

Punitive Damages Reform: The Case of Alabama

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This paper addresses the modern grounds for punitive damages reform.¹ It focuses on particular problems relating to punitive damages verdicts in Alabama, but the issue extends substantially beyond the Alabama case. Punitive damages verdicts are relatively infrequent in many jurisdictions.² From time to time, however, an occasional jury can render an enormous punitive damages verdict even in a jurisdiction where punitive damages awards are infrequent. Oftentimes, the trial or an appellate court will remit such a verdict, and the pattern of punitive damages infrequency will be restored. There is reason to believe, however, that in recent years the Alabama experience has been substantially different. As I shall describe in more detail below, beginning in the early 1990s, punitive damages verdicts increased in Alabama both in frequency and magnitude. While some of these verdicts were remitted in part on appeal,³ there was no clear signal from the Alabama Supreme Court or any court of appeal as to what limits there might be to continued punitive damages awards. Perhaps as a consequence, the frequency and magnitude of punitive damages awards continued to escalate and to dramatically affect the entire civil dispute process.⁴ As a consequence, punitive damages claims and awards have become a routine feature of the Alabama civil liability regime.

This paper addresses the Alabama phenomenon. While the Alabama experience, to my knowledge, is unique—there are no studies showing civil jury verdicts of this magnitude in any other American jurisdiction—there is no reason to believe that the phenomenon is unique to Alabama jurisprudence. Indeed, oddly enough, the procedures for trial and appellate review of punitive damages verdicts had been developed in the caselaw more completely for Alabama than for any other United States jurisdiction.⁵ Instead, the recent Alabama experience

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1. This paper is an expansion of testimony presented to the Senate Committee on the Judiciary on Punitive Damages Tort Reform in April 1995. It presents some results of empirical work conducted since that presentation and discusses the recent U.S. Supreme Court opinion in *BMW of North America, Inc. v. Gore*, 116 S. Ct. 1589 (1996).

2. See Michael Rustad, *In Defense of Punitive Damages in Products Liability: Testing Tort Anecdotes with Empirical Data*, 78 Iowa L. Rev. 1 (1992).

3. For a recent example, see *Life Ins. Co. of Georgia v. Johnson*, No. 1940357, 1996 WL 202543 (Ala. Apr. 26, 1996) (\$12.5 million punitive damages verdict remitted to \$5 million); *but cf. Foster v. Life Ins. Co. of Georgia*, 656 So. 2d 333 (Ala. 1994) (\$250,000 punitive damages verdict by trial judge vacated by Alabama Supreme Court reinstating jury's \$1 million punitive damages award).

4. For the extraordinary effects that repeated punitive damages verdicts have had on tort claims, see *infra* text accompanying notes 16-20.

5. See, e.g., *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 111 S. Ct. 1032 (1991); *TXO Production Corp. v. Alliance Resources Corp.*, 509 U.S. 443, 113 S. Ct. 2711 (1993) (U.S. Supreme Court approval of Alabama punitive damages review procedures).

seems reflective, more generally, of the consequences of permissive appellate review of jury trial punitive damages verdicts. As suggested by the Alabama experience, punitive damages verdicts can begin to snowball. As citizens see large punitive damages verdicts awarded in increasing numbers of cases, expectations and understandings begin to change. The large punitive damages verdict becomes the norm, rather than the exception. This paper documents that experience in Alabama and discusses the effects of such judgments on deterrence and on the welfare of consumers.

Within the past weeks, the United States Supreme Court has once again reviewed an Alabama punitive damages verdict and, for the first time, determined that the verdict and, to some extent, current Alabama punitive damages review procedures, fail constitutional norms.⁶ This paper reviews that decision in the context of the broader Alabama experience, and discusses the likelihood that the new approach toward the review of punitive damages judgments adopted by the Supreme Court can halt the spiraling punitive damages experience in Alabama or other jurisdictions.

