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...news, views and reviews from the Center for Justice & Democracy

IN THIS ISSUE: PUNITIVE DAMAGES

WHAT'S UP WITH PUNITIVE DAMAGES?

Punitive damages, also known as "exemplary damages," have ancient origins and deep roots in our legal system. The Babylonian Hammurabi Code in 2000 B.C., the Hindu Code of Manu in 200 B.C. and the Bible were among the earliest recorded legal systems that provided for multiple awards where a defendant had engaged in certain types of bad behavior. The ancient Romans also enacted laws in 450 B.C. that mandated the imposition of multiple damages as a means of punishing egregious misconduct.

America's current punitive damages doctrine dates back to 18th century common law, where their purpose was to punish and deter outrageous acts. Although punitive damages were initially assessed only against individuals, often for physical abuse, by end of the 1800s most courts allowed punitives to be levied against corporations. This was due, in part, to the extent that railroads and other companies amassed enormous wealth at the expense of poor workers and innocent consumers. By the early 20th century, punitive damages were increasingly used to protect consumers from egregious business practices.

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TIME TO CLOSE THIS TAX LOOPHOLE

Tax deductions are meant to reward or incentivize good behavior. So why do federal and state tax laws generally allow corporations to deduct punitive damages payments? Good question. Allowing companies to deduct punitives as "ordinary and necessary business expenses" effectively rewards and subsidizes grossly irresponsible or intentional misconduct, undermining the very purpose of punitive damages — to penalize and deter egregious misbehavior. Such deductibility is also particularly outrageous given that most states, as well as the federal government, include punitive damages as part of the plaintiff's taxable income.

Not surprisingly, this tax loophole has its share of critics. For example, in "Overcoming Tradeoffs in the Taxation of Punitive Damages," Florida State University Law Professor Dan Markel argues that deductibility creates an "under-punishment problem." As he explains in the 2011 law review article, "On the one hand, jurors assess punitive damages in an amount that they believe will best 'punish' the defendant. On the other hand, defendants are not always punished to the degree that the jury intends because punitive damages paid by business defendants are tax deductible under the Internal Revenue Code.

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CENTER FOR JUSTICE & DEMOCRACY
****NEWS****

Dear Friends,

I hope you had the opportunity to catch the new documentary film, *Hot Coffee*, by first-time director Susan Saladoff. I was honored to participate in this film and to contribute to information on *Hot Coffee's* web site.

We hope that this film will have an impact for years to come. The DVD will be out sometime this Fall, and we intend to use it as an educational tool for lawmakers, community groups and opinion leaders. We have also heard from a number of tort law professors with whom we work, who tell us they will be showing the film the very first day of torts class. Talk about setting the right tone with students!

For more information about what you can do to help, go to the "Take Action" page on *Hot Coffee's* web site (hotcoffeethemovie.com). And stay in touch with the Center for Justice & Democracy (centerjd.org) to learn more about all the issues raised in the film.

Sincerely,
Joanne Doroshow
Executive Director

TIME TO CLOSE THIS TAX LOOPHOLE continuted...

As a result, these defendants often pay far less in real dollars than the jury believed they deserved to pay."

The *L.A. Times* has harsher words for punitive damages deductibility, calling the current system "counterproductive," "an obvious wrong" and "ridiculous public policy" in a June 2, 2011, editorial. "Punitive damages are appropriately rare — juries award them in only about 5% of cases" and "[t]he intent is to punish outrageous conduct and deter future misdeeds. Both of those goals are undermined by existing law," the paper points out, adding that "[c]riminal fines, by contrast, are not deductible, underscoring the aberrance of this policy."

This aberrance has been recognized by President Obama, whose budget request for 2012 denies businesses a deduction on punitive damage payments. It has also been recognized by U.S. Senator Patrick Leahy (D-Vt.), who recently introduced legislation to close the tax loophole. "When corporate wrongdoers can write off a significant portion of the financial impact of punitive damages, the incentives in our justice system that promote responsible business practices lose their force," Leahy said in an April 12, 2011 press release. "This is wrong. It undermines one of the primary deterrent functions of our civil justice system, and American taxpayers should not subsidize this misconduct."

