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

Steve P. Calandrillo*

Abstract

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

This Article critically examines modern punitive damages jurisprudence using a law and economics lens. From that standpoint, there is no justifiable basis for tort law’s requirement of morally reprehensible or intentional conduct before punitive damages may be awarded. Indeed, punitives should be imposed—must for deterrence purposes—even in the absence of egregious behavior, when a defendant has escaped liability previously, either intentionally or serendipitously. In this manner, the punitive award makes up for the occasions in which the defendant avoided liability and failed to compensate victims for harm caused. On the other hand, sound economic analysis dictates that imposing enormous punitive damages simply because a tortfeasor’s behavior was morally offensive can inadvertently lead to overdeterrence, price inflation.

* Associate Dean and Charles I. Stone Professor of Law, University of Washington School of Law. J.D., Harvard Law School; B.A., University of California at Berkeley. I wish to express my gratitude to Tyler Arnold and the Marian Gould Gallagher reference librarians for their excellent research assistance, as well as to Jeff Fisher, Greg Adams, Craig Allen, Dustin Buehler, Chryssa Deliganis, Josh Gaul, Greg Gorder, Zach Hiatt, Amy Howe, Doug Hutchinson, Allen Israel, John John, Robert Kunold, Shan Mullin, Peter Nicolas, Dave Oesting, Bill Rodgers, Dave Tarshes, Kellye Testy, Holly Vance, and Lou Wolcher for inspiration and helpful comments in writing this Article. My sincere thanks as well go to the Washington Law Foundation and the Charles Stone professorship for their generous financial support.

In the interest of full disclosure, this Article’s author was one of the contributors to an amicus brief before the U.S. Supreme Court in Exxon Shipping Co. v. Baker, 128 S. Ct. 2605 (2008), which dealt with litigation over the infamous Exxon Valdez oil spill. Brief Amici Curiae of Sociologists, Psychologists, & Law & Economics Scholars in Support of Respondents, Exxon Shipping Co., 128 S. Ct. 2605 (No. 07-219), 2008 WL 275482. This brief was unique in that it employed an economics-based argument in favor of punitive damages against Exxon rather than relying on the traditional and, in our opinion, unprincipled and arbitrary approach taken by the Supreme Court in punitive damages cases.
beyond optimum, quantity of goods purchased below optimum, and a significant reduction in overall social welfare. In sum, the Supreme Court must drastically revise its approach to punitive damages jurisprudence: such awards should not be arbitrarily based on a gut reaction to how reprehensibly we feel a defendant acted. Rather, punitive damages should be granted only where tortfeasors have the potential to escape liability for their actions, and they should be awarded in that case even if the defendant in no way meets the modern requirement of egregious behavior. Moreover, the Supreme Court’s arbitrary due process litmus test of ten times compensatory damages as a ceiling on punitive damages makes zero sense from an economic analysis point of view, and needs to be summarily abolished.

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Introduction

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

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2. See, e.g., State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 419 (2003) (“[T]he most important indicium of the reasonableness of a punitive damages award is the degree of reprehensibility of the defendant’s conduct.”) (alteration in original) (quoting BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 575 (1996))). The view that punitive damages should be used to send...
In its defense, the Supreme Court has been concerned about preventing juries from handing down punitive damages awards that are entirely arbitrary.\(^3\) Unfortunately, the manner in which the Court has gone about curing this problem has been completely arbitrary in its own right. In the early 1990s, the Court required that a jury be given instructions that provide “reasonable constraints” on its discretion to provide punitive damages.\(^4\) Two years later, in *TXO Production Corp. v. Alliance Resources Corp.*,\(^5\) a divided Court found that punitive damages awards could not be “grossly excessive,” whatever that phrase might be interpreted to mean.\(^6\) *Honda Motor Co. v. Oberg*\(^7\) followed, in which the Court found that judicial review of punitive damages awards was necessary because such oversight provided a check on punitive damage awards that may be the result of bias or prejudice toward the defendant.\(^8\) Shifting its analysis to one predicated on the notion that punitive damages are quasi-criminal, the Court held in *Cooper Industries, Inc. v. Leatherman Tool Group, Inc.*\(^9\) that courts of appeals must review punitive awards under a de novo standard.\(^10\) The Court justified this opinion by invoking the old adage that punishment must be proportional to the offense, while explicitly referencing the Eighth Amendment’s prohibition on excessive fines and cruel and unusual punishment.\(^11\)

Unfortunately, the Court’s solution in each case failed to solve the ultimate problem: jury awards that aim to put a price tag on the defendant’s level of moral reprehensibility are inherently arbitrary.

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\(^3\) See *Exxon Shipping Co.*, 128 S. Ct. at 2627 (“[A] penalty should be reasonably predictable in its severity, so that even Justice Holmes’s ‘bad man’ can look ahead with some ability to know what the stakes are in choosing one course of action or another.” (citing Oliver Wendell Holmes, *The Path of the Law*, 10 Harv. L. Rev. 457, 459 (1897))).


\(^6\) Id. at 458.


\(^8\) Id. at 432 (holding that the absence of judicial review violated due process).


\(^10\) Id. at 443.

Under modern traditional Supreme Court jurisprudence, there is simply no way to consistently or fairly put a dollar value on society’s disapproval of certain “reprehensible” behaviors. Justice Scalia, criticizing the majority opinion in *BMW of North America, Inc. v. Gore*,12 which presumptively limited punitive damages to no more than ten times actual harm,13 stated that “[t]he Court has constructed a framework that does not genuinely constrain, that does not inform state legislatures and lower courts—that does nothing at all except confer an artificial air of doctrinal analysis upon its essentially ad hoc determination that this particular award of punitive damages was not ‘fair.’”14

Moreover, current jurisprudence, which examines a defendant’s financial condition before assessing punitive damages,15 results in disparate and unequal treatment because the damages award is not based on an individual’s actual conduct, but instead on an individual’s position.16 Justice O’Connor in her *TXO* dissent specifically expressed this fear, explaining that “[c]ourts long have recognized that jurors may view large corporations with great disfavor.”17 Unfortunately, this concern has more than materialized in recent Supreme Court decisions.18

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13 See id. at 581–82. Though the Court maintained it was not establishing “a simple mathematical formula,” id. at 582, this seems to be a rule honored in the breach. For research suggesting that lower courts do tend to use a simple mathematical formula, see generally Lauren R. Goldman & Nickolai G. Levin, *State Farm at Three: Lower Courts’ Application of the Ratio Guidepost*, 2 N.Y.U. J.L. & BUS. 509 (2006).
14 *BMW of N. Am., Inc.*, 517 U.S. at 606 (Scalia, J., dissenting).
15 See, e.g., *Green Oil Co. v. Hornsby*, 539 So. 2d 218, 222 (Ala. 1989) (“The defendant’s financial position is . . . a consideration essential to a post-judgment critique of a punitive damages award.”).
16 Perhaps analogously, Dr. Martin Luther King, Jr., famously longed for the day when persons would “be judged [not] by the color of their skin but by the content of their character.” Martin Luther King, Jr., I Have a Dream, Speech at the Lincoln Memorial, Washington, D.C. (Aug. 28, 1963), in 114 CONG. REC. 9163, 9165 (1968). Of course, there is a difference between racial discrimination against individuals and financial discrimination against wealthy corporations, but the same basic principle that actors should be judged on their actions (rather than who they are) applies.
18 Cf. *Pac. Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 22 (1991) (noting that while the factfinder can properly consider the financial position of the defendant, that should not mean that plaintiffs should “enjoy a windfall [simply] because they have the good fortune to have a defendant with a deep pocket”). Of course, juries do not always consider a defendant’s financial position when determining punitive damages. Compare id. at 6 (noting that the jury did not hear evidence on Pacific Mutual’s wealth), *with Exxon Shipping Co. v. Baker*, 128 S. Ct. 2605, 2614
Against this backdrop, the oft-criticized law and economics movement provides a principled, workable solution by viewing punitive damages as a means of creating socially optimal deterrence and levels of care, rather than as a tool for imposing punishment for morally reprehensible actions.\textsuperscript{19} The ultimate goal of modern tort law jurisprudence should be to make injurers internalize the full costs of all of their actions so that they will take the proper level of care—not too much, not too little, but just right.\textsuperscript{20} Jurors would have no reason to take into account a defendant’s wealth, but would instead be asked to focus on what amount of money would incentivize the defendant, or other similarly situated parties, to act in a socially optimal manner in the future.\textsuperscript{21} Such an analysis would avoid arbitrary determinations of how offensive the particular defendant’s behavior was, and instead would focus on whether she had a chance of escaping liability that justified the award of punitive damages.\textsuperscript{22} Indeed, punitive damages should be imposed (nay, must for deterrence purposes) even in the absence of egregious behavior when a defendant has escaped liability previously, either intentionally or serendipitously. Conversely, sound economic analysis dictates that imposing punitive damages simply because a tortfeasor’s behavior was morally offensive can inadvertently lead to overdeterrence, price increases beyond optimum, quantity of

\textsuperscript{19} See A. Mitchell Polinsky & Steven Shavell, \textit{Punitive Damages: An Economic Analysis}, 111 \textit{Harv. L. Rev.} 869, 873–76 (1998) (arguing that punitive damages should be utilized to serve the goal of deterrence rather than that of punishment per se). Polinsky and Shavell note that Jeremy Bentham was perhaps the first to observe that sanctions must be increased in order to achieve optimal deterrence if defendants can potentially escape liability. See id. at 876 n.12; \textit{Jeremy Bentham, Principles of Penal Law}, in \textit{The Works of Jeremy Bentham} 365, 402 (John Bowring ed., 1962) (“[A]s there are always some chances of escape, it is necessary to increase the value of the punishment, to counterbalance these changes of impunity.”). Other notable economic scholars who have addressed punitive damages include Robert D. Cooter, \textit{Punitive Damages for Deterrence: When and How Much?}, 40 \textit{Ala. L. Rev.} 1143 (1989), and Bruce Chapman & Michael Trebilcock, \textit{Punitive Damages: Divergence in Search of a Rationale}, 40 \textit{Ala. L. Rev.} 741 (1989).

\textsuperscript{20} See generally Polinsky & Shavell, supra note 19, at 873, 878–900 (discussing optimal damages for deterrence purposes when the defendant is found liable with certainty or can sometimes escape liability, and the relationship between punitive damages and the basic economic theory of deterrence).

\textsuperscript{21} See id. at 910–14.

\textsuperscript{22} Legendary Seventh Circuit Judge Richard Posner was one of the first to reference the factor of escaping liability as a justification for the imposition of punitive damages. See \textit{Richard A. Posner, Economic Analysis of Law} 77–78 (1972); see also Dorsey D. Ellis, Jr., \textit{Fairness and Efficiency in the Law of Punitive Damages}, 56 \textit{S. Cal. L. Rev.} 1, 25–26 (1982).
goods purchased far below optimum, and a significant reduction in overall social welfare.

I. Traditional Punitive Damages Law

The concept of punitive damages has ancient origins. The following discussion traces the evolution of such damages from antiquity, through English common law, and into American jurisprudence, including the complex and (at times) contradictory legal rubric fashioned by the modern U.S. Supreme Court for determining the constitutional limitations on punitive damages.

