Corporate Wealth: The 800-Pound Gorilla that Sabotages Fair Adjudication of Punitive Damages

by Andrew L. Frey

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The first punitive damages case I argued before the U.S. Supreme Court, *Browning Ferris Industries of Vermont v. Keico Disposal Co.*, 492 U.S. 257 (1989), involved punitives of $6 million, which I thought at the time was exceptionally hefty. Today, most big companies would probably breathe a sigh of relief if a jury, having found them to have engaged in punishable conduct, returned such a "modest" punitive verdict. Verdicts in the tens of millions have become increasingly commonplace, those in the hundreds of millions not all that infrequent, and multibillion dollar punishments by no means unheard of.

It seems perfectly obvious, to this writer at least, that by far the most significant factor fueling the drive over the past couple of decades to ever larger punitive awards is evidence of corporate finances, and instructions and arguments that punitive damages should be set on the basis of defendants' net worth. It is easy to see why.

Picture yourself as a dedicated kindergarten teacher, expert computer programmer, landscape designer, or retired postal worker who is serving on a jury in a civil trial at which punitive damages are in issue. You have just awarded the plaintiff $1 million in actual damages and found that her injuries were caused by reckless misconduct on the part of employees of the defendant company. You also have found that such conduct supports liability for punitive damages. Your task now is to set a punitive amount. This task is totally unlike anything you have done before. In performing it, you are given precious little guidance in the jury instructions, and you are not told what level of award has been deemed proper in other, comparable cases. Should the punitive damages be in the thousands? Millions? Hundreds of millions? The predictable result of this lack of guidance, through no fault of the jurors, is a randomness and capriciousness in punitive verdicts. This phenomenon is confirmed by recent empirical scholarly work. *See* Sunstein et al., *Punitive Damages: How Juries Decide* (2002).

In such circumstances, a juror who is at sea naturally seeks some numerical frame of reference to anchor the inquiry. The defendant's financial data —

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showing assets in the hundreds of millions or billions for many corporate defendants — supply such an anchor, and it's a whopper. Use of financial evidence as a basis for setting punishments is driven home by the plaintiffs' arguments that only a very large penalty will "get the attention" of a very large corporate defendant, accompanied by an invitation to use a percentage of the defendant's net worth in the same way they would impose penalties upon persons of modest means. The argument goes like this: If a person earning $50,000 per year engaged in comparable conduct and you would set punitive damages at $5,000, or 10 percent of his annual income, why should this greedy corporation, with revenues of $5 billion a year, receive better treatment? Such arguments are in turn greatly reinforced in most jurisdictions by instructions identifying the defendant's net worth as an affirmative basis for setting punishment. In California, for example, juries have been instructed as follows: "In view of [defendant's] financial condition, what amount is necessary to punish it and discourage future wrongful conduct?" Cal. Jury Inst. (BAJI), Civ. No. 14.71 (2004).

I know from personal experience that these arguments and instructions make a difference. I handled the appeal in a case in which the jury had returned a punitive verdict of more than $150 million. In post-trial interviews, the jurors generally agreed that although they believed that the defendant manufacturer should have acted differently and that punitive damages were appropriate, they did not view its conduct as especially heinous. For that reason, the jury imposed only "modest" punitive damages — modest, at least, in relation to the defendant's $30 billion net worth. This is a striking, real-world example of the "anchoring effect" of financial evidence.

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In our legal system, criminal fines or judicial or administrative civil penalties, like punitive damages, are intended to serve the goals of effective deterrence and just punishment. But fines and penalties are rarely if ever calibrated to the defendant's financial circumstances, except insofar as a defendant's impecuniousness may be grounds for reducing the penalty that would otherwise be imposed. Nevertheless, of the 45 or so states that allow the imposition of punitive damages for aggravated torts, all but a handful have permitted evidence of the defendant's finances to be adduced and argued as a legitimate factor in setting this amount. Many courts see no problem with this result and simply assume that a defendant's wealth is a proper benchmark for assessing punitive damages, even though wealth is not ordinarily a factor in the size of a criminal fine or civil penalty. Where did this attitude come from?

Punishment Fits the Criminal

It is interesting to note that consideration of wealth was rare in 19th century punitive damages case law. As the Iowa Supreme Court stated, "while some of the cases have held, that the pecuniary condition of the defendant may be shown, when plaintiff is entitled to vindictive damages … yet it is believed that the weight of authority is the other way." *Hunt v. Chicago & N.W.R.R.*,

26 Iowa 363, 373 (1868). And it was the very end of the century before the first case in which corporate finances had been admitted for punishment-setting purposes, *Washington Gas-Light Co. v. Lansden*, 172 U.S. 534 (1899), reached the U.S. Supreme Court, although the Court's disposition of the case rendered it unnecessary to consider the propriety of the practice.

