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PUNITIVE DAMAGES AND THE SUPREME COURT'S REASONABLE RELATIONSHIP TEST: IGNORING THE ECONOMICS OF DETERRENCE

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I. INTRODUCTION

In this paper, we briefly review how punitive damages have been used to punish and deter.1 We then argue that to the extent the recent Supreme Court rulings limit punitive damages to an award “reasonably related” to actual damages, the Supreme Court has eliminated the economic foundations of deterrence. We make the case that the reasonable relationship test ignores the fundamentals of economic theory that drive the perfect competitive model. Fundamental economic theory recognizes the individually specific nature of budget and/or isocost constraint functions and utility and/or isoquant functions upon, which economic agents make rational choices. To the extent that tort reform ignores such economic theory and constructs, it obstructs the rational choice model, which is the cornerstone of western political and economic thought. With respect to the issue of

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1 See David G. Owen, Punitive Damages In Product Liability Litigation, 74 Mich. L. Rev. 1258, 1371 (1976) (discussing the roots of punitive damages going back to English common law and beyond).
punitive damages, we argue that the Supreme Court’s "reasonably related" test ignores the rational choice models prevalent in economic policy. Finally, we discuss how this ignorance of economic theory is arguably at the center of tort reform in general; thus the arguments of this paper are applicable to other tort reforms, including caps on non-economic damages.

II. TORT REFORM AND PUNITIVE DAMAGES

The tort reform movement has influenced a number of procedural and substantive legislative changes addressing such issues as standing, standards of proof, and damage limits or caps, all of which have placed constraints on the judicial administration of tort claims. Reformation implies "an improvement by alteration, a correction of error, or a removal of defects; a change for the better or correction of evils or abuses." Whether a change constitutes a reform necessitates the identification of the abuse to be corrected and an inquiry as to

2 Various state statutes have modified the common law methods for awarding punitive damages. See Jacob A. Stein, Stein on Personal Injury Damages, Practice Aids § 7:92 (3d ed. 1997). Citations and comments are from Stein. In Germanio v. Goodyear Tire & Rubber Co., 732 F. Supp. 1297 (D.N.J. 1990), the Federal District Court in New Jersey determined that the New Jersey Products Liability Act of 1987, N.J. STAT. § 2A:58C-5(a)-(c) (1987) (amended by Punitive Damages Act, Pub. L. 1995, ch. 142), could survive constitutional challenges under the due process and excessive fines clauses. The court rejected the defendant's argument that the statute created "standardless discretion" for juries, or suffered from vagueness; it also held that the absence of a higher burden of proof and double jeopardy protections were not constitutionally required. Id. at 1300-04. Finally, it held that the requirement for consideration of defendant's wealth did not violate the equal protection clause. Id. at 1305. In McBride v. General Motors Corp., 737 F. Supp. 1563 (M.D. Ga. 1990), the federal district court declared Georgia's Tort Reform Act provisions regulating punitive damages unconstitutional. The Georgia Tort Reform Act 1987, GA. CODE ANN. § 51-12-5.1(e)(2) (1987), provided that in products liability cases there would be no limit on the size of awards but that "only one award of punitive damages may be recovered from a defendant for any act or omission... regardless of the number of causes of action that may arise from such act or omission." Further, it provided that 75 percent of any amounts awarded shall be paid into the state treasury. Id. § 51-12-5.1(e)(2). First, the court held that the one-award provision unconstitutionally discriminates between plaintiffs in products liability actions because it would deny any awards to all but the first plaintiff whose claim arose out of a particular act or omission. McBride, 737 F. Supp. at 1569. Further, it unconstitutionally discriminates between products liability punitive damage claimants and plaintiffs in non-products liability cases who are not limited by the one-award provision. Id. Additionally, the act "on its face arbitrarily discriminates between product liability punitive damages plaintiffs who secure an award of punitive damages and may under the statute retain only 25% of such an award and punitive damage tort plaintiffs in cases other than product liability actions who may retain 100% of any award of punitive damages." Id.

3 The American Heritage Dictionary 1039 (2d ed. 1982).
the existence of a corresponding improvement expected to result from the implemented change. Punitive damages have been included as one of the targets for reform.4

The United States Supreme Court has recently identified the award of excessive punitive damages as a matter to be addressed and corrected. In BMW of North America5, Cooper Industries6, and State Farm Mutual Automobile Insurance Co.,7 the Court reversed and remanded three state court awards of punitive damages, concluding that each was excessive.8 Although tort reformers welcomed the Supreme Court's proactive reversals of each award, a thorough consideration of the Supreme Court's evolving but myopic rationale reveals that we cannot expect a corresponding improvement with respect to the regulation of reprehensible conduct within the context of punitive damage awards. Moreover, to characterize the Court's holdings as reformatory is clearly suspect, especially given the asymmetrical favor each holding bestows on the tortfeasor.