Part I reviews the Alabama experience to document what I regard to be the increasing commonality of Alabama punitive damages verdicts and claims. Parts II and III address the effects of routine punitive damages claims and verdicts. Part II focuses on deterrence, the principal rationale for punitive damages, and Part III discusses consumer welfare. Part II shows that the deterrent effect of punitive damages verdicts has been vastly overrated, especially with respect to corporate defendants. Part III explains how the principal victims of excessive punitive damages verdicts are consumers, and low-income consumers most of all. Finally, Part IV discusses whether effective punitive damages reform can be effected through the courts, reviewing the Supreme Court's decision in *BMW of North America, Inc. v. Gore*,⁷ or whether a legislative constraint on punitive damages is necessary. It is, of course, too early to determine what the effect of the *BMW* decision will be; indeed, it is premature to anticipate how the Alabama Supreme Court will respond to the decision. Part IV, however, hazards some preliminary thoughts on the extent to which the more careful inquiry now required by the United States Supreme Court can affect a punitive damages "environment," an environment now reaching to the level of citizen-juror expectations, such as that in Alabama. Part IV suggests that there are reasons to believe that legislative approaches to the punitive damages problem may still be required.

I. THE INCREASING COMMONALITY OF PUNITIVE DAMAGES

Forty years ago, punitive damages verdicts were exceptionally rare in all jurisdictions and were available against only the most extreme and egregious of

6. *BMW of North America, Inc. v. Gore*, 116 S. Ct. 1589 (1996).

7. *Id.*

defendant actions.⁸ The world of civil litigation is surely different today, especially in Alabama. Both the number and, especially, magnitude of punitive damages judgments have increased dramatically. Indeed, in Alabama, the frequency of claims for punitive damages has increased to approach the routine. These claims affect the settlement process by increasing the litigation rate⁹ and, necessarily, the ultimate magnitude of settlements, even in cases that are settled out of court.

A recent study of punitive damages trial verdicts illustrates the phenomenon.¹⁰ Punitive damages verdicts of greater than \$1 million are alleged to be rare, and verdicts in the multi-millions extremely rare.¹¹ Alabama appears to be an exception. In 1991, there were eleven reported punitive damages verdicts equal to or greater than \$1 million and individual verdicts of \$25 million, \$45 million and \$50 million.¹² In 1992, there were twenty-two reported punitive damages verdicts equal to or greater than \$1 million and individual verdicts of \$18 million, \$25 million and \$33.2 million. In 1993, there were fifteen verdicts equal to or greater than \$1 million and individual verdicts of \$12.5 million, \$19.5 million and \$65 million. Finally, in 1994, there were twelve verdicts equal to or greater than \$1 million and individual verdicts of \$22.7 million, \$25 million¹³ and \$33.5 million.

The frequency of million dollar and multi-million dollar verdicts over this time period is astounding and is suggestive of the commonality of punitive damages in Alabama. There remains, however, a better test of the commonality thesis. Some commentators continue to dismiss concerns about punitive damages on the grounds that even these numbers are not very large, given the number of jury verdicts reported across the country in any year.¹⁴ In the American system of civil justice, of course, very few verdicts of any kind are reported, relative to the number of claims filed, since only two to five percent of civil cases filed

8. W. Page Keeton et al., *Prosser and Keeton on the Law of Torts* 9 (5th ed. 1984).

9. See, e.g., Richard A. Posner, *An Economic Approach to Legal Procedure and Judicial Administration*, 2 J. Legal Stud. 399 (1973); George L. Priest, *Selective Characteristics of Litigation*, 9 J. Legal Stud. 399 (1980).

10. These statistics are derived from a study by Forrest Latta, a summary of which formed the basis for the Alabama Supreme Court's statistical appendix in *Life Ins. Co. of Georgia v. Johnson*, No. 1940357, 1996 WL 202543 (Ala. April 26, 1996).

11. See Rustad, *supra* note 2.

12. All statistics presented are those for non-wrongful death cases only. Alabama procedures provide that the only measure of damages for wrongful death is punitive damages. It may well be appropriate to include wrongful death awards in this study both because the Alabama standards for wrongful death recoveries are equivalent to the standards for punitive damages recoveries in other cases and because the procedure for trial and appellate review is the same. See *Green Oil Co. v. Hornsby*, 539 So. 2d 218 (Ala. 1989). Nevertheless, the unusual character of Alabama verdicts in comparison to those of other states is best seen if the Alabama wrongful death experience is excluded since Alabama wrongful death procedures differ from those of virtually all other states.

13. *Gallant v. Prudential Life Ins. Co., Barbour County, AL, CV-93-50* (1994). See discussion *infra* text accompanying notes 27-36.

14. See Rustad, *supra* note 2.

ever proceed to a verdict.¹⁵ The better test of the commonality of punitive damages verdicts derives from a study of claims.