Today, however, there is a widespread belief that, at least when it comes to punitive damages, the punishment should fit not so much the crime as the criminal. It is often argued that a big company will not be deterred by a punishment that is proportionate to the harm it has caused and the gravity of its misconduct, rather than to its net worth, income, or revenues. This notion derives, I believe, from a faulty analogy to the intuitive notion — not altogether unreasonable — that a punishment that is adequate to deter an actor of modest means will not suffice to deter a very wealthy person. That concept, however, makes sense only with respect to wrongs that are motivated by noneconomic considerations. For example, the risk of a $25 fine for parking illegally may not deter a wealthy person, who may be willing to pay the $25 for the convenience of parking close to his destination. In contrast, a person of modest means would likely choose to walk a few extra blocks to avoid the penalty. Thus, consideration of a defendant's financial resources may serve an entirely reasonable purpose when done in the context of an individual committing a noneconomic tort. The penalty that is needed to deter an individual from committing an assault, or painting racially offensive graffiti, or poisoning his neighbor's noisy dog will depend on the wrongdoer's wealth because it is necessary to "monetarize" the satisfaction derived from the misconduct.

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This rationale falls apart, however, when the tort has economic motives. Economists who are knowledgeable about deterrence theory are virtually unanimous in the view that it makes no sense to set punitive damages on the basis of corporate financial data. Why is that so? Because the theoretical basis for considering a defendant's wealth does not apply when it comes to economically motivated torts. In such circumstances, what dictates the amount of punishment needed to accomplish optimal deterrence is not the defendant's overall wealth but the economic circumstances of the *specific transaction at issue in the cas*e. What loss did the victim suffer? What gain did the defendant expect and actually reap from the conduct at issue? What penalty would be necessary to alter the economic calculus of the defendant and others similarly situated, to provide appropriate incentives to deter repetition of the conduct at issue?

The overall net worth of a defendant is unrelated to these issues. A company that manufactures hundreds of safe and useful products as well as one defective product that injured a plaintiff can be deterred by a penalty that eliminates the profit attributable to the defective product without further punishing the defendant for the economic success of its many safe and useful products. Whether the defendant is rich or poor, large or small, the elimination of the prospect of profit from the *specific misconduct to be deterred* is what deter-

mines the efficacy of the deterrence and whether it is insufficient, appropriate, or excessive to accomplish its objective. Put another way, it simply is not true that a rich defendant, because of the size of its resources, will be unresponsive to a sanction that removes the prospect of profit from the misconduct at issue.

Thus, where the wrongdoer is acting to realize economic benefits, the "right" penalty for deterrence purposes is one set at a level that removes the economic incentives for the wrongful conduct. Ordinarily, economic theory tells us, compensatory damages do precisely that, and an overlay of substantial punitive damages based on wealth unrelated to the wrongful conduct risks undesirable over-deterrence. In any event, the optimal level of monetary liability for deterrence purposes has nothing to do with the wrongdoer's size. Big companies are as much interested in profits as little ones; remove the prospect of profit from undesirable behavior, and the big company will be as much deterred. (Indeed, if the theory that large companies ignore any amount that is small in relation to their overall finances were sound, those of us with large corporate clients could with impunity charge them $5,000 per hour. I am quite confident, however, that this would no more be accepted by my "wealthier" corporate clients than by those with more modest balance sheets.)

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An illustration will demonstrate the point. Suppose there are two pizza delivery companies — Joe's Pizzeria and Nationwide Pizza — competing in a particular city for business by promising the fastest home delivery. And suppose further that each company seeks to make good on its swift delivery promises by encouraging its drivers to speed, ignore red lights, and park illegally. Finally, suppose Nationwide is 100 times the size of Joe's. The level of penalty necessary to induce these businesses to stop ignoring the traffic laws is the amount that makes it unprofitable to reap whatever benefits attach to the extra increment of speed realized by illegal driving. That penalty is the same for each, despite their disparity in size. True, if $100 per violation is the right amount, no single penalty will cause Nationwide's board of directors to address the practice. But that isn't necessary because the accumulation of fines will cause the local branch to start losing money; that in turn will jeopardize the branch manager's job and therefore induce him to reform his drivers' practices.

