CLASS ACTION WATCH

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The Supreme Court Sets New Punitive Damage Limits Under Federal Common Law

by William E. Thomson & Kahn A. Scolnick

As it has done consistently for more than a decade, during the last Term the United States Supreme Court handed down a highly significant decision in the area of punitive damages jurisprudence. As virtually its last act of the Term, the Court issued its decision in *Exxon Shipping Co. v. Baker*,[1] clarifying the standards for review of punitive damages under federal common-law. In the process, the Court vacated a $2.5 billion punitive damages award as excessive under federal maritime common law, and imposed an upper limit on such awards of a 1:1 punitive-to-compensatory damages ratio. Among other things, *Baker* is significant for its clear signal of the Court's increasing concerns with the stark unpredictability and potential unfairness of punitive damage awards.

I. Background

Baker arose out of the well-documented and catastrophic events of March 24, 1989—when the supertanker *Exxon Valdez*, captained by Joseph Hazelwood, ran into a reef off the Alaskan coast, fracturing its hull and spilling millions of gallons of crude oil into Prince William Sound. The plaintiffs in *Baker* were a class of commercial fisherman and native Alaskans dependent on Prince William Sound for their livelihood. They sued to recover economic losses caused by the spill. (Exxon settled state and federal claims for environmental damage for more than $1 billon, and spent about $2.1 billion in cleanup efforts.)

In the district court, Exxon stipulated to its negligence and ensuing liability for compensatory damages, and the district court divided the trial into three phases. Phase I concerned Exxon's recklessness, and thus potential for punitive liability; the jury found Exxon reckless based on the acts of Hazelwood, its managerial employee. In Phase II, the jury awarded nearly $300 million in compensatory damages. (After subtracting out released claims, settlements, and other payments, the balance was approximately $20 million.) In Phase III, the jury awarded $5 billion in punitive damages against Exxon. The Ninth Circuit Court of Appeals subsequently reduced the amount of punitive damages to $2.5 billion, a punitive-to-compensatory damages ratio of 5:1

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A Colossal Class Action

by Jim Copland

In antiquity, the Colossus of Rhodes was one of the seven "wonders of the world"; built in the 4th-century B.C., the statue stood some 110 feet, roughly the size of the Statue of Liberty. Today, a different Colossus is making legal headlines. This Colossus is at the center of what has been dubbed "the largest class-action lawsuit ever filed in America", a sprawling suit in Texarkana, Arkansas, that has targeted over 500 insurance companies and already snared over $300 million in settlements—and $70 million in legal fees for the plaintiffs' bar—from only a small percentage of the defendants sued. And today's Colossus is, like its forebear, not only massive but also archaic: even as settlement negotiations proceed, the Colossus suit is the last of its breed, the state-court, national class-action lawsuit now made obsolete by 2005's Class Action Fairness Act.

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Endnotes

1 General Motors Corporation v. Bryant, 2008 WL 2447477 (Ark. June 19, 2008).

2 *Id.* at *1.

3 *Id.*

4 *Id.*

5 *Id.*

6 *Id.* at *2-3.

7 *Id.* at *3.

8 Security Benefit Life Insurance Co. v. Graham, 306 Ark. 39, 810 S.W.2d 943 (1991).

9 *General Motors Corporation*, 2008 WL 2447477 at *4 (quoting *Security Benefit*, 306 Ark. at 44-45, 810 S.W.2d at 945-46)) (citations omitted).

10 FirstPlus Home Loan Owner 1997-1 v. Bryant, 372 Ark. 466 (2008).

11 *General Motors Corp.*, 2008 WL 2447477 at *4.

12 *Id.*

13 *Id.*

14 *Id.*

15 *Id.*

16 *In re Prempro Prod. Liab. Litig.*, 230 F.R.D. 555 (E.D. Ark. 2005) ("observing that when class certification is sought in a case based on common-law claims, the question of which law governs is crucial in making a class-certification decision).

17 *General Motors Corporation*, 2008 WL 2447477 at *5.

18 *Id.*

19 *Id.* (emphasis added).

20 *General Motors Corporation*, 2008 WL 2447477 at *4.

21 *Id.* at *5 (emphasis added).

22 *Id.* at *9.

23 *Id.* at *10.

24 *Id.*

25 *Id.* at *11.

26 *Id.* at *9-10.

27 *Id.* at *11.

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(the total relevant compensatory damages, taking into account all the related awards and settlements, was $507 million). Against Captain Hazelwood himself, the jury imposed punitive damages of $5,000.

Exxon sought review of the remaining $2.5 billion punitive damages award under both federal maritime common law and the Due Process Clause of the Fifth Amendment, but the Supreme Court granted review on only the federal maritime-law question.