Recently, I participated in an empirical study of the frequency of punitive damages claims in Alabama. A study of claims—the proportion of all tort cases filed that incorporate a claim for punitive damages—is the best test of the commonality of punitive damages expectations. The study, which to my knowledge is one of the only studies of punitive damages claims, was conducted in three Alabama counties: Bullock, Lowndes, and Barbour Counties. Each of these counties is a relatively rural locale with a small population and without substantial industry. We studied all tort actions filed in these counties in the past several fiscal years to determine the numbers in which punitive damages were claimed. To summarize the most recent statistics, we found that in the fiscal year 1992-93, 76.5% of all tort cases filed in Bullock County included a punitive damages claim; 65.1% in Lowndes County; and 78.3% in Barbour County.¹⁶

The exceptionally high proportion of punitive damages claims and the universality of such high proportions over each of the counties studied are striking and nearly incredible. Again, the study was not limited to claims involving high dollar amounts or product liability claims or, even, claims against corporate defendants; the study addressed all tort claims. Anyone familiar with our civil justice system knows that most tort actions involve relatively routine forms of accidents, such as traffic accidents.¹⁷ That 65% to 78% of *all* tort actions over a given fiscal year included punitive damages claims starkly challenges the notion that punitive damages are an infrequent and seldom invoked remedy across American civil law.

Incredible as these numbers may seem, in the succeeding fiscal year, the proportion or number of tort cases including a punitive damages claim actually increased in each of the counties. During the 1993-94 fiscal year, an extraordinary 95.6% of tort cases filed in Bullock County included a punitive damages claim; 78.8%, in Lowndes County. In Barbour County, the proportion of tort cases including a punitive damages claim decreased from 78.3% to 72.1%, but the absolute number of punitive damages claims increased during 1993-94 by over 40%.

Much of the debate over punitive damages proceeds in the form of competing anecdotes in which a defender of our modern regime presents a case of exceptionally egregious defendant behavior deserving of punitive damages and

15. George L. Priest, *Private Litigants and the Court Congestion Problem*, 69 B.U. L. Rev. 527, Table 1 at 540 (1989).

16. These data were collected under a research project organized and directed by myself and Professor James R. Barth, Auburn University, and conducted by Cornerstone Research, Menlo Park, California, for the case *Gallant v. Prudential*. Data are available from the author.

17. See George L. Priest, *The Role of the Civil Jury in a System of Private Litigation*, 1990 U. Chi. Leg. Forum 161 (1990) (65% of all jury trials in the Chicago trial courts deal with auto accidents).

a supporter of reform presents an opposite example.¹⁸ The Alabama numbers belie anecdotes. No one can plausibly claim that 72.1% to 95.6% of all accident cases over an entire year in any county of the United States involve the form of exceptionally egregious defendant behavior that might merit substantial punitive damages. These numbers show that the role of punitive damages has changed dramatically in the Alabama civil justice system from an occasional remedy invoked against outrageous action to a commonplace of tort law practice.

These numbers also belie the commonly-heard defense that actual punitive damages verdicts are rare and that many of those awarded by juries are later reduced on appeal such that there is no substantial effect. Debate can be had on what is meant by the term "rare" and what constitutes, in terms of magnitude of verdicts, a "substantial" effect. The impression is often suggested, however, that even for the nation in its entirety, punitive damages claims amount to nothing more than a handful.

Our Alabama study demonstrates that this is a great misimpression. Again, we did not select the largest cities in Alabama or industrial or manufacturing centers; in fact, we did just the opposite. The counties that we studied in Alabama are rural, with modest populations and a relatively non-urbanized citizenry. For example, Bullock County has a total population of only 11,042, 4,040 of whom are employed, and a per capita income of \$9,212. Lowndes County has a total population of 12,658, with 5,300 employed, and a per capita income of \$10,628. Barbour County is somewhat larger, with a total population of 25,417, with 12,400 employed, and a per capita income of \$12,100.¹⁹ None of these counties, however, resembles in the slightest metropolitan areas such as Miami, Los Angeles, or Dallas.

What did we find? In 1993-94, despite these small populations, punitive damages claims in these rural counties constituted far more than the claimed nationwide "handful." In Bullock County, 43 of 45 tort actions included a punitive damages claim; in Lowndes County, 52 of 66 tort actions included a punitive damages claim; in Barbour County, 93 of 129 tort actions included a punitive damages claim. Are punitive damages in Alabama insignificant? The claims reported above are quite recent and remain in the litigation pipeline. Looking to much earlier claims, however, our study in Alabama showed that the magnitude of punitive damages judgments affirmed by the Alabama Supreme Court from 1987 through the first half of 1994 totalled \$53.2 million,²⁰ equal to roughly \$13 per Alabama citizen.