In fact, enhancing penalties based on net worth or other financial indicia will actually result in larger companies' having to pay a higher proportion of net worth in punitive damages. Consider two insurance companies, Goliath Insurance and David Insurance, that are morally equivalent. Each has the same claims-handling procedures, and the same proportion of their employees are bad apples. Suppose that Goliath processes 1 million claims a year and David 100,000, and that Goliath's net worth is ten times as great as David's. Each is successfully sued for bad-faith mishandling of one claim in every 20,000 it processes and found liable for punitive damages in such instances. If each individual case resulted in punitive damages set at 1 percent of net worth, any seeming parity of treatment would be a mirage. In fact, Goliath

would pay not ten times as much as David, as might seem appropriate given their respective sizes and equivalent culpability, but *100 times* as much (10 times as many cases x 10 times as large a punishment in each case); and it would forfeit 50 percent of its net worth to David's 5 percent.

In short, the conventional theory entirely overlooks that larger companies have more transactions, which generate more litigation, which in turn creates greater punitive damages exposure. If the penalties are also jacked up because of the size of the company, the result is manifest double-counting and *disproportionately higher* liability. This makes no economic sense.

But, you might still ask (especially if you are a plaintiff's lawyer), don't the punitive damages have to be large enough to cause the company to change its policies? The answer is an emphatic no. First and foremost, the verdict of any single jury cannot be counted as a reliable indicator of objective reality. Rather, the verdict in any given case is the product of a host of unpredictable and possibly idiosyncratic factors, including the comparative skill of the lawyers; the demeanor and attractiveness of each side's expert witnesses; the impact of hindsight bias, which is a recognized phenomenon skewing jurors' assessments of the propriety of pre-accident conduct; and the personal experiences and belief sets of the particular six or nine or 12 people constituting the jury. The fact is that the same body of evidence frequently produces different outcomes in different cases. For that reason, any single verdict may be aberrational, and no single jury should be accorded power disproportionate to its task, which is to resolve the dispute of the parties before it. I hear no one saying that if the defendant wins the first case, it should be immune from liability in any future cases involving the same allegations, yet that is every bit as reasonable as supposing that a single jury should be empowered to compel a defendant to change its practices through a punitive award that will "get the attention of the board of directors."

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There is also the associated problem of overdeterrence. Blockbuster verdicts, to the extent they are in fact effective to bring about changes, may induce companies to take excessive precautions that raise the costs to consumers of goods and services beyond any associated benefit, or that reduce the availability or utility of products. This happened in the 1980s with child vaccines and general aviation aircraft. A regime of punitive awards tied to the defendant's finances is a prescription for overdeterrence.

In addition, in my experience, most awards of punitive damages are met with considerable skepticism by company personnel, who often genuinely believe the company did nothing wrong and ought not change its policies because a jury, in the isolating and emotional crucible of a trial, came to a contrary conclusion. Indeed, often a finding of punishable or even merely tortious conduct is an outlier. The outcome of a particular case is one datum — but only one — to be considered in deciding whether changes are in order. It should not be converted into the proverbial 800-pound gorilla, sweeping aside all other inputs. If enough juries reach the same conclusion, the accumulated liability

will provide ample incentive for change. But no single jury should be given power disproportionate to the matter before it.

The mechanism that confines each jury to its proper domain is the requirement that punitive damages be reasonably related to a plaintiff's actual damages. Where the same conduct by a defendant has inflicted injuries to or losses on many plaintiffs, confining each jury that finds liability to punitive damages that are proportioned to the plaintiff's harms ensures that the overall punishment most fairly reflects the collective consensus of all the juries who have considered the defendant's conduct. On the other hand, if punishment is linked to the defendant's finances, the jury is effectively set free from any constraint of proportionality.

There is one legitimate reason for considering a defendant's finances in the punitive damage context: to implement the virtually universal principle that punitive damages are meant to correct rather than destroy, so that awards that seriously impair a defendant's continuing economic viability are inappropriate. This, however, is in the nature of an affirmative defense. It should be placed in issue only where the defendant seeks leniency based on limited financial capabilities. Aside from this use, the consideration of wealth as a basis for enlarging the punitive exaction beyond what would otherwise be warranted is, notwithstanding its current prevalence, both economically and legally illegitimate.

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Assets as Liability

Not only does the use of corporate finances in punishment setting make no sense as a means of achieving rational deterrence; there also is an increasing recognition that this particular idol has feet of clay. Leading the charge here is the U.S. Supreme Court, which, in last year's landmark decision in *State Farm Mutual Automobile Insurance Co. v. Campbell*, 123 S. Ct. 1513 (2003), criticized the Utah Supreme Court's reliance on State Farm's financial circumstances to justify the punitive award in that case.

