

Vol. 17 No. 11

February 22, 2002

FEDERAL COURT'S *EXXON* RULING SETS PUNITIVE DAMAGES PRECEDENT

by

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On November 7, 2001, the United States Court of Appeals for the Ninth Circuit vacated a \$5 billion punitive damage award imposed against Exxon Corporation for its conduct leading to the *Exxon Valdez* oil spill. The decision is significant, not simply because of the amount of money at stake or the publicity accorded this high-profile case, but because the Ninth Circuit rigorously applied the Supreme Court's new standards governing constitutional challenges to punitive damage awards, thus establishing an important, and likely enduring, precedent.

In re the Exxon Valdez, 270 F.3d 1215 (9th Cir. 2001), provides a striking example of the evolution, over the last five years, of the law governing punitive damages. At the time the jury handed down its staggering \$5 billion verdict in 1994, the Supreme Court was still struggling to define the legal landscape and to clarify the constitutional protections afforded corporate defendants in punitive damage cases. Since that time, the Court has issued two landmark decisions: *BMW of North America, Inc. v. Gore*, 517 U.S. 559 (1996), and *Cooper Industries, Inc. v. Leatherman Tool Group, Inc.*, 121 S. Ct. 1678 (2001). Those two decisions now serve as the polestars for constitutional challenges to punitive damage awards, and it was those two decisions that produced the Ninth Circuit's ruling in *Exxon*.

The *Exxon* decision also illustrates the extent to which economic analysis has infused and transformed the review of punitive damage awards. This is a long-awaited and welcome development, particularly for those who agree with the assessment of the en banc Sixth Circuit that "a sort of game-show mentality leads some contemporary juries to award punitive damages in amounts that seem utterly capricious." *Moreno v. Consolidated Rail Corp.*, 99 F.3d 782, 792 (6th Cir. 1996) (en banc). Consideration of the real-world economic consequences of mammoth punitive awards — and the incentives they create with regard to corporate decision-making — benefits defendants and the general public alike. In addition, it helps restore fairness and rationality to an area of law that is all too often marked by caprice and injustice.

Exxon Background and Posture. The facts of the oil spill are commonly known. Shortly after midnight on March 24, 1989, the *Exxon Valdez* ran aground on a reef in Prince William Sound off the coast of Alaska. The oil tanker was under the command of Captain Joseph Hazelwood, a troubled man with a history of alcoholism. Testimony at trial suggested that prior to boarding the ship, Hazelwood

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had consumed about fifteen ounces of 80-proof alcohol in waterfront bars and was intoxicated at the time of the accident.

The oil spill was undeniably catastrophic. Prince William Sound was polluted with eleven million gallons of oil, and Exxon spent over \$2 billion on efforts to remove the oil from the water, the adjacent shores, and even from the wildlife dirtied by the spill. The company also spent \$300 million on voluntary settlements with property owners, fishermen, and others whose economic interests were harmed. Exxon further agreed to a consent decree with the State of Alaska and the United States under which the company agreed to pay at least \$900 million to restore damaged natural resources.

The litigation that resulted in the Ninth Circuit's recent ruling concerned a lawsuit brought by commercial fishermen and others seeking redress for the harm to their economic expectations. Because Exxon had already been punished for the harm it caused to the environment (pursuant to its stipulation with the government), the jury was required to limit its award to punishment based on harm to economic, rather than environmental, interests. As the court noted at the outset, "[t]his is not a case about befouling the environment," but rather "a case about commercial fishing." 270 F.3d at 1221. Moreover, because issues regarding compensatory damages had largely been resolved by the time the case reached the Ninth Circuit, the primary questions faced by the court of appeals concerned the jury's \$5 billion punitive damage award.

Emerging Punitive Damages Guideposts. Until recently, defendants on the receiving end of a large punitive damage award had relatively few legal avenues of relief. They could always challenge the sufficiency of the evidence underlying the award, of course, and in some instances could point to the amount of a large award as proof that the jury was improperly motivated by passion or prejudice.

In the early 1990s, the Supreme Court began to sketch the contours of a jurisprudence recognizing that the United States Constitution placed limits on the amount of punitive damages that could be awarded against a tortfeasor. In 1996, it issued its momentous *BMW* decision, which held that elementary notions of fairness enshrined in the Due Process Clause barred the imposition of grossly excessive punitive damage awards. The Court identified three guideposts for determining whether an award is unconstitutionally excessive: (1) the reprehensibility of the defendant's conduct; (2) the ratio of the punitive damage award to the actual harm suffered by the plaintiff; and (3) the difference between the award and the amount of any civil or criminal penalties that could be imposed for comparable misconduct. 517 U.S. at 580-83.

In May of last year, the Court gave this constitutional guarantee some bite in the *Cooper Industries* decision. The dispute in that case centered on the standard of review an appellate court should use in reviewing a district court's holding that a punitive damage award passes constitutional muster under *BMW*. The Court rejected the suggestion that such rulings should be reviewed for abuse of discretion, and held that *de novo* review was the proper standard. 121 S. Ct. at 1685-86. The Court underscored its conclusion by directing courts of appeals to conduct a "thorough, independent review" of a district court's excessiveness determination. *Id.* at 1688.

BMW and *Cooper Industries* laid the foundation for the ruling in *Exxon*. Indeed, the Ninth Circuit prefaced its discussion of punitive damages by noting that "[t]he law began changing shortly after judgment" was entered below, and expressly recognized that "important aspects of this opinion are controlled" by *Cooper Industries*. 270 F.3d at 1221. The court then proceeded to conduct its own review of the punitive damage award in light of the *BMW* factors. Although it remanded the case to the

district court for determination of the precise amount of the award, it made clear that a \$5 billion award was grossly excessive and hence unconstitutional.