This study demonstrates that the number and magnitude of affirmed punitive damages verdicts is only the very small tip of an extraordinary iceberg. Again,

18. Indeed, I present an anecdotal case—though a telling one—*infra* text accompanying notes 27-36.

19. These statistics are taken from Alabama Dept. of Commerce, *1994 Economic Abstract of Alabama* at Tables 5-1, 5-4, 5-7, 5-13, 5-17, 9-7, 9-11, 13-4, 13-5, 13-6, 13-7, 13-9.

20. This figure again excludes wrongful death awards. See *supra* note 12. If such awards were included, the amount equals \$109 million, equal to \$26 per capita. See *Life Ins. Co. of Georgia v. Johnson*, No. 1940357, 1996 WL 202543 app. (Ala. Apr. 26, 1996).

it is universally conceded that only 2% to 5% of cases filed ever proceed to verdict. Thus, it is not surprising that the systematic observation of any single type of verdict is relatively rare. What the Alabama numbers show is that the availability of unlimited punitive damages affects the 95% to 98% of cases that settle out of court prior to trial. It is obvious and indisputable that a punitive damages claim increases the magnitude of the ultimate settlement and, indeed, affects the entire settlement process, increasing the likelihood of litigation. Thus, as shown in the Bullock, Lowndes, and Barbour County figures, modern Alabama rules with respect to punitive damages impose these effects on a majority of even settled cases.

The next two Parts review the effects of punitive damages verdicts in contexts in which such verdicts have become commonplace. Part II discusses the deterrence justification of punitive damages. Part III addresses the effects of punitive damages on consumers, low-income consumers in particular.

II. DO PUNITIVE DAMAGES SERVE A NECESSARY DETERRENT PURPOSE?

Virtually every supporter defends punitive damages on the grounds of deterrence, accompanied by an anecdote or two involving persons who suffered serious losses in contexts in which most observers would agree that the respective defendant should have prevented the accident. Generally, the anecdotes speak for themselves: I have never once seen a careful study in a specific case showing that a punitive damages judgment of some particular amount was necessary to deter some particular wrongful behavior. Instead, the argument proceeds by implication. The basic defense of punitive damages—and I believe that it is the only serious defense—is the implication that large, unlimited punitive damages verdicts are necessary to control injurious activities in society. Put in a slightly different way, it is implied that without the availability of unlimited punitive damages awards, potential defendants, especially corporate defendants, would face no deterrent threat to prevent them from causing injuries.

Forty years ago, in a tort law regime that provided little in the way of consumer remedies, it might have been believed that ever-increasing civil liability verdicts, including punitive damages verdicts, would serve to reduce the number of accidents.²¹ That view, however, has been totally discredited today, and I know of no serious tort scholar publishing in a major legal journal who could maintain it. Instead, it is widely accepted—and it is a routine proposition of a first-year modern torts course—that compensatory damages—economic losses and pain and suffering—serve a complete deterrent purpose in addition to their role in compensating injured parties. Compensatory damages impose costs on

21. For a discussion of the development of modern tort law, see George L. Priest, *The Invention of Enterprise Liability: A Critical History of the Intellectual Foundations of Modern Tort Law*, 14 J. Legal Stud. 461 (1985).

defendants who wrongfully fail to prevent accidents, costs equal in amount to the injuries suffered. Compensatory damages internalize injury costs to defendants where some action has wrongfully injured an innocent party.

Indeed, the strongest theory in the modern tort academy is that full compensatory damages generate exactly the optimal level of deterrence of accidents—not too little and not too much.²² For purposes of deterrence or accident prevention, there is no need for punitive damages of any dimension, not to mention unlimited punitive damages, given the availability of full compensatory damages. Of course, this is a theoretical conclusion, and there remains dispute in the academy as to whether, as an empirical matter, courts or juries calculate compensatory damages with perfection in every case or in every context. Thus, substantial academic attention has been given to the refinement of liability rules so that the deterrent effects of compensatory damages may be sharpened.