State Farm was an insurance bad faith case arising out of the defendant's failure to settle a claim against its insured within policy limits, resulting in an excess verdict. The jury found that State Farm's conduct caused the plaintiff $1 million worth of emotional distress. In reinstating the jury's $145 million punitive verdict, the Utah Supreme Court emphasized that the award was not out of line with State Farm's multibillion dollar finances. The U.S. Supreme Court, however, took a markedly different stance, stating in no uncertain terms, "The wealth of a defendant cannot justify an otherwise unconstitutional punitive damages award." 123 S. Ct. at 1525.

Although this criticism came as something of a surprise to many observers, it was in fact foreshadowed by the Court's disregard, and perhaps implicit rejection, of Dr. Gore's argument in *BMW of North America v. Gore*, 517 U.S. 559 (1996), that the $2 million punishment there at issue could be upheld because

it was so small in relation to BMW's net worth. Had the Court found merit in that oft-made argument, it presumably would have affirmed the judgment in *BMW* rather than reversed it.

In *State Farm*, the Court began its discussion of the wealth issue by criticizing the Utah court's reliance on wealth as an "argument[] that seek[s] to defend a departure from well-established constraints on punitive damages," because the defendant's financial condition "bear[s] no relation to the award's reasonableness or proportionality to the harm." 123 S. Ct. at 1525. This observation picks up on a central theme of Justice Breyer's concurring opinion in *BMW*, which emphasized the disconnect between wealth evidence and the excessiveness benchmarks identified in that case and reaffirmed in *State Farm*: reprehensibility, relationship to plaintiff's damages, and relationship to legislative or administrative penalties for similar conduct. Whether the defendant is a large company or a small one has nothing to do with the reprehensibility of its conduct, the harm that it caused or threatened to the plaintiff, or the criminal fines or civil penalties potentially attaching to the conduct. Reliance on corporate finances is therefore a mechanism for, in practical effect, nullifying the analysis that the Supreme Court has found to be constitutionally necessary.

In holding that "[t]he wealth of a defendant cannot justify an otherwise unconstitutional punitive damages award," 123 S. Ct. at 1525, did the Court also implicitly hold that evidence of a corporate defendant's finances is generally inadmissible? Plaintiffs and some courts appear to think otherwise, relying on a seemingly offhand comment in *State Farm* quoting from a somewhat enigmatic passage in Justice Breyer's *BMW* concurrence. The passage begins by seeming to criticize the use of wealth evidence as "provid[ing] an open-ended basis for inflating awards when the defendant is wealthy" but then goes on to state, "That does not make its use unlawful or inappropriate; it simply means that the factor cannot make up for the failure of other factors, such as reprehensibility, to constrain significantly an award that purports to punish a defendant's conduct." *Id*.

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Some courts have treated this passage as nullifying the rest of the Court's analysis and allowing the unrestricted use of wealth evidence at least during the trial itself. In this writer's opinion, it is wholly unreasonable to ascribe such nullifying effect to this stray passage. The passage does not indicate what relevance wealth evidence is thought to have, or in what respects its use might be "[]lawful" or "[]appropriate." And, as noted above, there are certain legitimate uses of wealth evidence — to "monetarize" the value of noneconomic misconduct to an individual defendant and to avoid an economically debilitating award. Perhaps the quoted comment is intended to convey nothing more than that such uses are not foreclosed.

In the end, if an arguably excessive award cannot be justified by reference to the defendant's finances, what legitimate purpose could such evidence serve? Plaintiffs have suggested that the evidence would still constitute a proper con-

sideration in setting an award *within* the constitutionally permissible range, and it is true that the Supreme Court's language does not explicitly prohibit such use. But the relevance objections outlined earlier in this article remain. And beyond that, as a practical matter the anchoring effect of wealth evidence in the jury's selection of a punishment will overwhelm the other, more pertinent considerations such as reprehensibility and relationship to actual damages, causing the prejudicial impact of the evidence to overwhelm any probative value it might be thought to possess.

True, verdicts driven to unconstitutional levels will be subject to remittitur in a process that, under *State Farm*, cannot properly consider wealth to sustain an award that would otherwise be excessive. But this is no remedy for the harm done by placing evidence of wealth before juries and encouraging them by argument and instruction to rely on such evidence to augment the punishment they would otherwise impose. Because such evidence, arguments, and instructions tend regularly to drive verdicts to levels that must then be reduced, the result is to condemn most defendants to punishment at the highest constitutionally allowable level even though a jury not dazzled by huge net worth, revenue, and income data might have returned a verdict well below that level. This defeats the right to a jury trial and demeans the punishment-setting process.

To sum up, evidence of a defendant's wealth has a legitimate role to play in setting punitive damages only in very limited circumstances. In the typical case of a corporate or other organizational offender accused of an economically motivated tort, financial data have no proper role to play in the process, and such evidence should be excluded.

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