In seeking to overturn, or at least reduce, the $2.5 billion in punitive damages awarded against it, Exxon presented three arguments: (1) maritime law precludes the imposition of punitive damages against a shipowner based on the acts of its managerial agents, (2) the federal Clean Water Act (CWA),[2] which has its own extensive penalty scheme, forecloses awards of punitive damages in maritime spill cases, and (3) the punitive damages were excessive as a matter of maritime common law. Justice Alito took no part in the consideration of the case, and thus only eight justices participated in the decision.

II. The *Baker* Decision

The first part of Justice Souter's majority opinion acknowledged that statements from two nineteenth-century maritime cases supported Exxon's argument against liability for the acts of the ship's captain. The Court also referred to Exxon's argument that the decision in *Kolstad v. American Dental Assn.*,[3] which established that employers are not liable for punitive damages for the discriminatory acts of their managerial employees if they maintained good-faith antidiscrimination policies, further supported a finding of no derivative liability in this case. The Court noted, however, that plaintiffs argued that the Restatement of Torts recognizes imposition of punitive-damages liability for the reckless acts of managerial agents, and that maritime-based common law should generally conform to land-based common law principles. Because the Court was equally divided (four-to-four) on this issue, the lower court's ruling was left intact.

The Court unanimously rejected Exxon's second argument—that the Clean Water Act's statutory penalty scheme preempts punitive damages in maritime spill cases. Exxon conceded that Congress could not have intended the CWA to preempt broad categories of damage awards that were not expressly mentioned in the

statute, including compensatory damages for thwarting economic activity and compensatory damages for personal injury. Absent a clear indication of Congressional intent to preempt punitive damages, or a conflict with the statutory scheme, the Court was unwilling to accord the CWA that preemptive effect.

The Court then turned to Exxon's third issue, which was one of first impression. Namely, as a matter of federal common law in maritime cases, was the $2.5 billion punitive damage award excessive? Writing for himself, Chief Justice Roberts, and Justices Kennedy, Scalia, and Thomas, Justice Souter began by tracing the "modern Anglo-American doctrine of punitive damages" from the eighteenth century to today, noting that in earlier eras punitive damages were often intended to provide redress for otherwise uncompensated injuries. Contemporary decisions, on the other hand, recognize that "punitives are aimed not at compensation but principally at retribution and deterring harmful conduct." In addition, the Court noted, heavier punitive damage awards have generally been thought to be justifiable when wrongdoing is hard to detect (increasing the defendant's chances of getting away with it), and when the value of injury and the corresponding compensatory award are small (providing low incentives to sue).

The majority opinion next examined various states' experiences with punitive damage awards, and the different methods employed to regulate them, such as barring punitive damages altogether, permitting them only when specifically authorized by statute, imposing statutory limits in the form of absolute monetary caps, and imposing a maximum ratio of punitive-to-compensatory damages. Yet despite these limitations, the Court noted with concern, "punitive damages overall are higher and more frequent in the United States than they are anywhere else" in the world.

The Court acknowledged that American punitive damages have been the target of significant criticism in recent decades, but noted scholarly research that indicated that the median ratio of punitive-to-compensatory awards in practice does not exceed 1:1. This shows "an overall restraint," the majority stated, and "that in many instances a high ratio of punitive to compensatory damages is substantially greater than necessary to punish or deter."

The heart of the punitive damages problem is not, the Court concluded, "mass-produced runaway awards." Rather, "[t]he real problem... is the stark unpredictability of punitive awards." Two cases with "strikingly similar facts" could produce two very different results; one defendant subjected to massive punitive damages, the other subjected to no punitives at all. This implicates one of the core values of our justice system: a sense of fairness. The scholarly research suggested that in some outlier cases, the ratio is significantly higher than 1:1, and thus in these cases punitive liability "dwarf[s] the corresponding compensatories."

The Court briefly summarized its earlier punitive damages decisions, in which it had imposed guidelines and limitations based on the Due Process Clause. Although the Court has thus far rejected any precise mathematical formula, it has also said that "few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process."[4] Yet the question presented in *Baker* was a somewhat different one; the issue was not the outer limits of the Constitution, but rather the Court's common law authority to regulate unpredictable and eccentrically high punitive damage awards in the absence of a statute.

