cause. Prominent scholar Steven Picou’s research has added that disasters caused by human error, such as the Exxon Valdez oil spill, also tend to have longer-lasting and more severe social, cultural, and psychological effects than other natural disasters. In communities based largely on the economic existence of natural resources for harvest and use, this man-made disaster created stress from economic uncertainty,

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224 See id. (citing Richard E. Thorne & Gary L. Thomas, Herring and the “Exxon Valdez” Oil Spill: An Investigation into Historical Data Conflicts, 65 ICES J. MARINE SCI. 44 (2007).

225 See William H. Rodgers, Jr. et al., The Exxon Valdez Reopener: Natural Resources Damage Settlements and Roads Not Taken, 22 ALASKA L. REV. 135 (2005). Prof. Rodgers and colleagues urged the United States government and the state of Alaska to make their “reopener claims” (for $92 million in additional compensation) under the terms of the 1992 settlement. However, yet another lawsuit will be necessary to collect this money. See Email from William Rodgers, July 14, 2009 (on file with author).

226 Brief Amici Curiae of Law & Economics Scholars, supra note 112 at 7.

227 Id.


231 Picou, Disruption and Stress, supra note 229 at 239.
of subsistence, and from “a unique relationship to the resources that have been contaminated, i.e., subsistence and/or commercial harvests.”

Furthermore, the Exxon Valdez tragedy caused the deaths of thousands of birds and marine animals, as well as severe declines in herring and pink salmon fisheries. The ecological effects of the spill were in fact so severe that many still persist: the herring fishery was closed eleven of the seventeen years after the spill and has still not fully recovered. Clean-up efforts strained local resources with the influx of aid workers and created social conflicts between locals who participated in the clean-up and those who did not. Residents exposed to the spill experienced high rates of anxiety, depression and even post-traumatic stress disorder. After all was said and done, the almost incomprehensible cultural, social, and psychological damage caused by the Exxon Valdez disaster was never close to adequately addressed or repaired by the compensatory damages awarded in the case.

D. Punitive Damages in Exxon Valdez Would Truly be Quasi-Compensatory

Hence, although Exxon had little chance of escaping liability generally (it is concededly unlikely that such a massive oil spill would go undetected and

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232 Id.
233 Id. The communities surrounding Prince William Sound derived much of their cultural, social, and economic identity from the available natural resources, the destruction of which caused significant non-economic harm. See Brief Amici Curiae of Law & Economics Scholars, supra note 112, at 10 (citing Picou, Disruption and Stress, supra note 229). The community of Cordova, for example, relied heavily on commercial fishing and subsistence harvesting. See id. at 11 (citing Picou & Gill, Chronic Psychological Stress, supra note 230 at 884). Members of the community depend on the fisheries for jobs; they depend on natural resources activities as a means of maintaining social relationships as well as being “a part of how individuals define themselves and their quality of life.” See Brief Amici Curiae of Law & Economics Scholars, supra note 112 at 11; Picou, Disruption and Stress, supra note at 241; and Arata, supra note 228 at 26.
234 See Picou, Disruption and Stress, supra note 229 at 240-41 (a summary of environmental impacts recently lodged in United States District Court (Alaska) reports that 3,500 to 5,500 sea otters were killed directly by the spill and over 350,000 birds perished.)
235 See Picou, Disaster, Litigation, supra note 230 at 1501 (noting that the damage appears to be related to chronic contamination of spawning areas in Prince William Sound); see also Charles H. Peterson, et al., Long-Term Ecosystem Response to the Exxon Valdez Oil Spill, SCIENCE, Dec. 19, 2003; Mark G. Carls, et al., Sensitivity of Fish Embryos to Weather Crude Oil: Part I, 18 ENVTL. TOXICOLOGY AND CHEMISTRY 481, 481 (1999) (Study conducted to evaluate the effects of oil on herring eggs in conditions similar to the Exxon Valdez spill supported the conclusion that the spill causes significant damage to herring eggs and larvae in Prince William Sound).
236 See Exxon Valdez Oil Spill Trustee Council, http://www.evostc.state.ak.us/Recovery/status.cfm (visiting June 4, 2009) (Listing the Pacific Herring as “Not Recovering” because it has shown “little or no clear improvement since spill injuries occurred.”); see also Bryan Walsh, Still Digging Up Exxon Valdez Oil, 20 Years Later, TIME, Jun. 4, 2009, http://www.time.com/time/health/article/0,8599,1902333,00.html.
237 Id. (citing Endter-Wada, et al., supra note 218 at 366-68, 384-87, 389-93; Mari Rodin et al., Community Impacts Resulting from the Exxon Valdez Oil Spill, 6 INDUS. CRISIS Q. 219, 223-26 (1992)).
238 Brief Amici Curiae of Law & Economics Scholars, supra note 112 at 14-15.
239 Id. (citing L.A. Palinkas et al., Community Patterns of Psychiatric Disorders After the Exxon Valdez Oil Spill, 150 Am. J. Psychiatry 1517-23 (1993)).
unlitigated),\textsuperscript{240} it ended up escaping liability for many of the harms it caused due to the quirks of governing maritime law. In essence, Exxon was never forced to pay for the full damage it imposed, never was made to internalize all social harms it caused, and thus still faces a diluted incentive to take due care.\textsuperscript{241}