A. Historical Origins

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

The modern concept of punitive damages first arose in England in the case of Wilkes v. Wood.25 In 1762, John Wilkes published a pamphlet that was allegedly libelous against the king.26 In response, Wilkes's house was searched and his property seized by, among others, Wood.27 The Court of Common Pleas granted Wilkes’s request for punitive damages in his case against the king’s agent because compensatory damages were deemed too small to deter the wrongdoer from causing such harm again.28 English courts have since also utilized punitive damages to compensate for nonpecuniary losses such as harm to one’s image.29

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23 SCHLUETER, supra note 1, at 2.
24 BARRY NICHOLAS, AN INTRODUCTION TO ROMAN LAW 217 (1975).
26 Id. at 493–94.
27 Id. at 489–91.
28 Id. at 498–99.
29 See Benson v. Frederick, (1766) 97 Eng. Rep. 1130 (K.B.) (upholding a damages award that was greater than the physical harm because the injury was unreasonable and the victim “was scandalized and disgraced”).
In the United States, there was some confusion over the purpose of punitive damages when they were initially introduced into our legal system. At times they were used as extracompensatory damages to account for the trial fees incurred by successful litigants, whereas at other times they focused on the more traditional goals of punishment and deterrence. Over a century ago, in Lake Shore & Michigan Southern Railway v. Prentice, the Supreme Court described punitive damages as “being awarded, not by way of compensation to the sufferer, but by way of punishment of the offender, and as a warning to others.” More recently, the Court restated this view, explaining that punitive damages “are not compensation for injury. Instead, they are private fines levied by civil juries to punish reprehensible conduct and deter its future occurrence.”

B. Modern Supreme Court Jurisprudence

The following discussion examines seven seminal cases in which the Court undertook to clarify the relationship between punitive damages and the constitutional rights of defendants. Unfortunately, the resulting body of law is complex, confusing, and preoccupied with seemingly arbitrary constitutional limitations; lacks a coherent and consistent regime for determining punitives; and, most disturbingly, fails to serve the essential functions of punitive damages: punishment, deterrence, and supplemental compensation.

1. Haslip: Seven Factors to Guide the Jury

Modern Supreme Court rulings on punitive damages have largely focused on the issue through the lens of the Due Process Clause of the Fourteenth Amendment, asking whether the sanction is so “arbitrary”...
or “grossly excessive” as to deprive the defendant of its constitutional right to due process under the law.\textsuperscript{36} In 1991, the Court decided \textit{Pacific Mutual Life Insurance Co. v. Haslip},\textsuperscript{37} a case involving an insurance agent’s fraudulent failure to renew his client’s health insurance policy.\textsuperscript{38} The jury returned a general verdict of $1,040,000,\textsuperscript{39} of which at least $840,000 was classified as punitive damages.\textsuperscript{40} The Court focused its analysis on whether the jury’s discretion in determining the award was subject to “reasonable constraints” so as not to be entirely arbitrary.\textsuperscript{41} Citing the Alabama Supreme Court’s review with approval, Justice Blackmun reiterated seven factors that a court should employ to evaluate its punitive damages award.\textsuperscript{42} A court is to consider:

\begin{enumerate}
\item [(a)] whether there is a reasonable relationship between the punitive damages award and the harm likely to result from the defendant’s conduct as well as the harm that actually has occurred;
\item [(b)] the degree of reprehensibility of the defendant’s conduct, the duration of that conduct, the defendant’s awareness, any concealment, and the existence and frequency of similar past conduct;
\item [(c)] the profitability to the defendant of the wrongful conduct and the desirability of removing that profit and of having the defendant also sustain a loss;
\item [(d)] the “financial position” of the defendant;
\item [(e)] all the costs of litigation;
\item [(f)] the imposition of criminal sanctions on the defendant for its conduct, these to be taken in mitigation; and
\item [(g)] the existence of other civil awards against the defendant for the same conduct, these also to be taken in mitigation.\textsuperscript{43}
\end{enumerate}

The Court determined that the objective criteria used by the lower courts to evaluate the propriety of the jury’s award (including

\textsuperscript{38} \textit{Id.} at 4–6.
\textsuperscript{39} \textit{Id.} at 6–7.
\textsuperscript{40} \textit{Id.} at 7 n.2.
\textsuperscript{41} \textit{Id.} at 20 (“As long as the [jury’s] discretion is exercised within reasonable constraints, due process is satisfied.”).
\textsuperscript{42} \textit{Id.} at 21–22.
\textsuperscript{43} \textit{Id.}
defendant’s degree of reprehensibility) satisfied due process concerns and therefore upheld the punitive damages award.  

Justice Scalia concurred in the judgment, but expressed his belief that the Constitution itself placed no explicit constraints on punitive damages awards. He defended this position by noting that punitive damages were “undoubtedly an established part of the American common law of torts” when the Fourteenth Amendment was passed. No special procedures were thought necessary at the time of the passage of the Fourteenth Amendment, so the Court should not impose its own version of “reasonable constraints” on the jury’s discretion to award punitive damages.

In her dissenting opinion, Justice O’Connor eloquently described the key element—arbitrariness—that has ultimately led to such inconsistent and confused Supreme Court rulings on the subject. Justice O’Connor believed that the Court needed to impose stronger constraints on a jury’s discretion to avoid such unpredictable punitive damages awards. While she did not question the legitimacy of punitive damages in general, the Justice stated boldly, “I see a strong need to provide juries with standards to constrain their discretion so that they may exercise their power wisely, not capriciously or maliciously. The Constitution requires as much.” She added that “[v]ague references to ‘the character and the degree of the wrong’ and the ‘necessity of preventing similar wrong’ do not assist a jury in making a reasoned decision; they are too amorphous.” Justice O’Connor’s solution was to require that states adopt precise methods to constrain juries in their imposition of punitive damages and to fix the amounts awarded. She did not offer a specific method, but believed that states should be allowed to experiment with and define their own methods.

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44 Id. at 23–24.
45 Id. at 24–25 (Scalia, J., concurring in the judgment).
46 Id. at 26.
47 Id. at 26–28.
48 Id. at 63 (O’Connor, J., dissenting).
49 Id. at 42–43.
50 Id. at 43.
51 Id. at 48.
52 Id. at 63.
53 Id. at 63–64. Justice O’Connor has long been known as an ardent supporter of entrusting controversial topics to the “laboratory of the States.” Cruzan v. Dir., Mo. Dep’t of Health, 497 U.S. 261, 292 (1990) (O’Connor, J., concurring). For example, though joining the majority in upholding New York’s ban on physician-assisted suicide in Vacco v. Quill, 521 U.S. 793 (1997), she nevertheless stated her belief that other states could legalize and regulate the practice if they so chose, Washington v. Glucksberg, 521 U.S. 702, 736–38 & n.† (1997) (O’Connor, J., concurring), opening the door to Oregon’s Death with Dignity Act. On this latter topic, see generally
Justice O’Connor’s dissent highlighted a crucial flaw in the Supreme Court’s punitive damages jurisprudence: namely, how can punitive damages awards avoid being arbitrary when they are based on inherently subjective factors like the defendant’s degree of reprehensibility? Up to this point in our judicial history, the Court was unsuccessfully employing a procedural due process rationale to address this core question. In the following case, the Court turned to a different set of constitutional principles for its analysis.

2. **TXO: Punitive Damages Must Not Be “Grossly Excessive”**

In *TXO Production Corp. v. Alliance Resources Corp.*, a splintered Supreme Court attempted to further constrain punitive damages awards, invoking constitutional substantive due process protections in addition to purely procedural ones. In explaining this doctrinal shift, Justice Stevens opined that “the Due Process Clause of the Fourteenth Amendment imposes substantive limits ‘beyond which penalties may not go’”; therefore, under this *TXO* test, such awards may not be “grossly excessive.” Despite this alleged concern, the plurality ultimately upheld a punitive damages award in *TXO* that was 526 times greater than the compensatory damages in the case because the defendant’s actions could have led to substantial loss for the plaintiffs and because its behavior was “part of a larger pattern of fraud, trickery and deceit.”

Perhaps cognizant of Justice O’Connor’s fears in *Haslip*, Justice Kennedy stated in his *TXO* concurrence that the Court’s review of
Punitive damages should focus not on some abstract concept like whether an award is “grossly excessive,” but rather should focus on the jury’s actual reasons for its award. The due process protection is not based on a specific dollar amount or ratio but rather avoidance of “arbitrary or irrational deprivations of property.” Justice Kennedy pointed out that the jury could rationally have made its award based on evidence of the defendant’s “deliberate, wrongful conduct” to meet “the [state’s] goals of punishment and deterrence.”

3. **BMW: Three Guideposts**

The next significant opportunity for the Court to refine limits on punitive damages came in *BMW of North America, Inc. v. Gore*, a seminal case in which an Alabama jury initially awarded $4000 in compensatory damages and $4 million in punitive damages to the defrauded owner of a BMW vehicle. The case was based on BMW’s practice of repainting slightly damaged cars and selling them as new without disclosing the damage to buyers. Deciding it was finally time to set out a clear standard for reviewing punitive damages awards, the *BMW* Court famously laid out “[t]hree guideposts” for analysis:

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

The first factor explicitly requires a court to examine “the degree of reprehensibility of a defendant’s conduct,” stating it was “[p]erhaps the most important indicium of the reasonableness of a punitive dam-

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59 *TXO Prod. Corp.*, 509 U.S. at 466–67 (Kennedy, J., concurring in part and concurring in the judgment).
60 Id. at 467.
61 Id. at 469. In another concurrence, Justice Scalia reiterated his position that the Constitution requires only reasonable procedural protections and places no “reasonableness” limitation on the amount of punitive damages. Id. at 471 (Scalia, J., concurring in the judgment).
63 Id. at 564–65. The $4 million punitive judgment was later reduced by the Alabama Supreme Court to $2 million, but even that reduction still faced constitutional challenge before the U.S. Supreme Court. Id. at 567.
64 *See id.* at 562–64.
65 *See id.* at 574–85.
ages award.” The Court justified its emphasis on this prong by explaining simply that “some wrongs are more blameworthy than others” and thus may support a larger award. In its review of the specific facts of the BMW case, the Court examined whether the harm was “purely economic” and whether the defendant’s actions demonstrated a “reckless disregard for the health and safety of others.” Further, it added that the degree-of-reprehensibility guidepost may also allow for more severe penalties based on a repeated pattern of bad conduct.

The second BMW factor dictated that punitive “damages must bear a reasonable relationship to compensatory damages.” Justice Stevens explained this comparative-ratio analysis, pointing out that the Haslip Court had found a relationship of 4:1 to be close to the constitutional limit, and that the Court in TXO “suggested that the relevant ratio was not more than 10 to 1.” The BMW Court rejected the adoption of an absolute mathematical ratio, however, again focusing the inquiry on whether an award was reasonable. Depending on the other BMW factors, a low compensatory damages award may support a higher ratio if “a particularly egregious act has resulted in only a small amount of economic damages.”

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

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66 Id. at 575.
67 Id.
68 Id. at 576.
69 Id. at 577.
70 Id. at 580 (internal quotation marks omitted).
71 Id. at 581 (citing Pac. Mut. Life Ins. Co. v. Haslip, 499 U.S. 1, 23–24 (1991)).
72 Id.
73 Id. at 582–83.
74 Id. at 582.
75 Id. at 583.
76 See id.
77 See infra Part III.
78 BMW of N. Am., Inc., 517 U.S. at 584.
4. Cooper v. Leatherman: Searching Scrutiny of Punitive Awards

In 2001, the Supreme Court added teeth to the BMW standard in the case of Cooper Industries, Inc. v. Leatherman Tool Group, Inc.79 The litigation concerned a dispute between rival tool manufacturers,80 but the relevant legal issue was whether the Ninth Circuit erred by applying an abuse-of-discretion standard of review to the district court’s consideration of the punitive damages award.81 The Supreme Court held that searching scrutiny must be given to any such punitive verdicts, stating “that courts of appeals should apply a de novo standard . . . when passing on district courts’ determinations of the constitutionality of punitive damage awards.”82 A less demanding abuse-of-discretion standard of review does not pass constitutional muster.

