

THE SUPREME COURT PAINTS A PICTURE
OF PUNITIVE DAMAGES:
A LOOK AT THE *BMW* DECISION

by
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The \$4,000,000 Paint Job

In recent years, challenges to punitive damage awards have been heard in the United States Supreme Court, on grounds that the awards violated the United States Constitution. Never before had the Supreme Court stricken an excessive punitive damage award handed down from a state court -- until the case of *BMW of North America, Inc. v. Gore*, 116 S.Ct. 1589 (1996).¹ In that case, Dr. Ira Gore, Jr., a physician in Alabama, purchased what he thought was a brand new pristine BMW for \$40,000. Unbeknownst to him, before he ever saw the car, it had been damaged in transit from Germany, was repaired, re-painted and subsequently delivered to Dr. Gore without notice of the damage. He learned that his car had been re-painted after taking it to a shop to be washed and waxed. It was also apparent that the patched-up paint job was not holding up as well as the factory original paint. Dr. Gore, incensed that BMW would pass off a "damaged" car as new without notifying him beforehand, brought suit in Alabama State Court, seeking compensatory and punitive damages.

During the course of the trial in Alabama, BMW stated that it had re-painted several cars which were headed for the United States - 983 in fact - and had a practice of not notifying the car's purchaser unless the cost of the repair exceeded 3% of the value of the car. Needless to say, the \$600 cost to repair the auto intended for Dr. Gore was less than 3% of the \$40,000 purchase price, and therefore, he was not notified. Furthermore, BMW would not have been guilty of deceptive trade practices under Alabama law (a statutory threshold was enacted after the *BMW* trial began), nor under the law of any state. In fact, BMW specifically established its disclosure requirements so as to be in compliance with the most stringent of the deceptive trade practice laws in the United States.² For arguments sake, even if BMW had been guilty of deceptive trade practices in Alabama, the maximum fine allowed by statute would have been a scant \$2,000.

The Alabama jury found that BMW's disclosure policy, or more aptly its *nondisclosure* policy, constituted fraud under Alabama law and returned a verdict against BMW for \$4,000 in compensatory damages, and \$4,000,000 in punitive damages. Plaintiff's counsel had urged that BMW should be punished for the thousand³ touch-up paint jobs it performed without telling the

¹ Marcia Coyle, *New Jury Verdict Role for Courts*, The National Law Journal, July 8, 1996, at A22.

² BMW Brief at p. 9.

³ Rounded up from the actual number of cars touched up in the United States, 983.

vehicle purchasers.⁴ And the jury did just that. Following counsel's instructions, the jury multiplied the compensatory award by one thousand to arrive at the disproportionate punitive award.

On appeal, the Alabama Supreme Court found that it was improper to punish BMW for every act that occurred in the United States, considering only 14 altered cars were sold in Alabama. Following that logic, and the lower court's calculations, the punitive award should have been 14 times \$4,000, for a total award of \$56,000. Instead, Alabama's highest court, displaying less than Solomon-like wisdom, simply cut the lower court award in half, to \$2,000,000, with no reasoning behind the decision. BMW appealed to the United States Supreme Court on the basis that the punitive award of 500 times the compensatory award violated protections afforded individuals under the Due Process Clause of the U.S. Constitution's Fourteenth Amendment (which states, in relevant part "nor shall any State deprive any person of life, liberty, or property, without due process of law . . .").

So Many Cases, So Little Time

There is no way for the Supreme Court to review every punitive damages award that works its way through the fifty state court systems. To compound the problem, the lower federal courts have no jurisdiction to review state civil jury awards. To put matters in perspective, the Supreme Court has been reviewing less than 100 cases selected from a total annual docket of more than 7000 cases.⁵ It is apparent, that a defendant who is unfortunate enough to be snared by a large verdict, in an otherwise unremarkable case, would have a difficult time passing the muster required to obtain Supreme Court review.

For some time the highest Court in the land has often struggled with the issue of punitive damages. In *Honda Motor Co. v. Oberg*,⁶ the Supreme Court evaluated the Oregon Constitution which did not allow for judicial review of punitive damages. Because punitive damages may capriciously deprive businesses of property, which is forbidden under the Fourteenth Amendment of the U.S. Constitution, the Supreme Court determined that Oregon appellate courts must review punitive awards with the same judicial scrutiny that is mandatory in other states.⁷ Simply put, the Court did not feel that the jury should have absolute discretion in handing out punitive awards. Unfortunately, the high Court gave no specific guidance as to how to determine what would constitute excessiveness. The *Honda* case was reversed and remanded to the state supreme court, which upheld the \$5,000,000 punitive damage award. Little more than a week after the *BMW* decision was handed down, the U.S. Supreme Court denied Honda's writ of certiorari.