Applying the Guideposts in Exxon. The court began by considering the reprehensibility of Exxon's conduct. It noted that, unlike in many other cases where punitive damages are awarded, the harm that Exxon caused was purely to economic interests. (Recall that the consent decree precluded the jury from considering harm to the environment.) Moreover, the court noted, Exxon mitigated the harm it caused by compensating landowners and helping pay for the cleanup. "Reprehensibility should be discounted if defendants act promptly and comprehensively to ameliorate any harm they cause in order to encourage such socially beneficial behavior," the court properly concluded. 270 F.3d at 1242.

Next, the court measured the ratio of the punitive damage award to the actual harm caused by Exxon's conduct. *BMW* held that punitive damages must bear a "reasonable relationship to compensatory damages," 517 U.S. at 580, and the Ninth Circuit noted that the ratio of roughly 17:1 greatly exceeded the 4:1 ratio the Supreme Court characterized as "close to the line" of unconstitutional excessiveness in *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 23 (1991). The court also recognized that the cleanup expenses already incurred by Exxon were a powerful deterrent in and of themselves, pointing out that "[a] company hauling a cargo worth around \$25.7 million has a large incentive to avoid a \$3.4 billion expense for the trip." 270 F.3d at 1244. Consequently, "[b]ecause the costs and settlements in this case are so large, a lesser amount is necessary to deter future acts." *Id.* Assessing disproportionate punitive damage awards, the court explained, would render certain activities unacceptably risky and might lead a company to avoid engaging in a socially beneficial activity entirely. *Id.*

The court then examined the penalties available for misconduct comparable to Exxon's. Observing that "[t]his case is unusually rich in comparables," the court found that a \$5 billion punishment vastly exceeded any existing civil or criminal sanction that could be imposed for similar wrongdoing. *Id.* at 1245-46. The court took particular note of the Oil Pollution Act — a federal law enacted after the spill — and determined that the maximum civil penalty that could have been imposed pursuant to the Act was \$786 million, or about 15 percent of the amount the jury awarded. Although the court did not identify the precise amount of a punitive damage award that would satisfy the requirements of *BMW*, it held that \$5 billion was plainly excessive and directed the district court to reduce the award on remand.

Ruling Reflects Deeper Trends. The Ninth Circuit's decision in *Exxon* reflects the rigor with which appellate courts review punitive damage awards in the wake of *BMW* and *Cooper Industries*. But the decision is also emblematic of several deeper trends that may presage a profound shift in the law of punitive damages.

One such trend is a more intense focus on the real-world deterrent effect of punitive damage awards. Unlike compensatory damages, which are intended to compensate the plaintiff for the harm he has suffered, punitive damages have long been viewed as a way to punish a wrongdoer and thereby deter him from future misconduct. *See, e.g., Haslip*, 499 U.S. at 20-21 (purpose of punitive damages is "to punish what has occurred and to deter its repetition"). But when juries impose punitive damage awards in the multimillions (or, as here, multibillions), there arises a very real risk of overdeterrence: that in seeking to deter the wrongful conduct, the award ends up deterring the activity as a whole.

Consider the *Exxon* court's discussion of the comparable civil and criminal penalties that could be imposed for environmental pollution. The court recognized that Congress, in passing the Oil Pollution Act, had made a legislative judgment concerning the amount of punishment necessary to deter misconduct by tanker owners. The amount — up to \$3,000 per barrel of oil discharged — was chosen because it was deemed sufficiently high to deter future oil spills, but not so high that it would deter the shipment of oil altogether. As the Ninth Circuit concluded: "Every large company knows that it cannot exercise absolute control over all its employees, so if there is too much risk in performing some activity, the entire activity may be avoided as a preferable alternative to bearing potentially infinite costs of avoiding the harm, and society would lose the benefit of the productive activity." 270 F.3d at 1244. Judicial recognition of this fundamental point is an important step towards ensuring that the public interest is actually vindicated by punitive damage awards.

Exxon also recognized the heightened power appellate courts now enjoy to review and modify punitive damage awards under *Cooper Industries*. En route to holding that excessiveness determinations by the district court are subject to *de novo* review, the Supreme Court explained that the amount of a punitive damage award is a question of law rather than fact. 121 S. Ct. at 1686. The Court reasoned that whereas a compensatory damage award measures the harm suffered by the plaintiff, and is therefore capable of precise quantification, a punitive damage award is "an expression of [the jury's] moral condemnation." *Id.* at 1683.

Conclusion. The obvious upshot of this conclusion is that the jury's calculation of punitive damages is not entitled to the deference accorded its factual determinations. Consequently, courts of appeals can be expected to police such awards more aggressively in the future; the Supreme Court made clear that an appellate court's role in performing a due process review is not a passive one. An additional and more subtle implication of *Cooper Industries* is that it may be the judge's prerogative, rather than the jury's, to calculate the amount of a punitive damage award in the first instance. Time will tell whether judges follow this logic and reserve for themselves the power to calibrate the amount of the punitive award to the defendant's misconduct and ensure that the punishment falls within constitutional boundaries.

The Ninth Circuit's decision in *Exxon* is the logical result of the Supreme Court's evolving punitive damages jurisprudence. It is a welcome sign that fairness and rationality are returning to an area of law from which they have all too often been absent.