III. THE NATURE OF PUNITIVE DAMAGES

The Restatement Second, Torts9 defines punitive damages as, "[d]amages, other than compensatory or nominal damages, awarded against a person to punish him for his outrageous conduct and to deter him and others like him from similar conduct in the future."10

Note that in this definition there are three points: (1) punitive damages are not the same as compensatory or nominal damages; (2) they address the objectives of punishment and deterrence;

4 See generally Kathryn L. Veniza, Constitutional Challenges to Caps on Punitive Damages: Is Tort Reform the Dragon Slayer or Is It the Dragon, 42 ME. L. REV. 219 (1990).
6 532 U.S. 424, 443 (2001) (remanding case back to court of appeals while commenting on the three Gore guidelines applicable to this case).
10 Id. (defining punitive damage); accord KEETON ET. AL., PROSSER & KEETON ON TORTS § 2, at 9 (5th ed. 1984).
and (3) they are to be based upon the performance of "outrageous" conduct by the defendant. Professor Stein has argued persuasively:

The Restatement definition of punitive damages is generally in accord with the majority of judicial decisions and statutory enactments governing their availability, although a few states apply the doctrine of punitive damages to serve compensatory or other purposes, which are described below. Moreover, to state that the purpose of punitive damages is not to compensate does not mean that they are not compensation—for obviously to the plaintiff they are perceived as additional payments made to "compensate" for the loss.

IV. PUNITIVE DAMAGES AND PUNISHMENT

Professor Stein sums up the position of most jurisdictions in that they "recognize the dual objectives of punishing the defendant for its wrongful conduct and deterring the defendant and others from repetition of the same or similar conduct in the future." The starting point in considering the doctrine of punitive damages in tort litigation is to recognize that they are awarded in most jurisdictions by juries in order punish conduct that is socially unacceptable in order to advance the objectives of retribution and deterrence, which are usually associated with the criminal law. It should be observed that while courts apply the

11 See STEIN, supra note 2, § 7:92 (discussing three points of punitive damages definition).
12 Id. (arguing Restatement definition follows majority rule on compensation and punitive damages).
13 Id. (explaining the purpose of punitive damages).
14 Id. (reporting "[a] few states apply the term 'punitive' or 'exemplary' damages as part of a doctrine that is limited to essentially compensatory purposes.").
term "punishment," what they usually mean is retribution against the wrongdoer, since the punishment itself (paying the tort judgment) is also the means of effectuating the deterrence and other objectives. In other words, one of the aims of punishment is to secure retribution for the conduct of the defendant.

According to Professor Dobbs:

Punitive damages might be assessed because the defendant deserves to suffer for his misconduct and accompanying mental state. That is to say, the defendant's wrong is such that it is right in a moral sense that he be made to suffer, irrespective of whether this will reform his character, deter his misconduct, or set an example for others. This "just desserts" approach is purely punitive. It is sometimes called retributive, and it is the closest to a purely "criminal" sanction.

In an Illinois decision, Kemner v. Monsanto Co., we see the notion that, when we punish the defendant, we also address the need for retribution and deterrence:

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16 Punitive damages have been with us since antiquity and were authorized in many ancient cultures. See, e.g., Code of Hammurabi, ALBERT KOCOUREK & JOHN WIGNORE, SOURCES OF ANCIENT AND PRIMITIVE LAW 391 § 8 (1915). See generally 9 Exodus 22:1 (King James); H.F. Jolowicz, The Assessment of Penalties in Primitive Law, in CAMBRIDGE LEGAL ESSAYS 205-6 (1926).

17 The use of the term 'punishment' to denote imposing a detriment upon someone implies retributive aim and, therefore, the notion of dessert. When detriment is deserved, the imposition of the detriment is itself the 'good' being sought, and it is not necessary that any other good consequences result. Dessert is necessary and sufficient and provides a complete answer to the question 'Why should X be punished?'


18 Dan B. Dobbs, Ending Punishment in "Punitive" Damages: Deterrence-Measured Remedies, 40 ALA. L. REV. 831, 844 (1989); STEIN, supra note 2, § 4:3 (discussing the role of punishment in punitive damages). See TXO Prod. Corp. v. Alliance Res. Corp., 509 U.S. 443, 444 (1993) (plurality) (emphasizing the retributive purposes of punitive damages where the defendant's conduct exhibited a pattern of a fraud, trickery and deceit); see also Gillespie v. Seymour, 853 P.2d 692, 695 (Kan. 1993) (noting that "[p]unitive damages are imposed by way of punishing a party for malicious or vindictive acts or for a willful and wanton invasion of another party's rights, the purposes being to restrain him and to deter others from the commission of a like wrong"); Adams v. Coates, 626 A.2d 36, 42 (Md. 1993) (noting that punitive damages are "awarded in an attempt to punish a defendant whose conduct is characterized by evil motive, intent to injure, or fraud, and to warn others contemplating similar conduct of the serious risk of monetary liability" (quoting Owens-Illinois, Inc. v. Zenobia, 601 A.2d 633, 648 (Md. 1992))).