Given the role of compensatory damages as a deterrent, however, the analysis of punitive or other exemplary damages becomes substantially different. The only justification on grounds of deterrence for any exemplary award beyond the compensatory is that compensatory damages are inadequate for some reason, such as juries awarding damages which are too low in some dimension or some set of injuries going undetected or perhaps being too insignificant individually to justify litigation.²³ The only plausible defense of punitive damages on deterrence grounds is to restore aggregate damages to a level equal to that which is fully compensatory.

Opponents of punitive damages reform currently avoid this issue, but their failure to confront it suggests the ultimate weakness of their opposition. Again, anecdotes involving individuals suffering serious losses are not generally helpful to the analysis. I am extremely sympathetic—as all of us are—to individuals suffering serious injuries. We all wish that wrongfully injurious actions might have been avoided. Given a wrongful injury, we all want the victim to receive full compensation for economic losses and pain and suffering.

The question for punitive damages tort reform, however, is as follows: Given full compensation to the victim, is there some affirmative deterrent purpose served by awarding further damages? Is there some reason to believe that the payment of full compensatory damages will fail to deter the defendant, such that some further multiple through punitive damages is absolutely necessary? For corporate defendants, the answer surely is no. Corporate defendants who must maximize profits net of costs must necessarily take the prospect of compensatory damages into account when determining how to invest in accident prevention. Again, this analysis presumes full compensation. If there were some reason to believe that juries were systematically undervaluing economic losses or pain and suffering,

22. William M. Landes & Richard A. Posner, *The Economic Structure of Tort Law* (1987); Richard A. Posner, *Economic Analysis of Law* (4th ed., 1992); Steven Shavell, *Economic Analysis of Accident Law* (1987).

23. See sources cited *supra* note 22. Of course, the latter is also a justification for the class action.

punitive damages might be necessary to make up for the shortfall. Of course, the opposite may be true. Many, including myself, believe that juries overvalue compensatory damages, including pain and suffering, justifying increased limits on pain and suffering awards, especially in contexts of expanded liability.²⁴ Barring such a shortfall, however, there is no justification for punitive damages on deterrence grounds.

The analysis is, perhaps, somewhat different in the context of individual, non-corporate defendants who are less subject to cost constraints and, perhaps, more inclined to behave unconscionably. This is the reason that exemplary or punitive damages are often awarded in cases involving intentional harms such as assault.

As administered by juries, however, our current civil liability regime approaches the issue exactly backwards. In our current regime, large punitive damages verdicts are seldom awarded against non-corporate defendants. I know of no one objecting to a punitive damages cap on the grounds that it will impair the deterrence of private individuals. Instead, large punitive damages verdicts are most typically awarded against corporate defendants who, as profit maximizers (a motivation often irrationally held against them), will be carefully responsive to compensatory damages. Corporate defendants need no punitive damages verdict to encourage them to take all cost-effective precautions to prevent injuries; compensatory damages alone achieve that result. Thus, the increasingly commonplace plaintiff lawyer's charge to a jury to "send the corporate defendant a signal" ignores entirely the universally accepted academic view that, to a corporate defendant, full compensatory damages are not only an effective signal, but also the only signal needed.

III. DO PUNITIVE DAMAGES HELP OR HURT CONSUMERS?

If the effect of punitive damages were to benefit consumers or if their effect were even neutral to the consumer interest, we might not be concerned that punitive damages are unnecessary to deter corporate defendants from injurious behavior. The central problem of punitive damages, however, is that, except in the rare cases of jury undervaluation of damages or underlitigation, punitive damages settlements and verdicts affirmatively *harm* consumers, low-income consumers most of all.

Where punitive damages become commonplace in civil litigation, as in Alabama, or even where they become a significant risk to business operations, consumers are harmed because expected punitive damages verdicts or settlements must be built into the prices of products and services. The effect of the increased frequency and magnitude of punitive damages recoveries of modern times has been to increase the price level for all products and services provided in the United States economy. To observe this phenomenon is not to say that

24. See George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 Yale L.J. 1521 (1987).

injured consumers should go uncompensated. If a consumer suffers an injury that can be attributed to some wrongful activity of a defendant, whether manufacturer or service provider, that consumer should receive compensation for economic losses and for reasonable non-economic losses, such as pain and suffering.²⁵ In contrast, punitive damages, by definition, go beyond the compensatory. The problem with the increasing commonality of large punitive damages verdicts and settlements, such as those in Alabama, is that the awards to some consumers of greater than compensatory damages must be built into the prices paid by all other consumers.