The law and economics approach seeks to correct this inadequacy by using punitive damages as a kind of “gap-filler” to hold Exxon accountable for all harms caused.\textsuperscript{242} In this sense, the punitive award would really be “quasi-compensatory,”\textsuperscript{243} as opposed to true “punishment” beyond actual harm caused. In this sense, the name “punitive” is a misnomer, because the economic justification for punitive awards is based on the principle of creating optimal deterrence, as opposed to punishment per se. The punitive judgment would be based not on punishing the immorality of Exxon’s conduct, but instead on the full social cost impact of its actions. This approach would eliminate arbitrary awards and lead to proper deterrence, as companies such as Exxon would be faced with a predictable economic calculus for determining how to model their behavior in the most effective fashion, incorporating all the benefits they create and all the costs they impose on society.

Justice Souter explicitly rejected the “quasi-compensatory” rationale, however, stating that “this Court has long held that ‘punitive damages by definition are not intended to compensate the injured party, but rather to punish the tortfeasor . . . and to deter him and others from similar extreme conduct.’”\textsuperscript{244} While that proposition is undoubtedly true under various Court precedents, it ignores the fact that the Court’s holding accomplishes precisely the opposite of this worthy goal: thousands of innocent plaintiffs never received full and just compensation for their actual losses. Such an outcome inevitably runs afoul of the deterrence and punishment goals that the Supreme Court was supposedly furthering.\textsuperscript{245}

VI. CONCLUSION

Modern Supreme Court punitive damages jurisprudence has increasingly focused on the Due Process Clause of the Fourteenth Amendment as placing a constitutional limit on the size of any punitive award.\textsuperscript{246} The Court has repeatedly stressed its concerns

\textsuperscript{240} See Polinsky & Shavell, supra note 19 at 904.
\textsuperscript{241} See Brief Amici Curiae of Law & Economics Scholars, supra note 112, at 20.
\textsuperscript{242} See id. at 22.
\textsuperscript{243} See id. at 18-23. See generally Chapman & Trebilcock, supra note 19 (discussing punitive damages as a means of compensating for dignitary loss), Ellis, supra note 22 (suggesting that compensating victims for otherwise uncompensable losses are reasons frequently cited by jurists for imposing punitive awards);
\textsuperscript{244} See Exxon Shipping Co., 128 S.Ct. at 2633 (citing Newport v. Fact Concerts, Inc., 453 U.S. 247, 266-67 (1981)).
\textsuperscript{245} But cf. Polinsky & Shavell, supra note 19, at 939-40 (arguing that rather than using punitive damages to serve this quasi-compensatory role, that the remedies for missing components of harm would be best pursued through revision of the rules used to calculate compensatory damages).
\textsuperscript{246} See, e.g., BMW of North America, Inc., 517 U.S. 559, 574 (1996) (due process requires “fair notice not only of the conduct that will subject [a person] to punishment, but also the severity of the penalty that a State may impose”); State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 416 (2003) (“The Due Process Clause of the Fourteenth Amendment prohibits the imposition of grossly excessive or arbitrary punishments on a tortfeasor.”); Philip Morris USA, Inc. v. Williams, 549 U.S.
with the arbitrary and unpredictable nature of such judgments, and therefore has set out a
variety of tortured tests to help defendants avoid unnecessary or unfair exposure to
liability.\(^{247}\) The Court remains convinced that the defendant’s degree of moral
reprehensibility be the most important factor in the jury’s calculus,\(^{248}\) and that the
Constitution would be inherently suspect of any punitive verdict that exceeded nine
times actual damages.\(^{249}\) Anything greater than that magic line would likely be
considered “grossly excessive” and run afoul of the Due Process maxim that the
“punishment should fit the crime.”\(^{250}\)

Unfortunately, despite numerous attempts, our Supreme Court still employs
undefined, unprincipled and largely subjective terms that do little or nothing to correct
the arbitrary nature of punitive damages awards that it seems to fear so greatly. It is far
from clear that standards such as “grossly excessive” have consistent meanings across
various juries and cases. While ever-fearful of returning to a Lochner-esque approach to
substantive due process,\(^{251}\) the Court draws a bright-line rule that lacks reason (i.e.,
punitive damages cannot exceed a “single-digit multiple” of the compensatory award)
based on an implicit sense of unfairness and lack of notice to wrongdoers. Ironically,
this approach fails to adequately address the Court’s biggest concern: that punitive
damages awards are arbitrary and illogical, based not on the actual conduct of a

\(^{246}\) See BMW, 517 U.S. 575 (punitive damages must be evaluated based on the defendant’s degree of
reprehensibility, the ratio between the actual or potential harm and the punitive damages award, and
the difference between the punitive award and civil penalties imposed for comparable cases); State
Farm, 538 U.S. at 418 (punitive damages that do not fit within the BMW guideposts are “grossly
excessive”); Philip Morris USA, 549 U.S. at 353 (punitive damages cannot be applied to punish a
defendant for injuries to nonparties); Exxon Shipping Co., 128 S. Ct. at 2633 (punitive damages in
maritime cases may not exceed compensatory damages).