Today, the nature of punitive damages in Illinois is clearly singular—it is punishment for the defendant. That punishment is designed in turn to promote three purposes: (1) to act as retribution against the defendant; (2) to deter the defendant from committing similar wrongs in the future; and (3) to deter others from similar conduct.\(^{20}\)

Professor Stein argues:

Other courts have described this use of tort law to fulfill a criminal law function.\(^{21}\) Because most courts express the view, usually with little comment or discussion, that punitive damages are intended to serve the dual purposes of retribution and deterrence, courts have almost universally acknowledged that punishment is at least one of the principle rationales justifying the assessment of punitive damages.\(^{22}\) However, only a few decisions have expressed the view that the primary or sole purpose of punitive damages is to punish the tortuous wrongdoer.\(^{23}\)


\(^{22}\) STEIN, *supra* note 2, § 4:3; see, e.g., Newport v. Fact Concerts, Inc., 453 U.S. 247, 266–67 (1981) (discussing the dual purposes of punitive damages); Barber v. National Bank of Alaska, 815 P.2d 857, 864 (Alaska 1991) (acknowledging two-fold purpose of punitive damages); Ford Motor Co. v. Home Ins. Co., 172 Cal. Rptr. 59, 62–63 (Ct. App.1981) (noting that the purpose of punitive damages is to punish and deter culpable conduct); Shepherd Components, Inc. v. Brice Petrides-Donohue & Assoc., Inc., 473 N.W.2d 612, 617 (Iowa 1991) (noting that punitive damages punish and deter wrongful conduct); Traylor v. Wachter, 607 P.2d 1094, 1098 (Kan. 1980) (stating that punitive damages punish and restrain the offending party while deterring others); *Owens-Illinois, Inc.*, 601 A.2d at 649–55 (discussing extensively the purposes of punitive damages in Maryland); Andrew Jackson Life Ins. Co. v. Williams, 566 So. 2d 1172, 1189–90 (Miss. 1990) (noting that punitive damages are primarily used to deter and punish but also serve other functions such as awarding a private plaintiff for bringing the wrongdoer to account); Buzzard v. Farmers Ins. Co., 824 P.2d 1105, 1115 (Okla. 1991) (stating that "punitive damages are awarded to punish the wrongdoer for the wrong committed upon society."). Honeywell v. Sterling Furniture Co., 797 P.2d 1019, 1021 (Or. 1990) (discussing the trial judge's instructions to the jury that punitive damages are to be determined by looking at the defendant's conduct and to punish him); Hodges v. S. C. Toof & Co., 833 S.W.2d 896, 900 (Tenn. 1992) (stating the contemporary purpose of punitive damages are to punish the wrongdoer and to deter him, as well as others); Garnes v. Fleming Landfill, 413 S.E.2d 897, 900–04 (W. Va. 1991) (discussing thoroughly that the purpose of punitive damages is to punish and deter but also noting that it can serve other functions such as encouraging good faith efforts at settlement).

V. PUNITIVE DAMAGES AND DETERRENCE

Professor Stein succinctly sums up the goals of deterrence relating to punitive damages:

Although it is manifestly clear that the punitive damages doctrine, when serving a retributive purpose, is directed to the defendant, it is not equally clear when serving the function of deterrence, to whom they are directed. The issue is one of special deterrence versus general deterrence, with the former being targeted at the defendant alone and the latter at society more generally, or at those similarly situated as the defendant who might engage in similar conduct if not deterred by the penalty imposed on the defendant.24

Stein refers us to Professor Dobbs, who defines specific or special deterrence as “an assessment necessary to deter the defendant from repeated misconduct,” and general deterrence as “not to deter the defendant himself, but to set an example to deter others who are not parties and who may have done nothing wrongful.”25 “The latter represents the exemplary damages theory of punitive damages.26 A number of recent decisions have explicitly recognized the general deterrence objective in allowing sizeable awards of punitive damages.”27


24 STEIN, supra note 2, § 4:4.
25 Dobbs, supra note 18, at 844-46.
26 STEIN, supra note 2, § 4:4; see Michael Rustad & Thomas Koenig, The Historical Continuity of Punitive Damage Awards: Reforming the Tort Reformers, 42 AM. U.L. REV. 1269, 1320-21 (1993) (discussing the different purposes that punitive damages serve); see also Robert A. Klinck, Reforming Punitive Damages-The Punitive Damages Debate, 38 HARV. J. ON LEGIS. 469, 470-71 (2001) (discussing the history and purposes of punitive damages).

Consequently, high punitive damages may be awarded when warranted by the facts in light of the state’s purposeful interest in individualized assessment of appropriate deterrence and punishment . . . . A judgment of $30 million against this defendant under the justifying circumstances of this case sends a sharp, but certainly not
VI. PUNISHMENT, DETERRENCE, AND THE SUPREME COURT

The Supreme Court accepts the view that, unlike compensatory damages, which are intended to redress a plaintiff's concrete loss, punitive damages are aimed at the different purpose of deterrence and retribution. In a 1991 case entitled Pacific Mutual Life Insurance Co. v. Haslip, the Court said "punitive damages are imposed for purposes of retribution and deterrence." In Cooper Industries, Inc. v. Leatherman Tools Group, Inc., the Court said, "punitive damages may properly be imposed to further a State's legitimate interests in punishing unlawful conduct and deterring its repetition." According to the Court, punitive damages "serve the same purpose as criminal penalties." Furthermore, the Due Process Clause prohibits the imposition of grossly excessive or arbitrary punishments on a tortfeasor. Given that civil defendants are not accorded the same protections of criminal defendants, punitive damages pose an acute danger of arbitrary deprivation of property, which is heightened when the decision maker is presented evidence having little bearing on the amount that

devastating lesson of deterrence to this defendant and any other potential defendant who is like minded and similarly situated.