And on the state level, California Assemblyman Mike Feuer (D-Los Angeles) proposed legislation in February that would redefine punitive damages as nondeductible expenses that bad-acting companies should be force to pay, or as the *LA Times* put it, keep punitive damages punitive. As of June 23, 2011, the bill had been moved to an inactive file to be considered at a later date.

PUNITIVE DAMAGES UNDER ATTACK

Congress.
Under the so-called "HEALTH Act of 2011" (H.R. 5), punitive damages would only be awarded when a medical malpractice, nursing home or drug injury victim meets the heightened standard of "clear and convincing evidence." And if punitives are assessed, they are limited to two times the amount of economic damages or $250,000, whichever is greater. In addition, punitive damages would be eliminated against manufacturers of drugs and medical devices approved by the FDA as well as those not FDA-approved yet "generally recognized as safe and effective." Manufacturers and sellers of drugs would also be immunized from punitives for packaging or labeling defects.

South Carolina.
Gov. Haley recently signed legislation into law that in most cases limits punitive damages to $500,000 or three times compensatory damages, whichever is greater.

Tennessee.
Gov. Haslam recently signed legislation into law that in most cases caps punitive damages, which must be proved by "clear and convincing evidence," to twice the amount of compensatory damages or $500,000, whichever is greater. The new law also makes it virtually impossible for victims to win punitive damages in product liability actions.

Wisconsin.
Gov. Walker recently signed legislation that limits punitive damages to $200,000 or two times compensatory damages, whichever is greater. Drunk-driving cases are not subject to the cap.

PUNITIVE DAMAGES BY THE NUMBERS

Statements about the destructive nature of punitive damages have served as an important tool in the rhetorical assault on the civil justice system. Yet when pressed for real-world data to support such claims, "tort reformers" come up empty. That's because there is no empirical evidence to support wildly-exaggerated, negative characterizations of punitive damages.

Punitive damages are rarely awarded. In 2005, the most recent year studied by the U.S. Department of Justice (DOJ), punitive damages were awarded in only 5 percent of civil cases where plaintiffs prevailed at trial. Punitive damages were awarded in only 3 percent of tort cases with plaintiff winners; for contract cases, it was 8 percent.

Punitive damages are also rare in the areas often targeted for tort restrictions: products liability and medical malpractice. According to the DOJ, in 2005 punitive damages were awarded in only 1 percent of product liability cases with a successful plaintiff. This includes asbestos and other product liability trials. Similarly, punitive damages were awarded in a mere 1 percent of cases where medical malpractice victims established liability at trial.

The incidence of punitive damages is consistently low. Long-term DOJ data from state trials in the nation's 75 most populous counties show that:

• The percentage of plaintiff winners receiving punitive damages before civil juries was 6 percent in 1992, 4 percent in 1996, 6 percent in 2001 and 5 percent in 2005;

• The percentage of prevailing plaintiffs awarded punitive damages in all tort trials was 3.3 percent in 1996, 5.3 percent in 2001 and 3.6 percent in 2005;

• The percentage of successful medical malpractice plaintiffs receiving punitive damages was 1.1 percent in 1996, 4.9 percent in 2001 and 2.6 percent in 2005;

• The percentage of plaintiff winners awarded punitive damages in product liability trials was 7.7 percent in 1996, 4.2 percent in 2001 and 1.3 percent in 2005; and

• The percentage of winning plaintiffs receiving punitive damages in contract cases was no greater in 2005 than in 1996, with plaintiffs' success rate totaling 8 percent both years.

Punitive damages have decreased in frequency. Long-term DOJ data from state tort trials in the nation's 75 most populous counties show that:

• The percentage of successful plaintiffs awarded punitive damages in tort trials declined by 33.3 percent between 2001 and 2005;

• From 2001 to 2005, the percentage of prevailing plaintiffs awarded punitive damages in medical malpractice cases decreased by 46.1 percent; and

• The percentage of plaintiff winners receiving punitive damages in product liability trials dropped by 70.4 percent between 2001 and 2005.

Most punitive damage awards are modest. In 2005, the median overall punitive damage amount awarded to plaintiff winners in civil cases was $64,000. The median punitive damage award for all tort cases was $55,000. Moreover, in 76 percent of the 632 civil trials with both punitive and compensatory awards, the ratio of punitive to compensatory damages was 3 to 1 or less.