5. State Farm: Defendant’s Reprehensibility Is Key; Presumptive Single-Digit Ratio

Not long after Cooper, the Supreme Court once again took up the issue of punitive damages in State Farm Mutual Automobile Insurance Co. v. Campbell,83 hoping to clarify the relative importance of the BMW guideposts. The Campbells had sued State Farm for bad faith, fraud, and intentional infliction of emotional distress arising out of an insurance dispute.84 Plaintiffs prevailed on the merits, and in the compensatory and punitive damages phase of the trial, they successfully introduced evidence that pertained to State Farm’s business practices in numerous states but which bore no relation to the type of claims underlying the Campbells’ complaint.85 A Utah jury considering this information returned a $2.6 million compensatory damages judgment topped off by an astounding $145 million in punitives.86 Not surpris-ingly, State Farm countered with a substantive due process objection, but the Utah Supreme Court stood firm, holding that the punitive

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80 Id. at 427–28.
81 Id. at 426. After finding Cooper Industries guilty of unfair competition, a federal jury awarded compensatory damages in the amount of $50,000 and an additional $4.5 million in punitive damages. Id. The district court determined that the punitive damages award did not violate the Constitution, and the Ninth Circuit affirmed while applying a relatively lenient abuse-of-discretion standard to the district court’s determination. Id.
82 Id. at 436.
84 Id. at 413–14.
85 Id. at 414–15.
86 Id. at 415. The trial court subsequently reduced the compensatory portion to $1 million and the punitive remedy to $25 million, but the Utah Supreme Court reinstated the full $145 million award after applying the BMW factors. Id.
award was justified because of State Farm’s “massive wealth,” and because of the fact that State Farm could conceal its conduct so that it would be punished in only one out of every fifty thousand cases.87

The U.S. Supreme Court nevertheless struck down the punitive award against State Farm, stating that it was “grossly excessive” under the BMW guideposts and therefore served no legitimate state purpose.88 Finding the case “neither close nor difficult,” the Court clarified that BMW factor number one—the defendant’s degree of reprehensibility—was the most important indicator of a punitive damages award’s reasonableness.89 In evaluating this factor, Justice Kennedy stated that courts must consider whether:

(1) the harm was physical rather than economic;
(2) the tortious conduct demonstrated indifference to or reckless disregard of others’ health or safety;
(3) the conduct was a single occurrence or consisted of repeated actions; and
(4) the harm resulted from “intentional malice, trickery, or deceit,” versus “mere accident.”90

After laying out these principles and acknowledging that State Farm’s conduct was reprehensible, the Court nonetheless easily determined that the award was unjustified since it was based in large part on State Farm’s conduct nationwide.91 Justice Kennedy’s focus was primarily on the fact that each state had independent sovereignty to evaluate and punish conduct occurring within its own borders and could go no further than that without violating the strictures of due process.92

In addition, the State Farm Court strongly reinforced the BMW ratio analysis, holding notably that “few awards exceeding a single-digit ratio between punitive and compensatory damages . . . will satisfy due process.”93 Once again the Court stopped just short of establishing an absolute bright-line rule, but reasoned that single-digit ratios

87 Id. at 415–16.
88 Id. at 417–18.
89 Id. at 418–19.
90 Id. at 419 (citing BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 576–77 (1996)). The Court opined that “[i]t should be presumed a plaintiff has been made whole . . . by compensatory damages, so punitive damages should only be awarded if the defendant’s culpability . . . is so reprehensible as to warrant the imposition of further sanctions to achieve punishment or deterrence.” Id.
91 Id. at 420–23.
92 Id. at 422–23.
93 Id. at 425 (emphasis added).
were more likely to survive due process analysis while still achieving a state’s legitimate goals of deterrence and retribution. 94

6. Philip Morris: Juries Cannot Consider Harm to Nonparties

In 2007, the Court again addressed the propriety of punitive damages in Philip Morris USA v. Williams, 95 this time explicitly focusing on the question of whether a jury could consider harm to nonparties in assessing punitive awards. 96 A jury granted the widow of a long-time smoker $821,000 in compensatory damages stemming from the tobacco company’s wrongful behavior, and a whopping $79.5 million in punitive damages. 97 Writing for the Court, Justice Breyer struck down the punitive damages award as a violation of constitutional due process, 98 stating that the Due Process Clause of the Fourteenth Amendment requires that a defendant be given “an opportunity to present every available defense” before he may be punished. 99 The majority reasoned that allowing awards based on harm to nonparties would amount to a taking of a defendant’s property because the defendant would have “no opportunity to defend against the charge.” 100 Additionally, awards based on harm to nonparties “would add a near standardless dimension” to the calculation of punitive damages because factors such as the number of plaintiffs and the extent of harm could not be established with any certainty. 101

Perhaps realizing that its holding would not adequately deter wrongdoers, 102 however, the Court stated that a jury could consider

94 Id.
95 Philip Morris USA v. Williams, 549 U.S. 346 (2007). The Court remanded the case to the Oregon Supreme Court for reconsideration based on the federal high court’s opinion. Id. at 357–58. The Oregon Supreme Court responded by once again upholding the punitive damages award, this time on independent state grounds. Williams v. Philip Morris, Inc., 176 P.3d 1255, 1263–64 (Or. 2008). The Supreme Court granted certiorari to rehear the case, Philip Morris USA, Inc. v. Williams, 128 S. Ct. 2904 (2008) (order granting certiorari), but about nine months later dismissed the writ as improperly granted, Philip Morris USA, Inc. v. Williams, 129 S. Ct. 1436 (2009) (order dismissing certiorari).
96 Philip Morris USA, 549 U.S. at 349.
97 Id. at 349–50.
98 Id. at 349.
99 Id. at 353 (internal quotation marks and citation omitted).
100 Id.
101 Id. at 354.
102 The Court’s opinion does not explicitly discuss this potential problem. But see infra Part III (discussing the law and economics notion that the deterrence goal of punitive damages demands that society force defendants to pay for the times they escaped liability, including for harms defendants caused to nonparties who decided it was not worth their time or money to sue, or to nonparties who never even realized that they were harmed by defendants’ actions).
harm to nonparties when deciding the reprehensibility of a defendant’s conduct. Justice Breyer made valiant efforts to explain this confusing distinction:

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

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

7. Exxon Valdez: Punitive Damages Jurisprudence Meets Maritime Law

Coming to the case upon which this Article takes a special interest, the Supreme Court most recently confronted its tortured punitive damages jurisprudence in 2008 in the aftermath of the infamous Exxon Valdez oil spill. The tragedy spawned one of the most epic class action lawsuits in history, spanning an unbelievable twenty years of bitter litigation that involved tens of thousands of devastated plaintiffs and almost incomprehensible environmental devastation. This time, the Court faced the additional wrinkle of operating under maritime law as it wrestled with the proper scope of punitive damages

103 Philip Morris USA, 549 U.S. at 357 (noting that the reprehensibility of conduct often increases with the number of people harmed). Professor Chemerinsky pointed out the confusion that would result from the Court’s holding, stating that “[t]rial judges are likely to struggle for years with formulating jury instructions that simultaneously tell the jury to consider and not consider harm to people other than the plaintiffs.” Erwin Chemerinsky, More Questions About Punitive Damages, TRIAL, May 2007, at 72.

104 Philip Morris USA, 549 U.S. at 357.

105 Id. The four dissenters were fairly baffled by the majority’s attempted distinction. See id. at 360 (Stevens, J., dissenting) (“This nuance eludes me.”); id. at 363 (Ginsburg, J., joined by Scalia & Thomas, JJ., dissenting).

106 See Exxon Shipping Co. v. Baker, 128 S. Ct. 2605 (2008). For an extensive discussion of Exxon Valdez, see infra Part V (addressing the case’s unique maritime context and the implications for the punitive damages award laid down in connection with it).

107 See Gabrielle Nomura, Exxon Valdez Ruling Sinks Fishermen’s Hopes: Lawsuit Offers Too Little, Too Late for Those Whose Dreams Floated on Tainted Waters, BELLINGHAM BUS. J., Aug. 2008, at 26, 26 (providing a brief history of the sad affair and chronicling the toll it has taken on countless fishermen in Alaska); see also Felicity Barringer, $92 Million More Is Sought for Exxon Valdez Cleanup, N.Y. TIMES, June 2, 2006, at A14 (discussing some of the environmental harm caused by the spill).
Penalizing Punitive Damages

On March 24, 1989, the Exxon Valdez supertanker ran aground off the coast of Alaska, spilling eleven million gallons of oil into Prince William Sound. The ship's captain, Joseph Hazelwood, was drunk at the time of the accident, and a jury determined that Exxon recklessly failed to address Captain Hazelwood's history of alcoholism. Exxon settled its claims with the United States and the State of Alaska for spill cleanup, agreeing to pay substantial fines in the several millions of dollars and far more than that to restore natural resources. Plaintiffs in the remaining litigation were coastal landowners, commercial fishermen, and Native Alaskans who sought compensation for actual harm caused by the spill—price diminishment in their fisheries, reduced value of their fishing vessels and permits, harm to the general tourist trade, and debilitating emotional distress and pain-and-suffering injuries. The jury awarded $287 million in compensatory damages, which after settlements and other payments reached approximately $500 million, and a staggering $5 billion in punitive damages against Exxon. During decades of subsequent painful litigation challenging the constitutionality of the award, this $5 billion punitive remedy was reduced to $4 billion, raised to $4.5 billion, and then reduced again to $2.5 billion by 2006. Finally, in 2008, the Supreme Court threw out the vast majority of the remaining punitive damages judgment, reducing it to just $507.5 million, or one-tenth of the original verdict.

Significantly, Justice Souter, writing for the Court, relied primarily on maritime law rather than on due process to reject the punitive damages award, and generally ignored the fact that maritime law barred compensation for many elements of actual harm. Like prior

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108 Exxon Shipping Co., 128 S. Ct. at 2611.
109 Id. at 2611, 2613.
110 Id. at 2613–14.
111 Id. at 2613 (outlining expenditures exceeding $1 billion).
112 See id.; Brief of Petitioners at 11, Exxon Shipping Co., 128 S. Ct. 2605 (No. 07-219).
114 Exxon Shipping Co., 128 S. Ct. at 2614.
115 See In re Exxon Valdez (Valdez Circ II), 472 F.3d 600, 602 (9th Cir. 2006) (per curiam).
116 Exxon Shipping Co., 128 S. Ct. at 2633–34.
117 Id. at 2626.
118 See Brief Amici Curiae of Sociologists, Psychologists, & Law & Economics Scholars in Support of Respondents at 3, Exxon Shipping Co., 128 S. Ct. 2605 (No. 07-219), 2008 WL 275482, at *1–2 [hereinafter Amici Curiae Brief of Law & Economic Scholars]. As noted above, see supra n.*, this Article’s author was one of the contributors to and signatories of this amicus brief, employing an economics-based argument in favor of punitive damages. Plaintiffs had al-
Supreme Court jurisprudence, however, much of the majority opinion focused on the problem of remediating unpredictability in imposing punitive damages in order to bring such awards in line with procedural due process concerns against arbitrary judgments. Since punitive damages express society’s disapproval over the moral quality of a defendant’s conduct, Justice Souter was understandably worried about determining a consistent measure of society’s need for retribution. Citing numerous quantitative studies, he determined that the median ratio is generally less than 1:1 between compensatory and punitive damages awards. Accordingly, the Court asserted that a ratio of 1:1 should “roughly express jurors’ sense of reasonable penalties in [maritime] cases with no earmarks of exceptional blameworthiness within the punishable spectrum.”

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

120 Exxon Shipping Co., 128 S. Ct. at 2621.

121 Id. at 2624–25 & n.14. Interestingly, despite Justice Souter’s wide-ranging survey of empirical statistical evidence, the authors of one of the studies he relied upon have written a paper disputing his interpretation of their work. See Theodore Eisenberg, Michael Heise & Martin T. Wells, Variability in Punitive Damages: An Empirical Assessment of the U.S. Supreme Court’s Decision in Exxon Shipping Co. v. Baker (Cornell Law Sch., Legal Studies Research Paper No. 09-011, 2009). Professors Eisenberg, Heise, and Wells assert that

[t]he award reduction in Exxon Shipping may have promoted consistency with other high compensatory award cases but the 1:1 ratio [that the Supreme Court] hints at is not statistically supportable across the broad range of compensatory awards, and could contribute to an inability to tailor punitive awards to the facts and circumstances of particular cases.