29 Id. at 19.
31 BMW of N. Am. v. Gore, 517 U.S. 559, 568 (1996), in which the Supreme Court held that the due process clause prohibits the imposition of "grossly excessive" awards in relation to the legitimate interest of the State.
32 State Farm Mut. Auto. Ins. Co v. Campbell, 538 U.S. 408, 417 (2003) (stating that although punitive damages awards serve the same purposes as criminal penalties, defendants in civil actions do not have the traditional protections that a defendant has in criminal proceedings).
33 See id. at 416-17, in which the Court explained that the Due Process Clause of the Fourteenth Amendment creates limitations on the discretion of the states in imposing punitive damages. See also Cooper Indus., Inc. v. Leatherman Tool Group, Inc., 532 U.S. 424, 433-34 (2001), in which the Court states that the Due Process Clause creates these limitations because it makes the Eighth Amendment's "prohibition against excessive fines" applicable to the States. But see TXO Prod. v. Alliance Res., 509 U.S. 443, 446 (1993) (plurality), where the Supreme Court upheld a punitive damages award of $10 million where the compensatory damages award was only $19,000, which was 526 times the compensatory damages awarded and was probably not an endorsement of such a high ratio given the fact that the court also considered the potential compensatory damages. Cf. Colbern C. Stuart III, Note, Mean, Stupid Defendants Jarring Our Constitutional Sensibilities: Due Process Limits on Punitive Damages After TXO Production v. Alliance Resources, 30 CAL. W. L. REV. 313, 333-37 (1994), where the author discusses the Supreme Court's "reasonableness" test, which was created in order to limit punitive damages based on due process concerns, and argues that courts will have difficulty in applying these Constitutional limits on punitive damages because of the ambiguity of TXO.
should be awarded. In a 1996 case, *BMW of North America v. Gore*, the Court held that the due process clause of the Fourteenth Amendment to the Constitution was violated, based on an award of $145 million in punitive damages and $1 million in compensatory damages. To reach this conclusion, the Court used, and instructed that when reviewing an award of punitive damages, courts are to consider:

1. The degree of reprehensibility of the defendant's misconduct,

2. The disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award, and

3. The difference between the punitive damages awarded by the jury and civil penalties authorized or imposed in comparable cases.

As late as April 7, 2003, *State Farm Mutual Automobile Insurance Co. v. Campbell* applied these three factors from the Gore case. This decision concerned a Utah case dealing with the claims of an auto insurance carrier and its insured. The *Campbell* court did not set a specific multiplier, but said "few awards exceeding a single digit ratio between punitive and compensatory damages will satisfy due process." The Court went on to say that "an award of more than four times the

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34 *State Farm*, 538 U.S. at 418 (describing shortcomings of civil punitive damages, which give juries wide discretion in imposing awards).

35 BMW, 517 U.S. at 585–86 (holding that the punitive damages award granted by the jury was "grossly excessive" and "transcend[ed] the constitutional limit").


37 BMW, 517 U.S. at 574–75 (describing the three factors used by the Court, and holding that the defendant did not receive adequate notice of the size of the potential punishment, and that the punishment was grossly excessive).

38 *State Farm*, 538 U.S. at 418–29 (applying the Gore factors, stating that the degree of reprehensibility of the defendants' conduct is the most important of the factors).

39 Id. at 425 (rejecting strict mathematical methods of establishing a constitutional limit on the proportion of punitive damages to compensatory damages, but affirming the need for a relatively low ratio).
amount of compensatory damages might be close to the line of constitutional propriety."  

Although we know that punitive damages are supposed to serve as a deterrent and to punish, we also know that most cases settle and that punitive damages are rarely awarded in those cases going to trial.  

Although there is reason to believe that settlements are impacted by the threat of possible punitive damages, one must wonder if tort reform and the recent Supreme Court holdings are acting to negate the very purpose of such damages.  

While these factors identified by the Court may be relevant to a comprehensive analysis of the merits of a punitive damage award, they completely ignore the historical and fundamental purposes of punitive damages, economics of punishment and deterrence.  

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40 Id. at 425 (stating that a punitive damages award that was four times compensatory damages had a significant historic precedent).  

41 See William M. Landes and Richard A. Posner, New Light on Punitive Damages, REG. Sept-Oct. 1986 at 33 (finding that only 2% of product liability cases result in punitive damages); see also Stephen Daniels and Joanne Martin, Myth and Reality In Punitive Damages, 75 MINN. L. REV. 1, 31 (1990) (finding that only 4.9% of all verdicts included punitive damages from their research sample); Michael Rustad, In Defense of Punitive Damages in Products Liability: Testing Tort Anecdotes With Empirical Data, 78 IOWA L. REV. 1, 38-39 (1992) (reporting that only 355 cases with punitive damages were found in a quarter of a century of cases); RICHARD L. BLATT, ET AL., PUNITIVE DAMAGES: A STATE-BY-STATE GUIDE TO LAW & PRACTICE, §1.4 (2004 ed.) (reporting that as late as 1992 there were no punitive damage awards for more than $100 million, but in 2001, there were 16 awards that were that large); Thomas Koenig, Measuring the Shadow of Punitive Damages: Their Effect on Bargaining, Litigation, and Corporate Behavior: The Shadow Effect of Punitive Damages on Settlements, 1998 WIS. L. REV. 169, 201 (discussing the findings of the insurance industry, which reached the conclusion that claims for punitive damages had a low impact on settlements in the 27 states surveyed).  