It is an obvious implication of this proposition that low-income consumers are most seriously harmed by our current punitive damages regime. First, low-income consumers have less money generally and, regardless of the product or service, are more seriously affected in terms of the purchasing power of their limited resources when price levels increase. Secondly, and most importantly, low-income consumers are not the typical beneficiaries of large punitive damages verdicts or settlements, at least not on a systematic basis. Again, research of my own currently in progress shows that low-income consumers, if injured, are less likely to seek an attorney; even with an attorney, they are less likely to sue; less likely to recover; and, again by definition, less likely to recover large damage judgments since their lost income is typically low and pain and suffering awards, which are highly correlated with lost income, equally low.

Put more simply, where punitive damages verdicts and settlements are frequent and large, low-income consumers are forced to subsidize high-income consumers as expected punitive damages awards are built into the prices of products and services. All consumers—high-income and low-income alike—pay the increased prices; chiefly the high-income gain the return in high compensatory and punitive damages recoveries. Again, a low-income individual will receive a punitive damages windfall, but the far more systematic effect is to harm the low-income consumer as the prices of products and services generally are increased to adjust for the expectation of future punitive damages payouts.

It is important to recognize that the current effect of the doctrines of comparative negligence and joint and several liability is similar. Comparative negligence and joint and several liability have their most general effects on organizations or entities which engage in a large scope of activities, such as state and municipal governmental entities, public utilities, and the like. It has become a commonplace of modern civil litigation for plaintiffs' attorneys to join as defendants any governmental entity or utility remotely associated with an injury. Thus, state governments and municipalities are joined as defendants on claims that roads were misdesigned or poorly maintained, or that a guard rail or telephone pole could have been placed in a better position. Forty years ago, attorneys would not have thought to include entities whose causal relationship to

25. Again, I have endorsed limits on pain and suffering awards in contexts of expanded liability, though this issue is somewhat beyond the focus on punitive damages here. *See id.*

the harm was so low or, alternatively, if they had attempted to join such entities, the claim would have been dismissed. Today, such litigation is routine and imposes substantial litigation expenses upon our state and municipal governments as well as liability expenses, infrequently but chiefly under the operation of the doctrines of comparative negligence and joint and several liability, where the truly responsible defendants have gone bankrupt, leaving our governments and utilities to suffer the remaining judgment.

It is clear that, for very similar reasons, operation of the doctrines of comparative negligence and joint and several liability harms citizens in general, but low-income citizens most of all. Damages judgments against state and municipal governments must be paid from state and municipal financial sources. It is well-established that state and, especially, municipal finance are seriously regressive in effect, charging more to middle- and low-income citizens, proportionate to income, than to relatively high-income citizens.²⁶

These propositions about the effect of punitive damages, comparative negligence and joint and several liability on low-income citizens may appear abstract; however, I believe that they are generally accepted within the academic community. To illustrate their import with greater salience, however, I would like to present one recent example of a punitive damages verdict in Alabama: the case that inspired the research presented above. The case will both reaffirm the pressing need for punitive damages reform and illustrate why such reform should be expanded to all state and federal litigation.

In the case of *Gallant v. Prudential*,²⁷ decided by jury verdict in April 1994, Iran and Leslie Gallant sued Prudential Life Insurance Company based on the actions of a Prudential agent. The Gallants purchased a combination life insurance-annuity policy with a \$25,000 face value at a monthly premium of roughly \$39.00. At the time of sale, the agent told them that the value of the annuity was roughly twice what it in fact was. The agent had added together the table indicating "Projected Return" with the table indicating the lower "Guaranteed Return." A jury found this action fraudulent and held the agent liable and Prudential separately liable for failing to better supervise the agent.²⁸

Fortunately, the problem was discovered before the policyholder had died or had retired to receive the annuity. Thus, to the time of trial, there was no true economic loss beyond the failed expectation of the larger future return. According to the transcript of the testimony, the Gallants testified that, between the time they discovered the misinformation and Prudential called them to offer a remedy (Prudential offered to return their premiums or to discuss adjusting the policy), they had suffered roughly two weeks of sleepless nights and substantial anger at having been misled. That was the extent of their "mental anguish."

26. Joseph E. Stigletz, *Economics of the Public Sector* 347 (1986).

27. *Gallant v. Prudential Life Ins. Co.*, Barbour County, AL, CV-93-50 (1994) [hereinafter cited as *Gallant*].