⁴ *BMW*, 116 S.Ct. at 1593.

⁵ Thomas E. Baker, *Justices Void Punitive Award: Five Eyebrows to Four*, Washington Legal Foundation, July 12, 1996.

⁶ *Honda Motor Co. v. Oberg*, 114 S.Ct. 2331 (1994).

⁷ *Id.*

Another case which was reviewed based on a potential Fourteenth Amendment Due Process violation was *Pacific Mut. Life Ins. Co. v. Haslip*,⁸ which involved a life insurer who continued to collect premiums after the policy had expired. In rejecting the insurer's due process arguments, the Court said:

We are aware that the punitive damages award in this case is more than 4 times the amount of compensatory damages, is more than 200 times the out-of-pocket expenses of respondent Haslip, and, of course, is much in excess of the fine that could be imposed for insurance fraud . . . Imprisonment, however, could also be required of an individual in the criminal context. While the monetary comparisons are wide and, indeed, may be close to the line, the award here did not lack objective criteria. We conclude, after careful consideration, that in this case it does not cross the line into the area of constitutional impropriety.⁹

Thus, the Court, while acknowledging that the punitive damages were high, determined that a 4:1 punitive to compensatory ratio did not cross the line so as to be unconstitutionally excessive.

In *TXO Production Corp. v. Alliance Resources Corp.*,¹⁰ the Court affirmed a \$10,000,000 punitive damage award, which was decided against a compensatory award of \$19,000. Although the *BMW* Court subsequently struck down a 500:1 punitive to compensatory ratio, and previously said in *Haslip* that a 4:1 ratio was close to the line, it affirmed the 526:1 ratio in *TXO Production*. Apparently, the Supreme Court put stock in the potential harm that TXO attempted to cause, through fraud, deceit and trickery.¹¹ TXO stood to realize an \$8,000,000 profit from its illegal conduct.¹² The dissent in *TXO* renounced the decision of the majority, stating that "this Court held out the promise that punitive damages awards would receive sufficient constitutional scrutiny to restore fairness in what is rapidly becoming an arbitrary and oppressive system. Today the Court's judgment renders *Haslip*'s promise a false one."¹³ However, the plurality opinion upheld the decision below because there was evidence of deliberately false statements, acts of affirmative misconduct, or concealment of evidence of improper motive.

⁸ *Pacific Mut. Life Ins. Co. v. Haslip*, 111 S.Ct. 1032 (1991).

⁹ *Id.* at 1046.

¹⁰ *TXO Production Corp. v. Alliance Resources Corp.*, 113 S.Ct. 2711 (1993).

¹¹ *Id.* at 2714.

¹² *Id.*

¹³ *TXO Production Corp.*, 113 S.Ct. at 2728.

BMW Puts “Guideposts” Along the Road

Like *Haslip* and *TXO Production* that came before, the *BMW* Court again refused to draw a bright line between permissible and impermissible punitive damage to compensatory damage ratios. The Court reasoned “we need not, and indeed we cannot, draw a mathematical bright line between the constitutionally acceptable and the constitutionally unacceptable that would fit every case¹⁴. . . when the ratio is a breathtaking 500 to 1, however, the award must surely ‘raise a suspicious judicial eyebrow.’”¹⁵ Instead of a bright line, the Court constructed guideposts intended to assist in revealing excessive punitive awards, namely:

- 1) the degree of reprehensibility
- 2) the ratio of the punitive damage award to the actual harm inflicted on the plaintiff, and,
- 3) the state’s sanctions for comparable misconduct.

There are no hard and fast rules for litigators and lower courts to apply when considering the potential of a sizeable punitive award, which, unfortunately, is reminiscent of Justice Potter Stewart’s infamous definition of pornography - I know it when I see it.

Guidepost 1 - Degree of Reprehensibility

First and foremost, the Court realized that the degree of reprehensibility of the defendant's conduct is “perhaps the most important indicium of the reasonableness of a punitive damages award”.¹⁶ As the Court stated nearly 150 years ago, exemplary damages imposed on a defendant should reflect “the enormity of his offense.”¹⁷ This principle reflects the accepted view that some wrongs are more blameworthy than others.