42 See Cynthia T. Andreason, State Farm v. Campbell: What Happens Next?, 71 U.S. L. WK. 2691, 2692 (May 5, 2003) (explaining that the "Campbell Court drastically curtailed consideration of potential criminal penalties on the ground that cases in which punitive damages can be awarded lack the protections that attach to criminal prosecutions").  

43 See Patrick S. Ryan, The U.S. Supreme Court Introduces the Single-Digit Multipliers To Punitive Damages (State Farm Mutual Automobile Insurance Company vs. Campbell), EUR. L. REP., May 2003, at 190, 193, referring to the dissenting opinions as follows:  

Justices Scalia and Thomas regularly dissent whenever the Supreme Court overturns punitive damages. According to Scalia and Thomas, the Constitution should not be used to reduce the size of punitive damage awards. Scalia and Thomas would have upheld the $145,000 judgment.  

Justice Ginsburg's dissent was more detailed and speaks to the tort reform movement in the U.S. According to Ginsburg, the legislatures, not the courts, should pass laws to limit punitive damages. Ginsburg also extensively reviewed the data and found the action by State Farm was extremely reprehensible. Consequently, Ginsburg, like Scalia and Thomas, would have let the $145,000 award stand.
VII. THE DEGREE OF REPREHENSIBILITY

The Court views that the most important indicia of the reasonableness of a punitive damages award is the degree of reprehensibility of the defendant's conduct.\(^{44}\) However, this specific inquiry drives the determination of whether punitive damages should be awarded in the first place.\(^{45}\) This line of inquiry provides little insight into whether the amount of the award is unconstitutionally excessive. It merits noting that many state court jurisdictions legislatively mandate that a plaintiff must prove a degree of reprehensible conduct, as defined by statute, before being entitled to seek an award of punitive damages. For example, in Texas, it is necessary for a plaintiff to plead and prove by clear and convincing evidence by a unanimous verdict that the harm in question resulted from fraud, malice, or a willful act or omission, or gross neglect.\(^{46}\) Texas further statutorily defines *malice* to mean: "a specific intent by the defendant to cause substantial injury to the claimant."\(^{47}\) Texas statutorily defines *gross negligence* to mean an act or omission:

(A) which, when viewed objectively from the standpoint of the actor at the time of its occurrence, involves an extreme


The United States Supreme Court's recent *Campbell* decision further secures the rationale and policy, and provides further clarification (particularly the "single digit multiplier" in cases of low reprehensibility). While the U.S. Supreme Court has still declined to set an absolute constitutional limit on punitive damage awards, its holding in *State Farm* that "single-digit multipliers" are more likely to agree with due process is so far the clearest guidance available concerning the permissible size of punitive damages.

*Id.* Cooper Indus. v. Leatherman Tool Group, 532 U.S. 424, 434–35 (2001). Citing United States v. Baj, 524 U.S. 321, 337 (1998), the court proposed that part of the relevant inquiry as to whether a punishment is excessive is the "degree of reprehensibility or culpability of the defendant's conduct."

\(^{45}\) See Ellis, Jr., *supra* note 17, at 3–9 (arguing that "desert requires proportionality of punishment in a relative sense as well: greater wrongs should be punished more severely than lesser transgressions"); see also Anthony J. Sebok, *What Did Punitive Damages Do? Why Misunderstanding the History of Punitive Damages Matters Today*, 78 CHI.-KENT L. REV. 163, 204–05 (2003) (concluding that the Court in *Cooper* erred in relying on a historical rationale for punitive damages as serving a compensatory purpose).

\(^{46}\) TEX. CIV. PRAC. & REM. CODE ANN. §41.003 (2004)

degree of risk, considering the probability and magnitude of the potential harm to others; and

(B) of which the actor has actual, subjective awareness of the risk involved, but nevertheless proceeds with conscious indifference to the rights, safety, or welfare of others.48

Upon the Texas trier-of-fact's unanimous determination that the plaintiff has satisfied his or her burden as to the existence of this reprehensible conduct, the plaintiff may then seek punitive damages. Upon this finding, one may then argue that the defendant must not only compensate the plaintiff for his damages, but must also be punished in order to deter the defendant from such conduct in the future, as well as to deter others similarly situated from engaging in such conduct.

Although this factor may be one of the more important factors to consider as to whether an award of punitive damages is appropriate (and if it is not appropriate, then any amount awarded would be considered excessive), it does not provide any insight as to whether an award is excessive in terms of constituting a punishment and/or deterrence.