Juries and judges use similar reasoning when making punitive damage award decisions in tort cases. The DOJ found no detectible difference in the percentage of litigants awarded punitive damages when comparing tort bench and jury trials in 2005. Moreover, the median punitive damage awards in tort jury ($100,000) and bench ($54,000) trials were not statistically different.

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WHAT'S UP WITH PUNITIVE DAMAGES? continuted. . .

This rationale for awarding punitive damages remains just as vital today. Time and again, punitive damages hold reckless companies and others accountable for egregious wrongdoing, and, in doing so, deter future misconduct by signaling that such malfeasance will not be tolerated.

Unlike compensatory damages, which are meant to make victims whole after suffering harm, punitive damages are intended to punish those who willfully or recklessly endanger health and safety. Punitives not only provide retribution to victims of outrageous conduct but also in some cases incentivize them to pursue claims in the public interest as "private attorneys general" when the state fails to act. And in cases where criminal laws are violated, the potential for punitive damages can often be a more effective deterrent than criminal sanctions.

Punitive damages also give culpable wrongdoers the proper economic incentives to become safer and more responsible. History shows that the imposition or threat of punitive damages has caused corporations to take dangerous products and services off the market and operate more safely. Companies often weigh the potential costs of liability to determine whether a defective product should be redesigned or removed from the market, or an unsafe practice should be stopped. This "cost/benefit" process was first brought to public attention in the famous 1981 Ford Pinto "exploding gas tank" case, *Grimshaw v. Ford Motor Company*. In that case, Ford knew its gas tank design was flawed but decided not to make necessary design changes, instead finding it cheaper to pay liability claims. There, the court observed that unlike "compensatory damages" which a manufacturer may find "more profitable to treat as a part of the cost of doing business rather than to remedy the defect," punitive damages cannot be treated as such and so "remain as the *most effective remedy* for consumer protection against defectively designed mass-produced articles." [emphasis added]

Equally important, punitive damages communicate society's moral condemnation for certain types of behavior. In this way, punitives perform a norm-setting or signaling function that deters potential wrongdoers from grossly irresponsible misconduct.

Additionally, the amount of money society saves as a direct result of the deterrence function of punitive damages — injuries prevented, health care costs not expended, wages not lost, etc. — is incalculable but significant. Some have estimated this savings to be perhaps a trillion dollars a year.

Despite their historic and current importance, 38 states have passed laws that undermine the purpose and power of punitive damages. Legislative restrictions now include: 1) outright bans on punitive damages; 2) liability caps; 3) mandatory assignment of a percentage of any punitive award to state funds; 4) heightened burdens of proof; and 5) bifurcated trials.

The U.S. Supreme Court has also been placing arbitrary limits on punitive damages remedies. For example, in *State Farm v. Campbell* (2003) and an earlier case, *BMW v. Gore* (1996), the U.S. Supreme Court said that "the degree of reprehensibility of the defendant's conduct" is the most important indication of the reasonableness of a punitive damages award, followed by the relationship between compensatory and punitive damages (the Court mentioned a single-digit ratio) and the difference between the punitive damages awarded and the civil penalties authorized or imposed in similar cases. However, in the recent case *Philip Morris v. Williams* (2007), the Court let stand a $79.5 million award with a much higher compensatory-punitives ratio of roughly 100-to-1, where it was argued that the tobacco's company misconduct was particularly reprehensible and the harm was physical, as opposed to economic, in nature.

Capping or limiting punitive damages clearly allows companies to treat liability arising from malfeasance as a cost of doing business, weakening their deterrent impact. As American University Washington College of Law Professor Andrew F. Popper recently explained in a 2011 *DePaul Law Review* article, any limit on punitive damages "allows for profit-maximizing behavior without the risk and critical disciplining effect of unplanned exposure to liability. The risk of unplanned exposure provides a market force of great consequence. It forces actors to consider the possibility of harm and injury associated with product or service failure. It pushes companies to optimize safety, within reasonable limits. This pressure is absent with a cap on liability."

The availability of punitive damages protects us all by holding companies accountable for egregious misconduct and deterring its future occurrence. Laws that restrict punitive awards place the public at serious risk, and lawmakers should not be misled by falsehoods spread by corporate special interests about this most valuable and important feature of our civil justice system.