See id. at i. Economists Kip Viscusi and Joni Hersch support this assessment in their own working paper, arguing that “[t]he Court’s conclusion that a 1:1 ratio establishes a fair upper bound lacks a sound scientific basis.” Joni Hersch & W. Kip Viscusi, Punitive Damages by Numbers: Exxon Shipping Co. v. Baker, at i (Vanderbilt Univ. Law Sch., Law and Economics Working Paper No. 09-04, 2009). This is an especially telling criticism of the majority in Exxon Shipping Co. because it calls into serious question the Court’s seemingly objective reliance on empirical research to support its holding.

122 Exxon Shipping Co., 128 S. Ct. at 2633.
Despite this outcome, some legal scholars and academics had hoped that the Court would use punitive damages as a means to address the uncompensated harms resulting from unique limits under maritime law. Specifically, maritime law did not allow the victims to recover for consequential economic damages (such as price declines in fishing vessels, permits, and tourist revenues), or for pain-and-suffering damages, leaving the plaintiffs in the case to bear much of the harm themselves. Justice Souter dismissed the attempt to use punitive damages as extracompensatory, insisting that “punitives are aimed not at compensation but principally at retribution and deterring harmful conduct.” In doing so, the Court completely ignored the reality that its holding could have exactly the opposite effect of that which it intended. For if a defendant escapes liability for a portion of the harm it causes (due to the quirks of maritime law, for example), then it will necessarily have a diluted incentive to take proper care, foiling society’s deterrence objectives.

II. A Principled Economic Approach to Setting Punitive Damages—or, Why the Supreme Court Needs a Lesson in Law and Economics

Employing a law and economics perspective provides a significantly different and far more principled approach to punitive damages jurisprudence than that adopted by our own Supreme Court. Instead of engendering debates in each case over irresolvable factors like reasonableness and moral reprehensibility, an economic approach views the assessment of punitive damages from a private and social deterrence perspective. Punishment for punishment’s sake is not the proper goal because inconsistency and unfairness are guaranteed by pursuing such a course. Rather, legal rules (including punitive damages awards) should seek to appropriately deter socially undesirable acts and maximize overall social welfare.

123 See Amici Curiae Brief of Law & Economics Scholars, supra note 118, at 3–4; see also Exxon Shipping Co., 128 S. Ct. at 2636–37 (Stevens, J., concurring in part and dissenting in part).
124 See Exxon Shipping Co. v. Airport Depot Diner, Inc., 120 F.3d 166, 167 n.3 (9th Cir. 1997) (noting how the district court dismissed plaintiffs’ claims for damages based on “emotional distress damages, price diminishment in fisheries that were not oiled, diminished value of limited entry fishing permits or fishing vessels absent a sale of the permit or vessel . . . [and] diminution of market value owing to fear or stigma”).
125 Exxon Shipping Co., 128 S. Ct. at 2621.
126 See Amici Curiae Brief of Law & Economics Scholars, supra note 118, at 19–26; see also Polinsky & Shavell, supra note 19, at 887–96.
127 See Polinsky & Shavell, supra note 19, at 870–76; see also Chapman & Trebilcock, supra note 19, at 805–26; Cooter, supra note 19, at 1149–66.
A. The Dichotomy Between the Traditional Versus Economic Approach to Law: A Simple Example

Let us take a simple example to highlight the dichotomy between the traditional versus economic approach to the law. Imagine an automobile factory produces pollution that causes a harm of $1 million to nearby residents. Let us further assume that the factory can install a smoke arrestor at a cost of $2 million. Should the factory make the purchase—i.e., is it socially optimal for our legal system to require it to do so? Obviously not, since the cost of preventing the harm outweighs the resulting damage. However, if the factory faced a punitive damages award of $5 million for intentionally or recklessly failing to install the smoke arrestor, it may very well make the decision to purchase one.\(^{128}\) Simply put, indiscriminate punitive damages awards have the potential to create perverse second-order consequences, as Justice O’Connor feared decades ago.\(^{129}\) The company may choose to go out of business, decrease production, or pass on the cost of the punitive award in the form of higher prices to all customers.

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

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\(^{128}\) This analysis assumes that the factory is unable to bargain with nearby residents to gain the right to pollute. The seminal Coase theorem dictates that the parties will bargain around the legal rule whenever a mutually beneficial agreement is possible, assuming no transaction costs prevent the negotiation. See R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15–16 (1960). Thus, in a world without transaction costs, the factory would pay the neighbors $1 million (or slightly more) to gain the right to pollute even if the governing law gives neighbors the legal entitlement to clean air. See Steven Shavell, *Foundations of Economic Analysis of Law* 83–84 (2004).


> Punitive damages are a powerful weapon. Imposed wisely and with restraint, they have the potential to advance legitimate state interests. Imposed indiscriminately, however, they have a devastating potential for harm. Regrettably, common-law procedures for awarding punitive damages fall into the latter category. States routinely authorize civil juries to impose punitive damages without providing them any meaningful instructions on how to do so. Rarely is a jury told anything more specific than “do what you think is best.”

*Id.* at 42 (citing Browning-Ferris Indus. of Vt., Inc. v. Kelco Disposal, Inc., 492 U.S. 257, 281 (1989) (Brennan, J., concurring)).
varies with the level of care taken. Let us consider the optimal level of care that the company should take in the table below.  

<table>
<thead>
<tr>
<th>Level of Care</th>
<th>Cost of Care</th>
<th>Probability of Accident ( (p) )</th>
<th>Expected Accident Losses</th>
<th>Total Social Costs ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>None (single-hull)</td>
<td>0</td>
<td>10%</td>
<td>( .10 \times 100 = 10 )</td>
<td>( 10 + 20 = 30 )</td>
</tr>
<tr>
<td>*Medium (double-hull)</td>
<td>4</td>
<td>3%</td>
<td>( .03 \times 100 = 3 )</td>
<td>( 4 + 3 + 20 = 27 )</td>
</tr>
<tr>
<td>Very High (triple-hull)</td>
<td>10</td>
<td>2%</td>
<td>( .02 \times 100 = 2 )</td>
<td>( 10 + 2 + 20 = 32 )</td>
</tr>
</tbody>
</table>

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

If we assume, however, that the company might face punitive damages of ten times the amount of harm (i.e., \$1000) if it causes an accident, let us reconsider the company’s cost-benefit calculus.

<table>
<thead>
<tr>
<th>Level of Care</th>
<th>Cost of Care</th>
<th>Probability of Accident ( (p) )</th>
<th>Expected Accident Losses</th>
<th>Total Company Costs ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>None (single-hull)</td>
<td>0</td>
<td>10%</td>
<td>( .10 \times (100 + 1100) = 110 )</td>
<td>( 0 + 20 + 110 = 130 )</td>
</tr>
<tr>
<td>Medium (double-hull)</td>
<td>4</td>
<td>3%</td>
<td>( .03 \times (100 + 1000) = 33 )</td>
<td>( 4 + 20 + 33 = 57 )</td>
</tr>
<tr>
<td>*Very High (triple-hull)</td>
<td>10</td>
<td>2%</td>
<td>( .02 \times (100 + 1000) = 22 )</td>
<td>( 10 + 20 + 22 = 52 )</td>
</tr>
</tbody>
</table>

\(^{130}\) In this example, optimal care would be medium (i.e., double-hull tankers), and the resulting full “price” of the product, incorporating care and expected accidents, would be \$27.
Thus, a company facing a potential $1000 punitive damages judgment would rationally choose to take very high care, for that minimizes the total costs the company expects to face. This outcome is perverse from society’s perspective, however, as it leads to dramatically increased prices. The company would now have to charge $52 to cover the expected punitive liability (even though the full social cost when the company employs optimal medium care is just $27).131

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

Table 3. Utility to the Customer

<table>
<thead>
<tr>
<th>Customer</th>
<th>Utility from Oil Product</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>$A$</td>
<td>$60$</td>
<td>With punitive damages, only $A$ can afford $52$ or more</td>
</tr>
<tr>
<td>$B$</td>
<td>$50$</td>
<td></td>
</tr>
<tr>
<td>$C$</td>
<td>$40$</td>
<td>But it is socially optimal for $A$, $B$, and $C$ to all buy the product because value &gt; total cost</td>
</tr>
<tr>
<td>$D$</td>
<td>$25$</td>
<td></td>
</tr>
</tbody>
</table>

Who purchases this oil-based product now? Only $A$ does, because $B$ and $C$ cannot afford a price tag of $52$. Nevertheless, it is clear from this simple example that it is socially optimal for $A$, $B$, and $C$ all to buy the product in a perfect world, since they all value it at greater than its full social cost of $27$. Significantly, indiscriminate punitive damages awards have the potential to prevent people whose utility from a product exceeds the product’s full social cost from being able to gain access to the product. This outcome is due to the unfortunate fact that unnecessarily high punitive damages judgments incen-

131 See supra Table 1. Conversely, setting damages below actual harm caused lets the company off the hook for a portion of the injuries it creates, and it might therefore rationally choose only to single-hull its tankers to avoid significant safety expenses. Clearly, then, if damages are arbitrarily set too high or too low, we will witness a suboptimal result from an economic deterrence perspective.
tivize companies to take excess care, leading to substantial price increases and quantity decreases.\footnote{See Polinsky & Shavell, supra note 19, at 877–900.}

B. Impacts of the Ill-Considered Traditional Legal Approach

A few further considerations will show how the current approach to punitive damages taken by the Supreme Court can have unintended (and negative) economic and social consequences.

1. Philip Morris Hypothetical

To demonstrate a real-world application of the economic theory laid out above, consider the Philip Morris case once again. Because the Court refused to make Philip Morris pay for the harms it caused to nonparties to the litigation,\footnote{Philip Morris USA v. Williams, 549 U.S. 346, 349 (2007) (holding that punitive damages awards based “in part on [a jury’s] desire to punish defendant for harming” nonparties “amount[s] to a taking of ‘property’ from defendant without due process” of law (emphasis omitted)).} Philip Morris was (and still may be) partially underdeterred from creating harm to consumers. Let’s assume that Philip Morris caused $10 worth of harm to ten different actors by producing dangerous tobacco products, but only one party found it worth the time and expense to actually sue for compensation. If that was indeed the case, then Philip Morris caused total social harm of $100, but was only held to pay for $10 of this harm because the Supreme Court explicitly prohibited any consideration of harm to nonparties in assessing the punitive damages award.\footnote{Id. at 353.} Philip Morris, or any other similarly situated tortfeasor, would therefore rationally continue its behavior as long as it gained a benefit of more than $10, rather than the socially optimal result of making Philip Morris consider (and answer for) all of the social costs it was imposing on the public.\footnote{See generally Polinsky & Shavell, supra note 19, at 887–96 (detailing companies’ diluted incentives to take precautions if they can escape liability for some portion of the time they create harm).}

Alternatively, if the Supreme Court had upheld an enormous punitive damages award without employing this type of economic thinking (e.g., perhaps because the defendant had extraordinarily deep pockets or was particularly reprehensible in its behavior), Philip Morris may have been overdeterred. Using the same oversimplified hypothetical as above, if a jury assessed a punitive damages award of $1000 when actual total harm was only $100, then Philip Morris would likely...
take extraordinary efforts to avoid paying these damages. If Philip Morris (or consumers) gained $120 of value from its activity, then net social welfare would increase by $20 by keeping the company in operation (i.e., $120 benefit minus $100 harm). If Philip Morris faced a $1000 punitive damages award, however, it would no longer choose to engage in this line of business at all and social welfare would correspondingly decline.136

2. Judgment-Proof Independent Contractors

A final problematic impact of ill-considered punitive damages awards is that companies that potentially face such judgments will have a perverse incentive to contract out their dangerous activities—such as shipping oil in single-hull tankers—to judgment-proof independent contractors who care not a whit about taking precautions because they lack the financial resources to pay any damages that they might inflict.137 In the event the independent contractor’s low level of care produces a catastrophic accident (and results in a punitive damages award), it can simply hand over its low level of cash on hand, declare bankruptcy, and walk away from the financial impact of the judgment.138

In fact, huge oil conglomerates now engage in this practice precisely because of the fear of the initial punitive damages award in Exxon Shipping Co. For example, oil giant Shell was recently criticized by Justice Ginsburg for attempting to avoid liability for cleanup costs at a Superfund site near Bakersfield, California, by arguing that the damage created by spilling its product was caused by an independent third party.139 In addition, in 2002, one such independent contractor

136 See id. at 943–44. While it might be difficult for the reader to entertain this hypothetical considering the devastating harm created by tobacco products, it must indeed be the case that smokers gain some net utility from using a product that they know significantly decreases their life expectancy by raising their cancer and heart disease risk.