VIII. THE DISPARITY BETWEEN THE ACTUAL OR POTENTIAL HARM SUFFERED BY THE PLAINTIFF AND THE PUNITIVE DAMAGES AWARD

The second indicium of an "unreasonable or excessive punitive damages award," which is applied by the Court, is the "ratio to the actual harm inflicted on the plaintiff."49 The Court refers to this prong of the inquiry as the "reasonable relationship" test; the Court has held that the award of exemplary damages must bear a reasonable relationship to the compensatory damages.50 Although the Court has been reluctant to identify concrete constitutional limits on the ratio of the harm, or potential harm,

48 Id.
49 BMW, 517 U.S. at 580 (noting that this concept has a long pedigree in English common law); TXO Prod. Corp. v. Alliance Res. Corp., 509 U.S. 443, 459 (1993) (acknowledging plaintiff's argument that the award of 526 times the actual damages is excessive); Pacific Mut. Life Ins. Co. v. Haslip, 499 U.S. 1, 23 (1991) (noting that the "reasonably satisfied from the evidence" standard for punitive damages is sufficient to survive a Due Process challenge).
50 BMW, 517 U.S. at 580 (noting that the "decisions in both Haslip and TXO endorsed the proposition that a comparison between the compensatory award and the punitive award is significant").
to the plaintiff and the punitive damage award, the Court stated that "few awards exceeding a single-digit ratio between punitive and compensatory damages will satisfy due process."\(^5\)

The Court's reasonable relationship test is not grounded on any objective standard; instead, it is grounded on the arbitrary dictum of the Court. More importantly, this prong is myopic in that it considers only the harm suffered by the plaintiff and fails to consider any individual or specific characteristics relevant to the defendant. This one-dimensional inquiry completely ignores data relevant to whether the magnitude of the award constitutes a *punitive* award from the defendant's perspective so that it will deter future similar wrongful conduct. We observe that an award that ultimately satisfies the Court's "reasonable relationship" test may nonetheless fail to punish and/or deter the defendant for his or her reprehensible conduct. While the award may be reasonably related to the harm (whatever that might mean), it may fail completely at being perceived by the defendant to be a punishment and thus lose its deterring effect.

Successful deterrence results from the defendant (or others similarly situated) making a rational choice to abstain from engaging in future reprehensible conduct. The Court's inquiry is completely void of any concern regarding the actual deterring effect of the punitive award. The Court's recent rulings ignore whether the award may have a deterring effect. Therefore, its approach may render punitive damage awards in many cases nothing more than an award of *enhancement* damages. To the extent the award may nonetheless result in a deterring effect on future reprehensible conduct, such an effect will be the result of chance only (the chance that, while it may satisfy the Court's reasonable relationship test, it is coincidently perceived by the defendant as punitive). The Court's algorithm for reviewing punitive damages essentially ignores the *punitive* nature of such damages.

IX. THE DIFFERENCE BETWEEN THE PUNITIVE DAMAGES AWARDED BY THE JURY AND CIVIL PENALTIES AUTHORIZED OR IMPOSED IN COMPARABLE CASES

The third and final indicia of excessiveness by the Court to compare the punitive damages award with the civil or criminal penalties that could be imposed for comparable misconduct.\textsuperscript{52} We reiterate that this prong of the inquiry completely ignores whether the award itself is actually punitive in nature. We therefore limit our discussion of this prong by observing that it provides the court with substantial discretion with respect to its determination of what is a comparable civil or criminal penalty.

The Court’s application of this tenet appears to be limited to identifying comparable, legislatively imposed, penalties and not other court imposed sanctions. This arguably dismisses the importance of the judicial branch of government. Moreover, given our common law tradition, we note that we would expect the existence of such legislative penalties to be limited; it is not reasonable to expect that one will likely find many relevant legislative sanctions against which to compare the award in question. Moreover, if such a comparison is merited, should the court not also take into consideration the many criminal penalties resulting in the forfeiture of liberty?

Many states impose the penalty of death for intentional, reprehensible conduct resulting in the death of another.\textsuperscript{53} Although excessive punitive damages may arguably be the equivalent of a death penalty with respect to a certain business, given the magnitude of the award, this requirement may nonetheless be relevant given the similar reprehensible conduct of a criminal defendant. In short, we conclude that this third prong of the analysis is at best ambiguous, distracting, and dubious.

\textsuperscript{52} BMW, 517 U.S. at 583 (noting that past jurisprudence has advised showing substantial deference to the legislature in determining punishment); State Farm, 538 U.S. at 425 (clarifying that “punitive damages are not a substitute for the criminal process, and the remote possibility of a criminal sanction does not automatically sustain a punitive damages award”).

\textsuperscript{53} See Adam M. Gershowitz, Note, The Supreme Court’s Backwards Proportionality Jurisprudence: Comparing Judicial Review of Excessive Criminal Punishments and Excessive Punitive Damages Awards, 86 VA. L. REV. 1249, 1253 (2000) (noting that “in its death-penalty jurisprudence, the Supreme Court has recognized that deprivations of life are entitled to more protection than deprivations of liberty”).
X. THE ECONOMICS OF PUNISHMENT AND DETERRENCE

Punishment and deterrence are individual-specific and related constructs. Although it is often said that the punishment prescribed by the trier-of-fact for one’s wrongful act is the price one must pay to society for his or her wrongful indulgence, it is also the threat of being assessed this price that serves to deter the wrongful conduct. While it is also often stated that “the punishment must fit the crime,” it must also fit the character of wrongful actor, e.g., the availability of probation for first time offenders, maximum sentences to repeat offenders, etc. The prescribed punishment internalizes the costs of wrongful, reprehensible conduct. The magnitude of the punishment (the price) necessarily places the wrongdoer in a scenario of rational choice. In the absence of punishment or threat of punishment, the cost of wrongful, reprehensible conduct is external to the rational acting individual. Accordingly, legally prescribed punishments attempt to correct market failure as it pertains to the internalization of the costs associated with antisocial conduct.