With this goal in mind, the Court considered three possible "approaches"—one verbal and two quantitative. First, several states had devised multi-factor "tests" to guide judicial review of juries' punitive awards. But the Court was "skeptical that verbal formulas, superimposed on general jury instructions, are the best insurance against unpredictable outliers." The Court's experience with attempts to produce consistency in criminal sentencing provided a useful comparison, and left the Justices "doubtful that anything but a quantified approach will work." In particular, in the last quarter-century, federal sentencing had rejected an "indeterminate" sentencing scheme, where "similarly situated offenders" received vastly disparate sentences, with a system of detailed guidelines tied to exactly quantified sentencing results. This experience "strongly suggest[ed]" that, absent specific limitations, "it is inevitable that the specific amount of punitive damages awarded... will be arbitrary."

Second, the Court considered a "hard dollar cap on punitive damages," which had been adopted by several states. The Court quickly dismissed this option, however, because of the difficulty in settling on a particular dollar figure that would apply across the board to all tort and contract injuries. Moreover, unlike legislation, court-imposed dollar caps cannot easily be revised to account for inflation or other unanticipated concerns.

The "more promising alternative" was to peg punitive to compensatory damages by using a ratio or maximum multiple. To critics who would complain that this sort of judicial policymaking is better left to the legislature, the Court answered that the judiciary could not wash its hands of a problem it created (by

allowing punitive damage awards in the first place) by calling quantified standards "legislative." In any event, courts have historically fashioned numerical caps in other contexts—for example, the 21-year rule against perpetuities, and certain judge-made limitations periods for civil actions. "And of course," the Court importantly added, "the relevance of the ratio between compensatory and punitive damages is indisputable, being a central feature in our due process analysis."

When it came to selecting a specific numerical ratio, the Court first considered and rejected 3:1. This was too high because states with 3:1 ratios generally apply them where the underlying tortious action is worse than negligent, but less than malicious. In *Baker*, Exxon's actions were merely reckless, and Exxon's recklessness regarding Captain Hazelwood was not motivated by financial gain. The Court also considered and rejected a 2:1 ratio, which arose from treble-damages statutes devised to induce private enforcement. This concern was not present in *Baker*, with its "staggering" damages and multiple criminal indictments.

The Court ultimately settled on a 1:1 ratio, for several reasons. It again cited the scholarly research that had catalogued hundreds of punitive awards—in these cases, which ranged from malice to recklessness to gross negligence, the median ratio was significantly *less than 1:1*. Specifically, the ratio expressed in these studies was 0.65:1. "In a well-functioning system, we would expect that awards at the median *or lower* would roughly express jurors' sense of reasonable penalties in cases with no earmarks of exceptional blameworthiness... and without the modest economic harm or odds of detection that would have opened the door to higher awards." The Court also referred back to its due process cases, in which it had announced that "substantial" compensatory damages warrant a lower ratio, perhaps "only *equal to* compensatory damages." Accordingly, the Court concluded "that a 1:1 ratio, which is above the median award, is a fair upper limit."

As a result, the Court vacated the judgment and remanded for re-calculation of punitive damages, given this maximum 1:1 ratio. In practical terms, *Baker* reduced the punitive award against Exxon from the Ninth Circuit's $2.5 billion to a maximum award of approximately $500 million.

Justice Scalia, joined by Justice Thomas, concurred, noting their continuing belief that prior decisions imposing due process limits on punitive damages "were in error," but "agree[ing] with the argumentation based upon those prior holdings."

Justice Stevens dissented as to the use of any precise ratio. Congress, not the Court, he wrote, should make these sorts of empirical judgments. He also argued that, unlike land-based tort cases, punitive awards in federal maritime cases are more likely necessary to *compensate* for certain "intangible injuries," such as pain and suffering, that are not compensable under general maritime law. In addition, Justice Stevens pointed out that the majority had failed to identify a single state *court*, as opposed to legislature, that had imposed a precise ratio. Finally, Justice Stevens contended that abuse-of-discretion review was adequate to deal with the sort of outlier cases driving the majority's decision, and that it, rather than the majority's more searching review, is more consonant with courts' traditional common-law review where no constitutional issue is implicated.

Justice Ginsburg also dissented. Although she recognized that it was "beyond question [that] 'the Court possesses the power to craft the rule it announce[d],'" she found "that the question is close [but she]... share[d] Justice Stevens' view that Congress is the better equipped decisionmaker."

Finally, Justice Breyer dissented as to the application of a 1:1 standard under the facts of the case. In his view, "a limited exception to the Court's 1:1 ratio is warranted here" because Exxon's behavior went beyond the mine-run case of reckless behavior, and because the Ninth Circuit had already reduced the award by 50%.

III. *Baker*'s Potential Implications for The Future

The *Baker* decision is significant not only for the limit it establishes in federal maritime common law but also for the broader guidance that it provides to courts throughout the country in interpreting the scope of the limits on punitive damage awards under the federal Due Process Clause and state common law. While *Baker* of course arose in a specific and somewhat specialized context—federal maritime law—the decision is important in several respects that may have application far beyond that narrow context.