137 See id. at 942–45. Companies facing potentially large punitive damages awards have an incentive to use independent contractors because any resulting liability from accidents falls on the contractor instead of the firm. If the contractor is “judgment proof,” i.e., capitalized below the level of the harm it might produce, it can take suboptimal care without the fear of facing huge liability.

138 See id. at 943–44.

139 See Jesse Greenspan, High Court Mulls $42M Shell, Railroads Superfund Case, Law360. COM, Feb. 24, 2009, http://www.law360.com/registrations/create_login?article_id=88706&success_location=http%3A%2F%2Fwww.law360.com%2Farticles%2F88706. In reviewing the statute at issue, Justice Ginsburg conveyed her belief that “the one thing that was not intended was for the parties to arrange themselves out of arranger liability by providing neatly that the moment the product reaches a destination there’s no continuing responsibility on the part of the seller.”
was sailing the oil tanker *Prestige*, which sank off the coast of Spain, killing more than 250,000 seabirds, affecting 30,000 jobs, and costing in excess of $2 billion to clean up.\footnote{Dale Fuchs, *A Seeping Tanker Turns Spain’s Beaches into an Oily Sandbox*, N.Y. Times, Aug. 31, 2003, at N8.} The ship was owned by a Liberian company, managed by a Greek company, carrying a Bahamian flag, and chartered by a Russian oil-trading company.\footnote{Emma Daly, *Off Galicia, Spill Spreads Devastation and Doubt*, N.Y. Times, Nov. 21, 2002, at A6.} Not surprisingly, the ship was an ancient single-hull tanker constructed in 1976\footnote{Keith B. Richburg, *Tanker Sinks Near Spain*, Wash. Post, Nov. 20, 2002, at A18.} that should never have been chartered in the first place. One can clearly see that the traditional legal approach has so far produced unwanted and perverse consequences that must be fixed before greater harm results.

C. Optimal Deterrence: When and How Should Punitive Damages Be Awarded?

Thus, the sensible goal of an economic approach to punitive damages is to deter wrongdoers *properly* by setting damages equal to actual harm, assuming that defendants are always caught.\footnote{See Polinsky & Shavell, *supra* note 19, at 878–87 (discussing optimal level of damages for a defendant whose liability can be definitely established).} At the same time, juries must also be vigilant to avoid indiscriminately handing out excessive punitive damages awards, not merely because of the Supreme Court’s due process concerns, but rather due to fear of potentially creating devastating negative second-order effects: overdeterrence, decreased productivity, increased cost, decreased consumption, and a decline in overall social welfare.

Does this mean that law and economics advocates are categorically opposed to awarding punitive damages in all cases? Absolutely not, but the justification for such awards has little to do with moral reprehensibility and everything to do with creating optimal incentives towards socially appropriate levels of care.\footnote{Cf. id. at 870–76 (arguing that, although defendants should pay only for harm caused, punitive damages serve to tax defendants for those instances when they escaped punishment).} For example, if a defendant escapes suit 50% of the time, then total damages in the case actually litigated should be set at twice actual harm to adequately deter defendant’s wrongful conduct.\footnote{See id. at 887–96.} If defendant escapes liability 99% of the time it causes harm, then total damages should be set at 100 times

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\footnote{Transcript of Oral Argument at 8–9, Burlington N. & Santa Fe Ry. v. United States, No. 07-1601, 2009 WL 453827 (Feb. 24, 2009).}
actual harm in order to incentivize the defendant to take care, and due process is not at all violated by doing so!\textsuperscript{146}

Thus, punitive damages should—nay, \textit{must}—be imposed for deterrence purposes whenever a defendant has a chance to escape liability, even in the absence of morally egregious behavior.\textsuperscript{147} A principled economic approach to punitive awards dictates that they should be calculated by multiplying the actual harm in the instant case by the inverse of the probability that the defendant escapes liability if he is not caught when he ought to be.\textsuperscript{148}

\subsection*{D. Avoidance of Liability}

But why do we assume that defendants are evading liability on occasion? A defendant’s avoidance of legal consequences might be due to his intentional concealment of a wrongful act or even sheer serendipity. Take, for example, an automobile company that intentionally disguises the fact that it is repainting its cars to look like they are new,\textsuperscript{149} or a company that conceals information about a product defect from consumers. Less sinister, one might imagine a factory that emits low-level pollution that is difficult for victims to detect. In either case, the company is likely to avoid being sued in all of the cases in which it creates harm because of the difficulty victims face in seeing it. Punitive damages awards must step in to fill this void in compensating victims when the defendant actually does indeed find itself caught. If they do not, defendants will systematically face diluted incentives to take socially optimal levels of care.

Moreover, even in examples where victims know they have been harmed, there are many situations in which the magnitude of the damage is small enough that it is not worth the victim’s time or expense to litigate. For example, in \textit{Mathias v. Accor Economy Lodging, Inc.},\textsuperscript{150} the defendants were operators of a Motel 6 chain in Chicago, and

\begin{itemize}
  \item \textsuperscript{146} Due process is not violated because the modified punishment in my model accurately reflects the severity of the crime that the defendant is well aware he has caused. The tortfeasor previously escaped liability 99 times out of 100 and is now being justly held to pay for those occasions he evaded the arm of the law. He cannot credibly claim that the punishment does not fit his crime.
  \item \textsuperscript{147} \textit{Id.} at 887–91.
  \item \textsuperscript{148} \textit{Id.} at 889. Polinsky and Shavell offer an algebraic formula as well: “If $H$ is the harm and $P$ is the probability of being found liable, then the injurer should pay $H \times 1/P$—that is, $H/P$—when he is found liable. Thus, the injurer’s expected damages will be $P \times (H/P) = H$.” \textit{Id.} at 889 n.48 (emphasis added).
  \item \textsuperscript{149} Such was the practice of BMW. \textit{See} BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 563 (1996).
  \item \textsuperscript{150} \textit{Mathias v. Accor Econ. Lodging, Inc.}, 347 F.3d 672 (7th Cir. 2003).
\end{itemize}
plaintiffs sued after suffering bedbug bites during a stay. The jury awarded a mere $5000 in compensatory damages but also a substantial $186,000 verdict in the form of punitive damages to each of the two plaintiffs. Relying on the Supreme Court’s misguided BMW and State Farm reasoning, the defendants argued vigorously that punitive damages could not exceed $20,000. Specifically, the defendants pointed directly to language in State Farm that “‘few awards [of punitive damages] exceeding a single-digit ratio between punitive and compensatory damages . . . will satisfy due process,’” and the further arbitrary statement that “‘four times the amount of compensatory damages might be close to the line of constitutional impropriety.’”

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

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151 Id. at 673. Journalist Jan Greenberg described the facts more vividly:

A day after Burl and Deseree Mathias arrived in Chicago for a packaging trade show, they found themselves itching to get away—at least from their downtown hotel overrun with bedbugs.

After a night in the Motel 6 on East Ontario Street, the brother and sister awoke to find itchy bumps all over their bodies, and the next evening they found the culprit: legions of insects scurrying about in their beds.

Hotel management wasn’t surprised by their horrified complaints, because it had been renting out rooms infested with bedbugs for months to unsuspecting customers.


152 Mathias, 347 F.3d at 674.
153 Id. at 675–76.
154 Id. at 675 (alteration in original) (quoting State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 425 (2003)).
155 Id. at 676.
156 See id. at 677.
157 See id.
158 Id. (emphasis added).
E. Punitive Damages as Quasi-Compensatory

Punitive damages can also serve the important purpose of operating as quasi-compensatory damages. In Exxon Shipping Co. v. Baker,\(^\text{159}\) for example, the applicable maritime law limited damages to those who were directly and physically harmed by the spill even though others undoubtedly suffered substantial economic and emotional harm.\(^\text{160}\) Punitive damages should serve to compensate those individuals when redress is not otherwise available under governing law.\(^\text{161}\) Without the use of punitive damages to account for this shortcoming in maritime jurisprudence, much of the harm caused by Exxon went uncompensated. Other potential tortfeasors would surely face diluted incentives to take care if society failed to use punitive damages in this quasi-compensatory manner.

F. Summary of the Economic Approach to Punitive Damages

Thus, law and economics scholars view punitive damages awards as an opportunity to create optimal deterrence by making up for the occasions where the defendant has (for whatever reason) previously avoided liability and failed to compensate for the full harm caused. Moreover, it should be emphasized here that no degree of morally offensive behavior is required before a punitive award is justified in the above scenarios. A morally innocent tortfeasor who unknowingly allowed bedbugs to bite customers should still be asked to compensate victims in all of the occasions in which it escaped liability, else it will face diluted incentives to take adequate care in the future.

On the other hand, sound economic analysis dictates that imposing punitive damages well beyond actual harm simply because a tortfeasor’s behavior was morally reprehensible can inadvertently lead to overdeterrence, price inflation beyond optimum, quantity of goods purchased below optimum, and a significant reduction in overall social welfare. Consider once again the example of the oil-shipping company discussed above.\(^\text{162}\) If punitive damages are assessed far above actual harm because of a drunken ship captain’s morally reprehensible behavior, then the company will do everything it can to avoid confronting those damages in the future. The company may choose to triple-hull its ships, which would dramatically increase oil prices, leav-

\(^{160}\) See generally Amici Curiae Brief of Law & Economics Scholars, supra note 118. As noted earlier, in its disposition of the case, the Court did not really address these issues.
\(^{161}\) See id. at 23–26.
\(^{162}\) See supra Part II.A.
ing consumers to bear the resulting costs. Alternatively, the deep-pocket firm will hire judgment-proof independent contractors to engage in work that runs the risk of punitive damages because undercapitalized contractors need not worry about their level of care or corresponding liability exposure. Clearly, the traditional legal approach to punitive damages awards can produce socially perverse consequences that need to be fixed before even greater harm materializes.

III. A Reexamination of the Supreme Court’s Misguided Approach to Punitive Damages

Given the principled economic analysis of punitive damages law presented above, the flaws in the Supreme Court’s approach quickly become apparent. In its early punitive damages jurisprudence, the Court shied away from drawing a hard line, choosing instead to focus on procedures it hoped would avoid arbitrary results. In Haslip, the Court held that a jury’s discretion with respect to the amount of punitive damages must be subject to “reasonable constraints.” Because the jury was given sufficiently focused instructions, the Court upheld the award. In TXO, the Court added that punitive damages may not be “grossly excessive,” but upheld a large award because of the potential loss to the plaintiff if TXO’s wrongful acts had been successful in creating greater harm.

By the time of the BMW case, the Supreme Court decided it needed to issue more specific guidelines to govern its due process analysis. The Court famously laid out three “guideposts”: (1) the degree of defendant’s reprehensibility, (2) the ratio between compensatory and punitive damages, and (3) the comparison of the punitive award to civil penalties in similar cases. Justice Stevens pointed out in his ratio analysis that, although there was no specific bright line, punitive damages awards generally should not exceed ten times com-

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164 Id. at 19–20.
165 Id. at 23. The Court also suggested that a ratio of four times compensatory damages “may be close to the line” beyond which punitive damages could not go. Id.
167 Id. at 462.
169 Id. at 582.
pensatory damages. In doing so, the Court hoped that this would lead to more predictable results and stem the tide of litigation.