While the Supreme Court reiterates its view of punitive damages as being aimed at the purposes of deterrence and retribution, the Court ignores the relevant economic

54 Russell L. Christopher, The Prosecutor’s Dilemma: Bargains and Punishments, 72 FORDHAM L. REV. 93, 127 (2003) (stating “integral to retributivism is the notion that punishment must be in proportion to, and to the extent of, an offender’s just deserts”).

55 See Steven L. Chanenson and John Y. Gotanda, The Foggy Road for Evaluating Punitive Damages: Lifting the Haze from the BMW/State Farm Guideposts, 37 U. MICH. J.L. REF. 441, 444 (2004) (arguing that the “guideposts” are difficult to use and have resulted in inconsistent decisions and that a third guidepost should compare the punitive damages award to the criminal or civil sanctions that could be imposed for conduct which is comparable).

56 See Ryan, supra note 44, at 92 on the rationality of the U.S. system regarding punitive damages:

[T]he U.S. System may operate in a manner that is confusing-some may say inefficient-it is not irrational. This is not to say that the U.S. tort system does not need reform, because it does. With respect to who receives the payouts of punitive damage awards, i.e. generally the victim, the author supports a commonly held reform view that punitive damages should be paid (at least partially) to government. Although this view still needs to be reconciled against the incentive argument, i.e. that plaintiffs should have an incentive to bring to court cases in which defendant conduct is egregious and against public policy. A trend in tort reform is already in place that requires portions of punitive damages to be given up by the plaintiffs; so far eight states have enacted laws in this regard. On the whole, however, solid empirical data exist to show that the full review procedure will often assure rational results for tort cases in the end. BMW v. Gore is an example of this rationality as a case that emerged from the full functioning of the U.S. system.
underpinnings related to the same. In determining whether punitive damages are excessive, it is necessary that the magnitude of the punitive damage award be assessed in the context of the wrongdoer's budget and/or isocost constraint functions. Clearly, the magnitude of the punitive damage must have some relationship to the tortfeasor's budget and/or isocost constraints. Ignoring any such relationship negates any underlying rationale for punishment and deterrence and renders the award of punitive damages much more susceptible to arbitrary implementation.

XI. THE RATIONAL CHOICE MODEL, ISOQUANT AND ISOCOST FUNCTIONS

Drawing from the fundamentals of microeconomics and price theory, it can be demonstrated that punitive damages must have some relationship to the financial status (the willingness or ability to pay) of the tortfeasor. If we assume a two input model of production consisting of neither capital nor labor, but rather, reprehensible production techniques and reasonable production techniques, we can derive an isoquant denoted below by I₁. Isoquant I₁ shows all combinations of inputs that yield the same level of output.

The amount of the two inputs (reprehensible and reasonable conduct) that the firm uses will depend on the prices of these inputs. The cost of hiring either of these factor inputs is

represented by a firm's isocost function. An isocost line shows all possible combinations of the two inputs that can be purchased for a given total cost.

The total cost $C$ of producing any particular output is given by the sum of the firm's input costs associated with reprehensible production activity and reasonable production activity summarized by the following linear equation:

$$C = P_x Q_x + P_y Q_y,$$

where

$C =$ total costs of production,

$P_x =$ the price of reasonable input activities,

$Q_x =$ the quantity of reasonable input activities utilized in production,

$P_y =$ the price of reprehensible input activities, and

$Q_y =$ the quantity of reprehensible input activities utilized in production.

If we rewrite the total cost equation as an equation for a straight line, we derive:

$$Q_y = C/P_y - (P_x/P_y)Q_x$$
It follows that the isocost line has a slope of $\Delta Q_y/\Delta Q_x$ (the change in quantity of reprehensible input activities utilized in the firm's production activities divided by the change in quantity of reasonable input activities utilized in the firm's production activities) which is equal to $-(P_x/P_y)$, the ratio of the price of reasonable input activities to the price of reprehensible input activities. It tells us that if the firm gave up a unit of reasonable input activities (and recovered $P_x$ dollars in cost) to buy $P_x/P_y$ units of reprehensible input activities at a cost of $P_y$ dollars per unit, the total cost of production would remain the same. For example, if the cost or price of reasonable input activities ($P_x$) was $10$ and the cost or price of reprehensible input activities ($P_y$) was $5$, the firm could replace one unit of reasonable input activities with two units of reprehensible input activities with no change in total cost.

A rationally acting firm will choose a combination of inputs where the firm's isoquant is tangent with the firm's isocost curve. The point of tangency of Isoquant $I_1$ and the isocost line reveals the cost-minimizing choice of inputs $Q_x$ and $Q_y$, which can be read directly from the above diagram. At this point, the slopes of the isoquant and the isocost lines are just equal.

Suppose that the price of reprehensible input activities were to increase as a result of the imposition of punitive damages. In that case, the slope of the isocost line $-(P_x/P_y)$ would increase in magnitude and the isocost line would become flatter.
The above diagram illustrates that the firm minimizes its costs of producing output $I_1$ by using $Q_x$ units of reasonable input activities and $Q_y$ of reprehensible input activities. When the price of reprehensible input activities increase, the firm's isocost function (or line) becomes flatter, pivoting on the X axis with the Y intercept shifting downward from $C/P_y$ to $C/P_y'$. Facing the higher price for reprehensible input activities, the firm minimizes its cost of production at $I_2$ utilizing $Q_x'$ units of reasonable input activities and $Q_y'$ units of reprehensible input activities. Notably, the rational firm has responded to the higher price of reprehensible input activities by substituting reasonable input activities for reprehensible input activities in the production process.