\(^{247}\) State Farm, 538 U.S. at 419 (“[T]he most important indicium of the reasonableness of a punitive
damages award is the degree of reprehensibility of the defendant’s conduct.” (quoting BMW, 517 U.S.
at 575)).

\(^{248}\) BMW, 517 U.S. at 582 (prior case law suggested “that the relevant ratio was not more than 10 to
1”); State Farm, 538 U.S. at 425 (“few awards exceeding a single-digit ratio between punitive and
compensatory damages, to a significant degree, will satisfy due process.”).

\(^{250}\) See BMW, 517 U.S. at 575, n. 24 (“The principle that punishment should fit the crime is deeply
rooted and frequently repeated in common-law jurisprudence.”)

\(^{251}\) The Supreme Court’s decision in Lochner v. New York, 198 U.S. 45 (1905), is “one of the most
condemned cases in the United States history.” BERNARD H. SIEGAN, ECONOMIC LIBERTIES AND THE
CONSTITUTION 23 (1980). The Court in Lochner held that due process created a substantive right to
freedom of contract, even though no such right was explicitly stated in the Constitution. Lochner, 198
U.S. at 64. Justice White expressed the Court’s fears about creating substantive rights when he
stated:

The Court is most vulnerable and comes nearest to illegitimacy when it deals with
judge-made constitutional law having little or no cognizable roots in the language or
design of the Constitution. . . . There should be, therefore, great resistance to expand
the substantive reach of [the Due Process Clauses of the Fifth and Fourteenth
Amendments] particularly if it requires redefining the category of rights deemed to
be fundamental.

(2003).
defendant or society’s need for deterrence, but instead on a jury’s emotional reaction toward this type of defendant (often a corporation with deep pockets and little sympathetic appeal).

Moreover, the Supreme Court’s misguided approach to punitive damages law and to the issue of creating optimal deterrence dramatically differs from that of sound law and economics principles. The Court seeks to deter undesirable behavior by examining how “morally egregious” a particular defendant’s conduct was and its relative wealth in order to determine how great of a penalty is necessary to make the defendant feel the consequences. Neither factor attempts to address the root of the problem: what amount of damages is necessary to incentivize injurers to take socially optimal care – not too much, and not too little.

By contrast, a principled economic approach to punitive damage jurisprudence would look far different. While current jurists and scholars largely base their opinions on gut reactions that they have to morally reprehensible behavior, legal legends like Oliver Wendell Holmes recognize that we need to separate emotion from the law in order to create law that makes sense. Legal rules should be aimed at systematically creating appropriate levels of deterrence in society, and that depends on the circumstances of each case and whether a defendant had an opportunity to escape litigation in previous cases. That realization means that the last thing we need our Supreme Court to do is hand down arbitrary lines in the sand like “ten times actual damages is too much.” Conversely, it requires careful thought about when punitive damages can compensate for the chance that a defendant may have otherwise escaped liability, and therefore needs to have his sanction increased in the instant case in order to create optimal deterrence.

The law’s ultimate goal in the punitive damages context should be to formulate legal rules that maximize social welfare: that translates into setting damages that are not too high and not too low, and which are carefully calibrated to the circumstances of each case. When a defendant can avoid liability – either due to intentional concealment of wrongful facts or to innocent serendipity that plaintiffs find it not worth their while to sue – punitive damages are justified. They should be set by multiplying the inverse of the probability of detection by the amount of actual harm in the instant case, a figure which could greatly exceed ten times actual damages without raising any constitutional red flags. On the other hand, when a defendant does not escape liability for harm it causes, punitive damages are completely unnecessary to deter and only create perverse second order consequences: price increases, decreased productivity, and reduced social welfare. It is at least two decades past time that the Supreme Court understand this problem and adopt the principled approach outlined herein. Otherwise, further litigation

252 See supra, Part III.
253 See HOLMES, supra note 3, at 458-69. Holmes made this observation in the context of contract law, noting that “nowhere is the confusion between legal and moral ideas more manifest than in the law of contract.” Holmes further expounded upon the “bad man” theory of the law, urging that if an observer wants to learn the law and nothing else, he “must look at it as a bad man, who cares only for the material consequences which such knowledge enables him to predict, not as a good one, who finds his reason for conduct, whether inside the law or outside of it, in the vaguer sanctions of conscience.” Id.
254 See supra, Part III.
255 See generally BMW, 517 U.S. at 582; State Farm, 538 U.S. at 425.
is sure to continue, further unfairness is certain to result, and our Court and society will both be the worse for it.