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

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

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170 Id. at 581.
171 Id. at 574 (“[C]onstitutional jurisprudence dictate[s] that a person receive fair notice not only of the conduct that will subject him to punishment, but also of the severity of the penalty that a State may impose.”).
173 Id. at 425.
176 Of course, the Supreme Court’s rationale in barring consideration of harm to nonparties was that doing so would violate a defendant’s due process rights to confront its accusers. Philip Morris, 549 U.S. at 353 (“[A] defendant threatened with punishment for injuring a nonparty victim has no opportunity to defend against the charge . . . .”); see also State Farm, 538 U.S. at 423 (“Due process does not permit courts, in the calculation of punitive damages, to adjudicate the merits of other parties’ hypothetical claims against a defendant under the guise of the reprehensibility analysis . . . .”). Although this makes sense, there was no balancing of this principle against the competing principle that defendants should compensate all victims that they have harmed. For, without this latter consideration, defendants will necessarily face diluted incentives to avoid injuring others in the future.
if you are only required to pay for a portion of the harm you actually cause?

Finally, the recent decision in *Exxon Shipping Co.* only served to prove the point that the Supreme Court’s punitive damages jurisprudence is a tortured mess. Hoping to once and forever put punitive damages law to a well-settled rest, the Court limited punitive damages in maritime cases to an amount equal to compensatory damages.177 Ignoring the reality that Exxon was escaping a substantial portion of liability for the harm it had caused to the Alaskan communities and businesses that were not physically oiled by the spill, the Court instead arbitrarily determined that the jury’s outrage could adequately be expressed by punitive damages set exactly equal to compensatory damages.178 Justice Souter declared: “In a well-functioning system, we would expect that awards [of an approximately 1:1 ratio between compensatory and punitive damages] would roughly express jurors’ sense of reasonable penalties in cases with no earmarks of exceptional blameworthiness within the punishable spectrum . . .”179

Despite these convoluted attempts at preserving constitutional due process protections, if the Supreme Court truly wishes to eliminate arbitrary and unpredictable punitive damages awards, the Justices must dramatically revise their approach to the entire issue. There is no legally or economically principled justification for a jury to award punitives based on gut reactions to how badly it feels a defendant acted. Rather, principled jurists understand that punitive damages should be awarded only where tortfeasors have the potential to escape liability for their actions. Thus, a defendant whose wrongful behavior is detected only 1% of the time should face a punitive damages award (when it is indeed caught) that takes account of the 99% of times it escaped liability, resulting in a total judgment of \( \frac{1}{0.01} = 100 \) times harm in the instant case. Likewise, punitive damages should be awarded in that case even if the defendant in no way meets the modern tort requirements of egregious behavior. Given this simple economic analysis, the Supreme Court’s arbitrary due process litmus test of ten times actual damages as a constitutional ceiling on punitive damages makes zero sense, and needs to be summarily abolished. It is high time that punitive awards create proper incentives to take so-

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178 *Id.*
179 *Id.* For the Ninth Circuit’s subsequent actions in the case, see *infra* note 208 and accompanying text.
cially optimal care rather than arbitrarily skew society’s deterrence and punishment goals.

IV. How to Deal Correctly with Special Cases Like Exxon Valdez

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

A. History of the Litigation

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

The spill resulted not just in massive environmental destruction but also triggered an epic twenty-year litigation involving over 32,000 plaintiffs. Exxon settled with the United States for violations of numerous federal statutes, ultimately paying approximately $125 million

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180 Exxon Shipping Co., 128 S. Ct. at 2611.
181 Amici Curiae Brief of Law & Economics Scholars, supra note 118, at 4–18.
182 Exxon Shipping Co., 128 S. Ct. at 2612. At the moment the tanker needed to move west to avoid the underwater reef off Bligh Island, Hazelwood inexplicably left the bridge, later claiming he needed to go down to his cabin in order to fill out paperwork. Id. Before doing so, he made matters worse by “put[ting] the tanker on autopilot [and] speeding it up, [thereby] making the turn trickier, and any mistake harder to correct.” Id. He decided to put his third mate, Joseph Cousins, in charge, despite Cousins’s lack of training to navigate the dangerous waters. Id.
183 In re Exxon Valdez (Valdez II), 296 F. Supp. 2d 1071, 1076–77 (D. Alaska 2004), vacated and remanded, 472 F.3d 600 (9th Cir. 2006). Though Captain Hazelwood completed a near month-long alcohol-treatment program as an employee of Exxon, he failed to continue with a mandated follow-up program with Alcoholics Anonymous. Exxon Shipping Co., 128 S. Ct. at 2612.
184 Exxon Shipping Co., 128 S. Ct. at 2612.
185 See id. at 2613.
in fines and restitution. Exxon paid another $900 million in response to a civil action by the United States and Alaska. The company paid an additional $303 million in settlements with various parties harmed by the spill, including property owners and fishermen.

Countless other civil suits remained after these settlements, and, ultimately, the U.S. District Court for the District of Alaska certified a mandatory class of those plaintiffs seeking punitive damages. These plaintiffs were landowners, commercial fishermen, and Native Alaskans. The court split the case into three phases: Phase I examined whether Exxon and Captain Hazelwood had been reckless and could therefore be subject to punitive damages; Phase II set the amount of compensatory damages for Native Alaskans and commercial fishermen; and Phase III set the amount of punitive damages. The jury ultimately awarded $287 million in compensatory damages to commercial fishermen, of which about $20 million was outstanding after the trial court deducted settlements and other payments. Native Alaskans, in two settlements, agreed to $22.6 million. But the attention-grabber was the fact that the jury awarded a stunning $5 billion in punitive damages against Exxon as well, a sum that was then—and still is today—by far the single largest punitive damages verdict in history.

Traditional legal jurists justified the initial $5 billion punitive damages award by pointing to Exxon’s reprehensible behavior in allowing a ship captain with a known drinking problem to pilot such a dangerous vessel. The fact that Exxon knew about Captain Hazelwood’s history of alcoholism but did little about it evidently did not sit well with the jury, or with most Americans for that matter. This staggering punitive damages award triggered seemingly endless subsequent litigation. While Exxon admitted wrongdoing and was more

\[\text{\footnotesize 186 Id.}\]
\[\text{\footnotesize 187 Id.}\]
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\[\text{\footnotesize 189 Id.}\]
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\[\text{\footnotesize 191 Id.}\]
\[\text{\footnotesize 192 Id. at 2614.}\]
\[\text{\footnotesize 193 See id.}\]
\[\text{\footnotesize 194 Id.}\]
\[\text{\footnotesize 195 See id. at 2613–14.}\]
\[\text{\footnotesize 196 See In re Exxon Valdez (Valdez II), 296 F. Supp. 2d 1071, 1077 (D. Alaska 2004) (recounting Exxon’s repeated failures to remove Hazelwood from command despite knowledge of his drinking).}\]
than willing to pay the compensatory judgment, it vigorously challenged the constitutionality of the punitive damages portion of the verdict.

On appeal, the Ninth Circuit realized that the award might be constitutionally suspect based on the decisions in *BMW* and *Leatherman* and, therefore, remanded for reconsideration in light of those cases. The district court held firm, however, finding that the award was justified under the three *BMW* guideposts. It remitted the punitive damages slightly from $5 billion to $4 billion based on plaintiffs’ willingness to accept such a judgment, which also brought the total number in line with the single-digit-ratio analysis suggested in *BMW*. Exxon appealed again, but before the parties submitted any briefing, the Supreme Court decided *State Farm*, prompting the Ninth Circuit to remand without opinion. On its third analysis of the case, the district court added discussion of the *State Farm* holding, once again determining that the original $5 billion was constitutionally acceptable.

Because the case had been remanded specifically for reduction of the punitive damages award, though, the district court agreed to reduce the award to $4.5 billion, roughly nine times the compensatory award. On appeal, after considering yet another remand to a defiant district court, the Ninth Circuit decided to remit the award to $2.5 billion—a legal splitting of the baby, if you will. The U.S. Supreme Court subsequently granted certiorari to end the legal wrangling once and for all, and to address explicitly the issue of punitive damages in the maritime context.

Five of the nine Supreme Court Justices agreed with Exxon that the jury had indeed chosen an excessive amount to award as punitive damages and concluded that Exxon’s conduct was morally reprehensible in a dollar amount set exactly equal to compensatory damages. This, Justice Souter opined without any sign of irony, “roughly express[es] jurors’ sense of reasonable penalties in cases with

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197 *In re Exxon Valdez (Valdez Circ I)*, 270 F.3d 1215, 1241 (9th Cir. 2001).
199 *Id.* at 1068 & n.88.
200 See *Valdez II*, 296 F. Supp. 2d at 1075.
201 *Id.* at 1110.
202 *Id.*
203 *In re Exxon Valdez (Valdez Circ III)*, 490 F.3d 1066, 1095 (9th Cir. 2007) (per curiam).
205 See *id.* at 2633–34. Justice Alito did not vote in the case. *Id.* at 2634.
206 See *id.* at 2634. Justices Scalia and Thomas joined the Court’s opinion but expressed their opinions that the caselaw compelling this resolution of the case was erroneous. *See id.* (Scalia, J., joined by Thomas, J., concurring).
no earmarks of exceptional blameworthiness within the punishable spectrum . . . .”207 In the middle of 2009, the Ninth Circuit tacked on 5.9% interest from 1996 to the present date, amounting to $507.5 million, to account for the fact that plaintiffs were due this money long ago.208

B. Traditional Economic Analysis of the Exxon Valdez Case

One very interesting point worth exploring in the *Exxon Valdez* case is that many notable law and economics scholars, including the intellectual giants Mitch Polinsky and Steven Shavell, were employed as consultants by the defendant oil company to argue that punitive damages were altogether unnecessary.209 Their argument was generally as follows: the chances of an oil conglomerate escaping litigation after dumping millions of barrels of oil across the coast of Alaska are essentially zero.210 Therefore, all the legal system need do to properly incentivize Exxon to take due care is to impose damages in the amount of actual harm.211 Anything larger than that would overdeter, increase prices, and lead to negative second-order consequences. For example, consumers might wind up paying $5 per gallon of gas, or Exxon and other similarly situated oil conglomerates might begin to hire judgment-proof (and careless) independent contractors to ship their oil in order to avoid massive liability exposure.212

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

Polinsky and Shavell’s argument initially appealed to the author of this Article, until he learned of the hugely consequential differences between modern tort law and the well-established maritime law governing the *Exxon Valdez* disaster. Unfortunately, both traditional legal jurists as well as traditional law and economists largely failed to consider the harms precluded by maritime law for which Exxon effectively escaped liability.213 The plaintiffs—commercial fishermen, Na-
tive Alaskans, and landowners—sought compensation for a number of injuries that would have been available under modern tort law but that the idiosyncrasies of well-established maritime law prohibited.\textsuperscript{214} These uncompensated harms fell into three categories: (1) economic harm from the spill that was precluded by the landmark 1927 maritime case of \textit{Robins Dry Dock & Repair Co. v. Flint};\textsuperscript{215} (2) economic harm prohibited by maritime law because its extent at the time of the spill was undetermined; and (3) noneconomic harm, such as emotional distress and pain and suffering, arising from the spill.\textsuperscript{216} As a result, plaintiffs failed to recover for substantial price diminishment in fisheries that were not oiled, diminished value of fishing permits and fishing vessels, lost tax revenue, damage to area tourism, and the significant pain and suffering caused by the disaster.\textsuperscript{217} Each of these categories should be explored briefly to assess the magnitude of the uncompensated harm, starting with the preclusive effect on damages from courts’ rulings under \textit{Robins Dry Dock}.