Equally important is that the higher price for reprehensible input activities resulting from the imposition of punitive damages also constrains the firm's input cost budget. Therefore, it can no longer afford to produce at the same level of production represented by isoquant $I_1$, but rather can only attain $I_2$ level of production at its point of tangency with the firm's isocost function with punitive damages.

In summary, the rational actor model that drives fundamental microeconomic theory upon, which the success of our large commercial republic thrives, demonstrates that the imposition of punitive damages requires a firm to internalize the cost of production associated with reprehensible conduct. Punitive
damages increases the price of reprehensible input activities that results in a rational firm decreasing its use of reprehensible input activities \( Q_y \) and increasing its use of reasonable input activities \( Q_x \). The magnitude of the effect on the firm's production activities and its choice of inputs necessarily depend on the firm's production budget and financial status of the firm, the wealthier the firm or greater its ability to pay, the smaller the effect. Accordingly, one of the dominant factors any court should consider when reviewing the award of punitive damages is the financial position of the firm, i.e. its isocost function (or production cost budget). The extent to which a firm is "willing to pay" the punitive price for reprehensible production activities is a function of the firm's isoquant and isocost functions. To ignore these individual-specific functional relationships renders the stated purposes of punitive damages, i.e. punishment and deterrence, meaningless.

XII. CONCLUSION

The existing synergy driving tort reform across the United States is grounded upon the economic utility of special interest groups. It ultimately threatens the fundamental economic principles upon which our great commercial republic thrives. Ironically, the proponents of tort reform welcome legislation and/or judicial mandates that essentially challenge, if not eliminate, critical components of the pricing mechanism of a perfectly competitive marketplace of which such proponents would unequivocally and zealously object if implemented in their relevant commercial markets. Accordingly, it is no surprise that the recent Supreme Court opinions rendered in BMW, Cooper and State Farm are perceived as welcomed victories by most tort reformers. However, such perceptions are economically ill-conceived.

Acknowledgement of individual producer and consumer isoquant and isoutility functions is fundamental in the study of microeconomics. More importantly, its recognition is vital to the efficient production, allocation and consumption of scarce resources. Producer and consumer isoquant and isoutility functions reflect the unique values market participants place on goods and services in all markets. Simply put, utility is the
satisfaction gained by producers and consumers in their respective economic transactions. The drive to maximize such utility fuels economic activity, minimizes economic waste, and maximizes market efficiencies, resulting in the creation of economic wealth.

Economic theory, as well as historical experience, demonstrates that governments cannot accurately regulate, mandate, or dictate individual economic utility. Economics has long observed that economic utility is profoundly unique to each producer and/or consumer, such that it is only capable of being measured from an individual perspective. Economic choice emanates from the efforts of atomistic individuals pursuing the maximization of their economic utility as they identify, reveal, and act upon their respective tastes and preferences in the market place. Market participants value goods and services differently. For example, one market participant values the consumption of certain products more than other market participants, and it is the manifestation of these unique values from which the supply and demand forces of the product market in question efficiently determine market prices.

The Supreme Court's recent proactive review of state court punitive damage awards is driven by a tripartite analysis that ignores the fundamental economic underpinnings of punishment and deterrence. While identifying the issue of excessiveness relevant to the awarding of punitive damages, the Court fails to provide any improvement with respect to the same, especially given its myopic reasoning and its unawareness of applicable economic theory. Such unawareness will likely influence the tortfeasor's rational-cost minimizing choice with respect to the utilization of reasonable and/or reprehensible input activities. If the price of reprehensible input activities decreases relative to the price of reasonable input activities, then one can anticipate an increase in such reprehensible activities.

Moreover, the Supreme Court's dismissive attitude towards the economics of deterrence and punitive damages is discouraging.58

By avoiding the economics underlying deterrence, the Supreme Court is characteristically reducing an entitlement and ultimate award of punitive damages to that of *enhancement damages*. Such damages are no longer grounded on and driven by conventional economic constructs, but rather are now grounded on the arbitrary precedent of the appellate judiciary.

By extension, the above analysis is applicable as well to other tort-reform measures, such as statutory mandates capping damages. To the extent such statutory caps operate to distort the price tortfeasors must pay to engage in negligent conduct, such caps will result in inefficient judicial outcomes. Statutory damage caps essentially fix the maximum price a tortfeasor must pay to engage in negligent activity. Accordingly, compensatory damages subject to statutory mandated caps (like the judicially mandated caps discussed above) are grounded on arbitrary policy choices, rather than the conventional economic constructs that have long been endorsed by and have fueled our commercial republic.

with respect to the award of punitive damages. *Id.* Justice Steven's maintained that "[h]owever attractive such an approach to punitive damages might be as an abstract policy, it is clear that juries do not normally engage in such a finely tuned exercise of deterrence calibration when awarding punitive damages." *Id.* at 439.