In the *BMW* case, the aggravating factors associated with particularly reprehensible conduct were lacking. As the Court noted: “the harm BMW inflicted on Dr. Gore was purely economic in nature, and [was not one that would jeopardize] the health and safety of others. The presale refinishing of the car had no effect on its performance or safety features, or even its appearance for at least nine months after his purchase. BMW's conduct evinced no indifference

¹⁴ *Id.* at 2720, citing *Haslip*, 111 S.Ct. at 1043.

¹⁵ *Id.*

¹⁶ The flagrancy of the misconduct is thought to be the primary consideration in determining the amount of punitive damages.” Owen, *A Punitive Damages Overview: Functions, Problems and Reform*, 39 Vill. L. Rev. 363, 387 (1994).

¹⁷ *Day v. Woodworth*, 13 How. 363, 371 (1852). See also *St. Louis, I. M. & S. R. Co. v. Williams*, 251 U.S. 63, 66-67 (1919) (punitive award may not be “wholly disproportioned to the offense”).

to or reckless disregard for the health and safety of others.¹⁸ To be sure, infliction of economic injury, especially when done intentionally through affirmative acts of misconduct, or when the target is financially vulnerable, can warrant a substantial penalty.¹⁹ But this observation should not be misconstrued to convert all acts that cause economic harm into torts, unless they are sufficiently reprehensible to justify a significant sanction in addition to compensatory damages.

Guidepost 2 - Ratio of Punitive Damages to Harm Inflicted

The second and perhaps most commonly cited indication of an unreasonable or excessive punitive damages award is its ratio to the actual harm inflicted on the plaintiff.²⁰ The Court's decisions in both *Haslip* and *TXO* endorsed the proposition that a comparison between the compensatory award and the punitive award is significant. The \$2,000,000 in punitive damages awarded to Dr. Gore by the Alabama Supreme Court is 500 times the amount of his actual harm as determined by the jury.²¹ Moreover, there is no suggestion that Dr. Gore or any other BMW purchaser was threatened with any additional potential harm by BMW's nondisclosure policy. Consequently, the Court determined that the disparity in the *BMW* result was dramatically greater than those considered in *Haslip* and *TXO*.

Guidepost 3 - Sanctions for Comparable Misconduct

Comparing the punitive damages award and the potential civil or criminal penalties that could be imposed for comparable misconduct provides a third, and final indication of excessiveness. As discussed above, BMW would have been subjected to a maximum fine of merely \$2,000, if convicted of Deceptive Trade Practice under Alabama State law. Therefore, the Alabama Supreme Court's decision failed to meet the mark of all three guideposts.

The Road to Nowhere

¹⁸ *BMW*, 116 S.Ct. at 1592.

¹⁹ *Id.* at 1599.

²⁰ *Id.* at 1601.

²¹ Even assuming each repainted BMW suffers a diminution in value of approximately \$4,000, the award is 35 times greater than the total damages of all 14 Alabama consumers who purchased repainted BMWs.

As Justice Scalia noted in his dissent, “[o]ne might understand the Court's eagerness to enter this field, rather than leave it with the state legislatures, if it had something useful to say. In fact, however, its opinion provides virtually no guidance to legislatures, and to state and federal courts, as to what a ‘constitutionally proper’ level of punitive damages might be.”²² Justice Scalia concluded that, “the ‘guideposts’ mark a road to nowhere; and provides no real guidance at all.”²³

Notwithstanding Justice Scalia’s scathing comments, in fairness, the *BMW* decision signifies the Supreme Court’s willingness to rein in runaway punitive damage verdicts. Under the tort system in place today, there is a lack of uniformity among state statutes on the issue of determining the availability of punitive damages, as well as the standards of conduct warranting the imposition of these damages, with no consistent means for evaluating the amount of punitive damages to be levied against a defendant.²⁴ While the judicial and legislative branches of government grapple with this area, the *BMW* guideposts, at best, mark a road under construction.

²² *BMW*, 116 S.Ct. at 1615.

²³ *BMW*, 116 S.Ct. at 1618.

²⁴ Brett T. D. McDonald, *The ABC's of Federal Tort Reform*, Aircraft Builders Council, Inc. Law Report, Fall 1995.