\section*{I. Robins Dry Dock: Substantial Economic Damages to Fishermen, Fishing Vessels, Permits, and Area Tourism Were Largely Excluded}

In \textit{Robins Dry Dock}, charterers of a ship sued the operators of a dry dock after the dock damaged the ship’s propeller, delaying the charterers’ ability to use the ship.\textsuperscript{218} The charterers did not own the ship, and the dry dock was working under a contract with the ship’s owners.\textsuperscript{219} Justice Holmes, writing for the Court, barred the plaintiffs from recovering against the dry dock because, as charterers and not owners, they were not a party to the dry dock contract and were owed no duty under it.\textsuperscript{220} In addition, the plaintiffs could not recover be-

\begin{footnotesize}
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\item[214] See generally Amici Curiae Brief of Law & Economics Scholars, \textit{supra} note 118, at 3–18.
\item[216] See Amici Curiae Brief of Law & Economics Scholars, \textit{supra} note 118, at 3–4.
\item[217] See \textit{Exxon Shipping Co. v. Airporo Depot Diner, Inc.}, 120 F.3d 166, 167 n.3 (9th Cir. 1997); Amici Curiae Brief of Law & Economics Scholars, \textit{supra} note 118, at 3.
\item[218] \textit{Robins Dry Dock}, 275 U.S. at 307.
\item[219] Id.
\item[220] Id. at 308–09.
\end{enumerate}
\end{footnotesize}
cause, while they suffered consequential damages due to delay, they suffered no physical injury.221

The Robins Dry Dock ruling was generally an attempt to place a policy limitation on the extent of maritime damages, in much the same way as the requirement of proximate causation operates in land-based torts.222 Land-based torts generally focus on whether harm is foreseeable, or, as Professor Dan Dobbs has stated: “[t]he most general and pervasive approach to proximate cause holds that a negligent defendant is liable for all the general kinds of harms he foreseeably risked by his negligent conduct and to the class of persons he put at risk by that conduct.”223 Anything beyond that is excluded from recovery. In maritime-based torts, Robins Dry Dock analogously placed a further restriction on foreseeability, requiring physical damage to a proprietary interest as well.224 Thus, even though it was completely foreseeable that Exxon’s oil spill would damage the local fishing industry, if those fishermen and vessels were not physically touched by the oil, there was limited recovery available.

221 Id. at 308.

222 See generally Thomas J. Schoenbaum, Admiralty and Maritime Law § 12-7 (4th ed. 2004). Much of the controversy surrounding the Robins Dry Dock rule stems from the issue of whether to apply a rule of negligent interference with contract or more traditional tort doctrines. See, e.g., Kinsman Transit Co. v. City of Buffalo, 388 F.2d 821, 823–24 (2d Cir. 1968) (“[W]e hesitate to accept the ‘negligent interference with contract’ doctrine . . . . [S]everal cases often cited as illustrations of the application of the . . . doctrine have been convincingly explained in terms of other more common tort principles.”).


224 See Robins Dry Dock, 275 U.S. at 308; see also State of Louisiana ex rel. Guste v. M/V Testbank, 752 F.2d 1019, 1021 (5th Cir. 1985) (en banc) (refusing to permit recovery of economic losses caused by shipping accident without physical damage to plaintiff’s property, although injury was perhaps foreseeable). Judge Wisdom vigorously disagreed with the M/V Testbank majority in his dissent, opting instead to apply the traditional tort principles of foreseeability and proximate causation because he felt this would lead to fairer and more economically reasonable results. See id. at 1035, 1046 (Wisdom, J., dissenting).

Courts have carved out an extremely limited exception to the general maritime prohibition created by Robins Dry Dock, allowing commercial fishermen to recover economic damages even in the absence of physical harm. See, e.g., Union Oil Co. v. Oppen, 501 F.2d 558, 567–68 (9th Cir. 1974). Yet courts have struggled to apply the general Robins Dry Dock rule, finding it difficult to determine when a physical-damage component should apply and when liability should simply be based on foreseeability and proximate causation. Compare Kinsman Transit Co., 388 F.2d at 825 (denying recovery where neither plaintiff “suffered any direct or immediate damage for which recovery [was] sought”), with Union Oil Co., 501 F.2d at 568 (permitting recovery for commercial fishermen even in the absence of physical injury because the harm to plaintiffs was foreseeable and imposition of liability would lower the likelihood of future harm). When the Ninth Circuit in Union Oil Co. specifically refused to apply the Robins Dry Dock rule to fishermen, the court stated that they enjoy a favored position in admiralty such that “their economic interests [are] entitled to the fullest possible legal protection.” Union Oil Co., 501 F.2d at 567 (citation omitted).
Unfortunately for the plaintiffs in the Exxon Valdez case, the ramifications of Robins Dry Dock were dramatic: substantial components of measurable harm, likely totaling hundreds of millions of dollars, were excluded from their compensatory damages judgment.\(^{225}\) Among the items precluded were damages to commercial fishermen in areas not oiled because of the stigma associated with fish from Alaskan waters;\(^{226}\) loss of profits for residents of local towns reliant on the fishing trade, including those who repaired boats, manufactured fishing nets, and provided goods and services to commercial fishermen;\(^{227}\) and loss of profits in the tourism industry.\(^{228}\) Local governments also lost significant tax revenues because of fishery closures.\(^{229}\) Worst of all, the oil spill caused the value of fishing permits to plummet, a devastating loss to Alaskan fishing communities.\(^{230}\) Because of the uncertainty caused by the oil spill as to the recovery of the fishing grounds, individual permits lost $100,000 to $200,000 in value.\(^{231}\) Fishermen were left with useless equipment and permission to fish in an ecosystem that had been ravaged and emptied; as one put it starkly, “[t]hey’ve lost everything.”\(^{232}\)

\(^{225}\) See Amici Curiae Brief of Law & Economics Scholars, supra note 118, at 4–6.

\(^{226}\) See id. at 4.

\(^{227}\) See Exxon Shipping Co. v. Airport Depot Diner, Inc., 120 F.3d 166, 168 n.3 (9th Cir. 1997).


\(^{229}\) See Amici Curiae Brief of Law & Economics Scholars, supra note 118, at 4–5.

\(^{230}\) See Charles Siebert, After the Spill, Men’s Journal, Apr. 1999, at 91, 94 (noting that the price of fishing permits in Alaska is based entirely on demand, which fell precipitously in the wake of the Exxon Valdez oil spill); see also Joel Connelly, Puget Sound at Risk of Oil Spill Too, Alaskans Warn, Seattle Post-Intelligencer, Mar. 3, 1999, at A1 (reporting that fishing permits lost ninety percent of their pre-spill value).

\(^{231}\) Amici Curiae Brief of Law & Economics Scholars, supra note 118, at 5; see also J. STEVEN PICOU & CECILIA G. MARTIN, LONG-TERM COMMUNITY IMPACTS OF THE EXXON VALDEZ OIL SPILL: PATTERNS OF SOCIAL DISRUPTION AND PSYCHOLOGICAL STRESS SEVENTEEN YEARS AFTER THE DISASTER 14 (2007) (final report submitted to the National Science Foundation).

\(^{232}\) See Nomura, supra note 107, at 26. One victim, David Mann, noted that at least sixty-five percent of fishermen plying the waters before the spill are now gone: “’They’ve lost everything. And to add insult to injury, after losing business, losing everything and waiting 20 years, they find out it’s worth [almost nothing].’” Id.
2. _Harm that Was Unknown at the Time of Trial Was Not Recovered_

Second, the *Exxon Valdez* oil spill caused additional uncompensated harm in the form of economic damages, the extent of which was unknown at the time of the 1994 trial. When the initial trial took place, scientists dismissed links between the collapse of the Prince William Sound herring fishery and the *Exxon Valdez* crash, but further research suggested that the fishery collapse occurred immediately after the spill. As a result of this timing, plaintiffs were unable to recover complete damages for harm to the fishery. Over the ensuing two decades, some plaintiffs attempted to reopen consideration of the damages that were unknown at the time of trial, but relatively little has been successfully recovered to date.

3. _Sociological, Cultural, and Emotional Distress Damages Were Barred_

The third major category of uncompensated harm resulting from the *Exxon Valdez* oil spill was the purely noneconomic injury—namely the sociological, cultural, and emotional distress damages that accompanied the disaster. Research in the wake of the *Exxon Valdez* crash has revealed that the spill and its impact on the area’s natural resources devastated communities around Prince William Sound. Sociologists have found that, in addition to the physical destruction, disasters can have “significant impacts on mental health functioning” because of the disruption and stress they cause. Prominent scholar Steven Picou’s research has added that disasters

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233 See Amici Curiae Brief of Law & Economics Scholars, supra note 118, at 6.

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

235 See William H. Rodgers, Jr. et al., *The Exxon Valdez Reopener: Natural Resources Damage Settlements and Roads Not Taken*, 22 ALASKA L. REV. 135, 179–83 (2005). Professor Rodgers and his colleagues urged the U.S. Government and the State of Alaska to make their “reopener claims” (for $92 million in additional compensation) under the terms of the 1992 settlement. Id. at 139. However, yet another lawsuit will be necessary to collect this money. See Email from William H. Rodgers, Jr., Stimson Bullitt Professor of Envtl. Law, Univ. of Wash. Sch. of Law, to author (July 14, 2009, 1:45 PM) (on file with author).

236 Amici Curiae Brief of Law & Economics Scholars, supra note 118, at 7.

237 Id. at 7–8.


caused by human error, such as the *Exxon Valdez* oil spill, also tend to have longer-lasting and more severe social, cultural, and psychological effects than natural disasters.240 In communities based largely on the economic existence of natural resources for harvest and use, this man-made disaster created stress from economic uncertainty, from disruption of subsistence, and from damage to “a unique relationship to the resources that have been contaminated.”241

Furthermore, the *Exxon Valdez* tragedy caused the deaths of thousands of birds and marine animals,242 as well as drastic declines in pink salmon and herring fisheries.243 The ecological effects of the spill were in fact so severe that many still persist: the herring fishery was closed eleven of the seventeen years after the spill and has still not fully recovered.244 Cleanup efforts strained local resources with the influx of aid workers245 and created social conflicts between locals who

240 J. Steven Picou et al., *Disaster, Litigation, and the Corrosive Community*, 82 SOC. FORCES 1493, 1495 (2004); Picou et al., *supra* note 239, at 239 (noting that those who live in close proximity to the spill or who have unique relationships with the affected area may suffer elevated stress); see also Arata et al., *supra* note 238, at 24; William R. Freudenburg & Timothy R. Jones, *Attitudes and Stress in the Presence of Technological Risk: A Test of the Supreme Court Hypothesis*, 69 SOC. FORCES 1143, 1154–59 (1991); Brent K. Marshall et al., *Technological Disasters, Litigation Stress, and the Use of Alternative Dispute Resolution Mechanisms*, 26 LAW & POL’Y 289, 291 (2004).

241 Picou et al., *supra* note 239, at 239. The communities surrounding Prince William Sound derived much of their cultural, social, and economic identity from the available natural resources, the destruction of which caused significant noneconomic harm. The community of Cordova, for example, relied heavily on commercial fishing and subsistence harvesting. See Amici Curiae Brief of Law & Economics Scholars, *supra* note 118, at 11 (citing Picou et al., *supra* note 239, at 241). Members of the community depend on the fisheries for jobs; they depend on natural resources activities as a means of maintaining social relationships, Picou et al., *supra* note 239, at 241, as well as being “a part of how individuals define themselves and their quality of life,” Arata, *supra* note 238, at 26.

242 See Picou et al., *supra* note 239, at 240–41 (summarizing environmental impacts recently filed in the United States District Court for the District of Alaska reporting that the spill killed 3500 to 5500 sea otters and 350,000 birds).

243 See Picou et al., *supra* note 240, at 1501 (identifying contamination of Prince William Sound’s spawning areas as a possible cause); see also Charles H. Peterson et al., *Long-Term Ecosystem Response to the Exxon Valdez Oil Spill*, 302 SCIENCE 2082, 2083 (2003).


Residents exposed to the spill experienced high rates of anxiety, depression, and even post-traumatic stress disorder. After all was said and done, the almost incomprehensible cultural, social, and psychological damage caused by the Exxon Valdez disaster was never close to adequately addressed or repaired by the compensatory damages awarded in the case.