Perhaps most directly, there is little principled basis for refusing to extend *Baker*'s 1:1 ratio to other areas of federal common law. After all, the impetus for this fixed upper limit derived from the Court's concern—expressed in its most dramatic statement yet—over the problem of the "stark unpredictability of punitive awards." It found that the "spread [between punitive damages awards] is great, and the outlier cases subject defendants to punitive damages that dwarf the corresponding compensatories," and that this disparity flows not from legitimate case-specific differences, or reasonable judgments by judges and juries based thereon, but from "the inherent uncertainty of the trial process."[5] The Court concluded that this "implication of unfairness" is in fundamental

tension with our system, where the "commonly held notion of law rests on a sense of fairness in dealing with one another." And the Court reaffirmed the centrality of the "fair notice" principle, stating that even those defendants characterized as the worst offenders should be able to "look ahead with some ability to know what the stakes are in choosing one course of action or another."

Decisions relying on *Baker* are still sparse, of course, but there is some early indication that its fundamental holding will be applied outside of the maritime context. For example, in *Mendez v. County of San Bernardino*, the Ninth Circuit indicated that *Baker*'s 1:1 ratio would also apply in the context of a federal civil rights case. Indeed, Justice Stevens noted in his *Baker* dissent that "there may be *less* reason to limit punitive damages in this sphere [of maritime cases] than in any other" because certain types of intangible harm are not compensable under general maritime law.[6]

The obvious question after *Baker* is whether the 1:1 maximum common-law ratio indicates a shift in the Court's due process jurisprudence toward a tighter limit on an acceptable ratio. Specifically, while the Court had consistently declined to impose a strict numerical limit in prior due process cases, might *Baker* signal a willingness to reconsider that approach? Justice Ginsburg squarely raises this question in her dissent: "On next opportunity, will the Court rule, definitively, that 1:1 is the upper limit due process requires"? In this respect it seems quite important that the Court expressly and repeatedly supported its 1:1 limit for federal maritime law with reference to its prior constitutional due process decisions in *BMW of North America, Inc. v. Gore*,[7] and *State Farm Mutual Automobile Insurance Co. v. Campbell*.[8] In particular, it noted *State Farm*'s presumption that single-digit multipliers are more likely to comport with due process, and that in cases with "substantial" compensatory damages a 1:1 ratio "can reach the outermost limit of the due process guarantee." *State Farm* powerfully signaled to lower courts that anything above a 9:1 ratio was likely to be unconstitutionally excessive. And *Baker* should point the courts in the further direction of tighter ratios and more searching excessiveness review, because concerns over unpredictability and "fair notice" to defendants have long been at the heart of constitutional due process review.

And specifically with respect to class actions, *Baker* makes the important observation that class actions involving a large number of potential plaintiffs may necessary involve "substantial" compensatory damages, regardless of the amount of the individual awards. "[I]n such cases, individual awards are not the touchstone, for it is the class option that facilitates suit, and a class recovery of $500 million is substantial. In this case, then, the constitutional outer limit may well be 1:1." In other words, at least in large class actions, *Baker*'s 1:1 ratio may in fact represent the due process ceiling for punitive damage awards.

Interestingly, the Court relied extensively at several junctures on scholarly studies in establishing the factual basis for its conclusion that there is a disturbing disparity in punitive damages awards, signaling for the first time the potential jurisprudential importance of statistical analysis in this area. Yet the Court explicitly declined to rely on other academic literature that demonstrated, anecdotally, consistency in punitive awards, "[b]ecause this research was funded in part by Exxon." Apparently research funded by the defendant before the Court will be accorded no weight, regardless of its quality and scholarly bona fides.

The significance of *Baker*'s 1:1 ratio cannot logically be confined to federal maritime cases. At the very least, this same ratio arguably should apply across the board in other types of federal cases as a matter of federal common law. But even more important, *Baker* may be a crucial step in the Court's progression toward a more precise due process limitation on punitive damages in *all* state and federal cases.

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Endnotes

1 Exxon Shipping Co. v. Baker, 128 S. Ct. 2605 (2008)

2 33 U.S.C. § 1251 et seq.

3 527 U.S. 526, 544 (1999)

4 State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 425 (2003).

5 Quoting BMW of N. Am., Inc. v. Gore (Ala. 1994) 646 So.2d 619, 626 (per curiam).

6 540 F.3d 1109 (9th Cir. 2008).

7 517 U.S. 559 (1996).

8 538 U.S. 408 (2003).