28. *Id.*

Twenty years ago, cases of this nature were part of the legal field entitled Restitution, in which the appropriate remedy was restitution of all paid premiums or out-of-pocket costs. On very rare occasions, such as especially egregious actions by a defendant, some courts considered awarding plaintiffs the benefit of the bargain, say, by increasing their annuity benefits.²⁹

Our modern world has changed. After a one and one-half day trial, an Alabama jury awarded the Gallants damages equal to \$30,000 in economic loss, \$400,000 in mental anguish, and \$25 million in punitive damages. Again, the face value of the insurance policy was only \$25,000.

I do not wish to minimize the harm to the Gallants, especially the indignity of the misrepresentation, or condone the fraudulent actions of the agent, apparently perpetrated on several other Alabama citizens who recovered separately. Nevertheless, there is not a single person to whom I have described this case—not an attorney, whether plaintiff or defendant; not a liberal or a conservative; not even a radical or idealistic Yale Law student (or faculty member)—who has not been shocked by the outcome or who could defend it as a rational or sensible verdict in the context of the harm. Again, many defenders of punitive damages argue that exceptionally large verdicts are usually overturned on appeal. Alabama's review procedure for punitive damages verdicts had been carefully analyzed and approved by the United States Supreme Court shortly before the *Gallant* trial.³⁰ In the *Gallant* case, however, the judge conducting the review affirmed the \$25 million award in its entirety, though directing part of the amount to be paid to the State.³¹ The case was later settled prior to the United States Supreme Court's recent decision in *BMW of North America, Inc. v. Gore*.³²

What will be the effect of a punitive damages verdict of this nature? The Gallants appear to be persons of modest means (at least before the verdict). Does a verdict of this nature help middle- or low-income consumers in the aggregate? Unfortunately, totally the opposite is true. The insurance policy in question—face value, \$25,000—was the cheapest form of life insurance/annuity available on the market; its monthly premium was only \$39.00. Obviously, at such a premium, the insurance carrier could not be expecting to make a substantial profit on the policy. Indeed, an economic expert in the case for Prudential estimated that, over the entire life of the policy, the premiums net of payouts paid by the Gallants would increase Prudential's assets by only \$46.00.³³ Prudential, like most other life insurance companies, profits more

29. See generally American Law Institute, *Restatement of Restitution and Unjust Enrichment* (1936).

30. *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 111 S. Ct. 1032 (1991). But see *BMW of North America, Inc. v. Gore*, 116 S. Ct. 1589 (1996), discussed *infra*.

31. *Gallant* (mem. op.).

32. *BMW of North America, Inc. v. Gore*, 116 S. Ct. 1589 (1996) (striking down a punitive damages verdict awarded by an Alabama court).

33. Testimony of Professor James R. Barth, Auburn University in *Gallant*, *supra* note 27. Copy on file with author.

substantially from large dollar, rather than small dollar, policies. The expert estimated that the verdict reduced dividends to every Alabama policyholder (Prudential is a mutual carrier) by \$323.³⁴

How do we analyze a case like this in terms of whether punitive damages serve a necessary deterrent effect? In his closing argument, the highly effective attorney for the Gallants asked the jury to determine a level of damages that would send a "message" to the giant Prudential Life Insurance Company that fraudulent behavior on the part of an agent would not be tolerated.³⁵ What kind of damages message is necessary to achieve that effect? Obviously, if the insurer stood to gain no more than \$46 over the life of the policy, any damages judgment greater than \$46 sends the insurer a message by making the policy unprofitable. (Of course, I ignore entirely Prudential's defense costs plus the reputational harm from the lawsuit.) The jury in the *Gallant* case went substantially beyond that amount, however, in awarding *compensatory* damages of \$30,000 for economic loss and \$400,000 for the mental anguish from the two weeks of lost sleep and anger. It certainly cannot be argued that the jury undervalued the Gallant's compensatory loss—indeed, the \$400,000 mental anguish award itself is extreme. The median per capita income in Barbour County, where the *Gallant* case was tried, was \$12,100.³⁶ Furthermore, there is no reason to think that the agent's behavior in other contexts would go undetected. (Prudential later settled other cases brought by the agent's clients.) As a consequence, there is little justification for a punitive damages award whatsoever.

What will be the effect of punitive damages verdicts such as that in the *Gallant* case? In the face of such a verdict, what is the rational response of an insurer like Prudential, or other insurers selling similar policies? Regrettably, but necessarily in a competitive industry, the rational response is to quit selling such low value policies altogether. It makes very little sense to expose the company and its policyholders to the risk of such a damages verdict given the very small gain from the sale of such a policy.