D. Punitive Damages Should Take into Account Harm to Nonparties

One of the major themes underlying this Article’s analysis of the Exxon Valdez case is the idea that nonparties who are impacted by a tortfeasor’s negligence must be compensated if that tortfeasor is to be properly deterred. The reader will note that each of the harms described above (which went uncompensated by the Exxon Valdez Court) included some form of harm to a nonparty.

Unfortunately, the Supreme Court in Philip Morris determined that nonparty harms should not be included in a jury’s punitive damages calculus because they are difficult to measure and would thus “add a near standardless dimension to the punitive damages equation.” The Court also held that harms to nonparties should not be included because the Due Process Clause of the Fourteenth Amendment requires that a defendant have an opportunity to defend against such a charge. Thus, two significant problems arise: (1) how should a court measure harm to nonparties without creating a “standardless dimension”; and (2) how can harm to nonparties be considered without violating due process?

In resolving the first issue, a court could simply measure the average amount of harm suffered by like individuals and then determine how many people actually suffered this harm. Consider, for example, harm to an individual living in a community on Prince William Sound. He may have suffered financial or psychological harm because of the Exxon Valdez oil spill, but perhaps he could not join the litigation because he did not suffer any direct injury. The harm to this person detracts from overall social welfare, but because he is not a party to the litigation, Exxon would escape liability under the Philip Morris

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247 Id. at 15 (citing Lawrence A. Palinkas et al., Community Patterns of Psychiatric Disorders After the Exxon Valdez Oil Spill, 150 AM. J. PSYCHIATRY 1517, 1517–23 (1993)).
249 Id. at 353–54.
approach and would not have to account for this harm in determining its level of care.

To solve this problem, law and economics requires that a court consider harm to this individual in calculating punitive damages. In order to make such a calculation, the plaintiffs could present evidence of the level of harm to each individual in these communities, considering quantitative factors such as loss in property value, lost wages, and increases in medical expenses due to the psychological impact of the spill. The court could then average the level of harm among members of the community and multiply this average by the number of persons in the community. For example, if individuals living on Prince William Sound suffered an average harm of $10 and there are 1000 individuals living in this area, then the court should properly assess damages of $10 multiplied by 1000, or $10,000.

The main criticism of this novel approach is that it is very difficult to determine the average level of harm as well as to ascertain which individuals actually suffered such harm. Yet, courts are frequently faced with difficult valuation issues; they choose to address them rather than to ignore such problems because it is in society’s best interest to do so.

Even if courts conquer the valuation question, that still leaves the crucial second issue: the potential due process violation. As mentioned above, the Philip Morris Court held that factoring harm to nonparties into punitive damages calculations would violate constitutional due process because the defendant would not have the opportunity to defend against such accusations. In these cases, however, the issue of harm to nonparties does not arise with respect to liability, but rather with respect to damages once liability has already been determined. The defendant has already had an opportunity to challenge whether or not it is at fault, and the issue then becomes one of measuring overall social harm rather than one of a defendant facing punishment without the chance to defend itself. For example, in Exxon Shipping Co., the issue was not whether Exxon had caused the harm resulting from the spill, but rather what was the appropriate magnitude of the award for the harm caused. The only real issue based on

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250 Cf. id. at 354 (questioning whether damages to third parties could be calculated when the number, severity, and circumstances of such damages would be unknown at trial).

251 See, e.g., Ohio v. U.S. Dep’t of the Interior, 880 F.2d 432, 474–81 (D.C. Cir. 1989) (discussing a challenge to the use of contingent valuation in the context of natural resources damage and determining that such a valuation is not arbitrary and capricious).

252 Philip Morris, 549 U.S. at 353–54.

harm to nonparties, therefore, was how much damage Exxon caused to those individuals not parties to the litigation. Often in mass torts, the level of harm is averaged, as courts do not assess the specific level of harm to each individual plaintiff in large class action suits. Adding harm to nonparties as an element of punitive damages would only require a court to determine how many individuals were actually harmed in calculating damages. A defendant could certainly present evidence that not all individuals were harmed, in which case the defendant would have an opportunity to defend against such damages in such a way that would satisfy any due process concerns.

E. Punitive Damages in Exxon Valdez Would Truly Play a Quasi-Compensatory Role

Hence, although Exxon had little chance of escaping liability generally (it is, concededly, unlikely that such a massive oil spill would go undetected and unlitigated), it ended up escaping liability for many of the harms it caused due to the quirks of the governing maritime law. In essence, Exxon was never forced to pay for the full damage it imposed—never made to internalize all social harms it caused—and thus still faces a diluted incentive to take due care.

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

Justice Souter explicitly rejected the quasi-compensatory rationale, however, stating that “this Court has long held that ‘[p]unitive damages by definition are not intended to compensate the injured party, but rather to punish the tortfeasor . . . and to deter him and others from similar extreme conduct.’” 259 Although that proposition is undoubtedly true under various Court precedents, it ignores the fact that the Court’s holding accomplishes precisely the opposite of this worthy goal: thousands of innocent plaintiffs never received full and just compensation for their actual losses. Such an outcome inevitably runs afoul of the deterrence and punishment goals that the Supreme Court was supposedly furthering. 260

Conclusion

Modern Supreme Court punitive damages jurisprudence has increasingly focused on the Due Process Clause of the Fourteenth Amendment, interpreting it as placing a constitutional limit on the size of any punitive award. 261 The Court has repeatedly stressed its concerns with the arbitrary and unpredictable nature of such judgments and therefore has set out a variety of tortured tests and arbitrary rules to help defendants avoid unnecessary or unfair exposure to liability. 262 The Court remains convinced that the defendant’s degree


260 But cf. Polinsky & Shavell, supra note 19, at 939–40 (arguing that, rather than using punitive damages to serve this quasi-compensatory role, the remedies for missing components of harm would be best pursued through revision of the rules used to calculate compensatory damages).

261 See, e.g., Philip Morris USA, Inc. v. Williams, 549 U.S. 346, 353 (2007) (holding that the “Due Process Clause forbids a State to use a punitive damages award to punish a defendant for injury that it inflicts upon nonparties or those . . . who are, essentially, strangers to the litigation”); State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 416 (2003) (“The Due Process Clause of the Fourteenth Amendment prohibits the imposition of grossly excessive or arbitrary punishments on a tortfeasor.”); BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 574 (1996) (finding that due process requires “fair notice not only of the conduct that will subject [a person] to punishment, but also of the severity of the penalty that a State may impose”).

262 See Exxon Shipping Co., 128 S. Ct. at 2633 (holding punitive damages in maritime cases may not exceed compensatory damages); Philip Morris USA, 549 U.S. at 353 (holding that punitive damages cannot be applied to punish a defendant for injuries to nonparties); State Farm, 538 U.S. at 418 (finding punitive damages that do not fit within the BMW guideposts are grossly excessive); BMW of N. Am., Inc., 517 U.S. at 575, 580, 583 (requiring that punitive damages be
of moral reprehensibility should be the most important factor in the jury’s calculus,\textsuperscript{263} and that the Constitution is inherently suspicious of any punitive verdict that exceeds nine times actual damages.\textsuperscript{264} Anything greater than that magic line would likely be considered grossly excessive and run afoul of the due process maxim that the “punishment should fit the crime.”\textsuperscript{265}

Unfortunately, despite numerous attempts, our Supreme Court still employs undefined, unprincipled, and largely subjective terms that do little or nothing to correct the arbitrary nature of the punitive damages awards that it seems to fear so greatly. It is far from clear that standards such as “grossly excessive” have consistent meanings across various juries and cases. While ever fearful of returning to a \textit{Lochner}-esque approach to substantive due process,\textsuperscript{266} the Court draws a bright-line rule that lacks reason—i.e., punitive damages cannot exceed a single-digit multiple of the compensatory award—based on an implicit sense of unfairness and lack of notice to wrongdoers. Ironically, this approach fails to adequately address the Court’s biggest concern: that punitive damages awards are arbitrary and illogical, based not on the actual conduct of a defendant or society’s need for deterrence, but instead on a jury’s emotional reaction toward this type

\textsuperscript{263} \textit{State Farm}, 538 U.S. at 419 (“[T]he most important indicium of the reasonableness of a punitive damages award is the degree of reprehensibility of the defendant’s conduct.” (quoting \textit{BMW of N. Am., Inc.}, 517 U.S. at 575)).

\textsuperscript{264} \textit{Id.} at 425 (“[F]ew awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process.”); \textit{BMW of N. Am., Inc.}, 517 U.S. at 581 (finding that prior caselaw suggested “that the relevant ratio was not more than 10 to 1”).

\textsuperscript{265} See \textit{BMW of N. Am., Inc.}, 517 U.S. at 575 n.24.

\textsuperscript{266} The Supreme Court’s decision in \textit{Lochner v. New York}, 198 U.S. 45 (1905), is “one of the most condemned cases in the United States history.” BERNARD H. SieGAN, \textsc{Economic Liberties and the Constitution} 23 (1980). The Court in \textit{Lochner} held that due process created a substantive right to freedom of contract, even though no such right was explicitly stated in the Constitution, and invalidated a New York statute protecting the health of bakery workers. \textit{Lochner}, 198 U.S. at 64. Much later, Justice White expressed the Court’s fears about creating substantive rights when he stated:

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

of defendant, often a corporation with deep pockets and little sympathetic appeal.

Moreover, the Supreme Court’s misguided approach to punitive damages law and to the issue of creating optimal deterrence dramatically differs from that of sound law and economics principles.267 The Court seeks to deter undesirable behavior by examining a particular defendant’s relative wealth and how morally reprehensible its conduct is in order to determine how great of a penalty is necessary to make the defendant feel the consequences of its actions. Neither factor attempts to address the root of the problem: what amount of damages is necessary to incentivize injurers to take socially optimal care—not too much, and not too little.

By contrast, a principled economic approach to punitive damages jurisprudence would look far different. While current jurists and scholars largely base their opinions on gut reactions that they have in response to morally reprehensible behavior, legal legends like Oliver Wendell Holmes, Jr., have recognized that we need to separate emotion from the law in order to create law that makes sense.268 Legal rules should be aimed at systematically creating appropriate levels of deterrence in society, and that depends on the circumstances of each case and whether a defendant had an opportunity to escape litigation in previous cases.269 This realization means that the last thing we need our Supreme Court to do is draw arbitrary lines in the sand to the effect that ten times actual damages is too much.270 Conversely, it requires careful thought about when punitive damages can compensate for the chance that a defendant may have otherwise escaped liability and, therefore, needs to have its sanction increased in order to create optimal deterrence.

The law’s ultimate goal in the punitive damages context should be to formulate legal rules that maximize social welfare. This translates into setting damages that are neither excessive nor insufficient, and

267 See supra Part III.
268 See Oliver Wendell Holmes, Jr., The Path of the Law, 10 HARV. L. REV. 457, 458–69 (1897). Holmes made this observation in the context of contract law, noting that “[n]owhere is the confusion between legal and moral ideas more manifest than in the law of contract.” Id. at 462. Holmes further expounded upon the “bad man” theory of the law, urging that if an observer wants to learn “the law and nothing else,” he “must look at it as a bad man, who cares only for the material consequences which such knowledge enables him to predict, not as a good one, who finds his reason for conduct, whether inside the law or outside of it, in the vaguer sanctions of conscience.” Id. at 459.
269 See supra Part III.
which are carefully calibrated to the circumstances of each case. When a defendant can avoid liability—either due to intentional concealment of wrongful facts or to innocent serendipity that plaintiffs do not think it worth their while to sue—punitive damages are justified. They should be set by multiplying the inverse of the probability of detection by the amount of actual harm in the instant case, a figure which could greatly exceed ten times actual damages without raising any constitutional red flags. On the other hand, when a defendant does not escape liability for harm it causes, punitive damages are completely unnecessary to deter and create only perverse second-order consequences: increased price, decreased productivity, and reduced social welfare. The time for the Supreme Court to understand this problem and adopt the principled approach outlined herein is at least two decades past due. Otherwise, further litigation is sure to continue, further unfairness is certain to result, and our Court and society will both be the worse for it.