Is this the type of product that our civil liability system should drive from the market? Obviously not, and low-income consumers in Alabama are directly harmed as a result. Here, the dramatically differential effects of such verdicts on high-income versus low-income consumers are made clear. In my own view, it is far more important to our society—if a choice had to be made—to have our insurance industry provide life insurance coverage to low-income citizens than to high-income citizens, since the relatively affluent of our society have other means of providing financial security for their families. The availability of financial protection and security at relatively low cost will be substantially diminished if such low premium policies, as here, are no longer available.

34. *Id.*

35. *Gallant*, *supra* note 27, Trial Transcript at 647, April 6, 1994.

36. *See supra* text accompanying note 19.

More generally, where expected punitive damages verdicts are added to the prices of products and services, the first to feel the effect will be low-income consumers. And where the magnitude of punitive damages verdicts rises, imperiling the continued provision of the product or service, the first to be affected will be those products and services with the lowest profit margins, those most attractive to the low-income consumers. The *Gallant* case provides a dramatic example of the effect. Following *Gallant* and other large punitive damages verdicts, several insurers quit offering coverage in Alabama altogether.

Punitive damages reform would cure that ill to the benefit of all Americans, especially low-income Americans. Punitive damages verdicts such as the \$25 million verdict in the *Gallant* case encourage wasteful litigation. Indeed, litigation seeking punitive damages judgments against financial service companies has become an industry in Alabama. By increasing the prices of all products and services, punitive damages verdicts and settlements reduce the purchasing power of all Americans, especially the poor.

IV. PUNITIVE DAMAGES REFORM: STATUTORY OR JUDICIAL?

Many defenders of the current regime question why legislatures should become involved in civil liability reform, rather than leaving reform initiatives to the courts. The question is particularly appropriate given that the Supreme Court has addressed the issue of the excessiveness of punitive damages in several recent cases, including the *BMW* decision.³⁷

First, it is evident, after many opportunities, that the Supreme Court has great difficulty proceeding beyond what might be called a "procedural" approach to the punitive damages problem. With the exception of the recent *BMW* opinion, the only form of punitive damages control that the Court has adopted has been purely procedural—approving a set of procedures at the state level for judicial review of punitive damages verdicts,³⁸ or disapproving a state judicial procedure as not providing sufficient review.³⁹ The recent *BMW* opinion, as I shall describe, addresses directly the question of the excessiveness of punitive damages verdicts, but chiefly adopts a new set of procedural comparisons for judicial evaluation.

In my view, a merely procedural approach to the punitive damages problem will never be successful. Indeed, we have stark evidence of its failure. In 1991 in the *Haslip* case, the Supreme Court specifically approved the procedure for reviewing punitive damages verdicts for excessiveness adopted by the Alabama Supreme Court.⁴⁰ Viewing the Alabama procedure on its face, few can contest

37. See, e.g., *BMW of North America, Inc. v. Gore*, 116 S. Ct. 1589 (1996); *Honda Motor Co. v. Oberg*, 114 S. Ct. 2331 (1994); *TXO Production Corp. v. Alliance Resources Corp.*, 509 U.S. 443, 113 S. Ct. 2711 (1993); *Pacific Mut. Life Ins. Co. v. Haslip*, 449 U.S. 1, 111 S. Ct. 1032 (1991).

38. *Haslip*, 499 U.S. at 1, 111 S. Ct. at 1032.

39. *Oberg*, 114 S. Ct. at 2331.

40. *Haslip*, 499 U.S. at 1, 111 S. Ct. at 1032.

that the review procedure appears reasonable.⁴¹ In practice, however, as the *Gallant* case proves and as the statistics from the rural Alabama counties strongly suggest, the punitive damages problem in Alabama, under the procedures approved by the United States Supreme Court, has grown to epidemic proportions.

The Court's recent *BMW* opinion, however, strikes out in a new direction. The Court found that a \$2 million Alabama punitive damages verdict in a case involving a \$6,000 compensatory economic loss to be constitutionally excessive.⁴² The Court adopted three new metrics for the evaluation of excessiveness: the relation between the punitive damages verdict and 1) the "degree of reprehensibility" of the underlying tortious action; 2) the magnitude of compensatory losses; and, 3) criminal statutory penalties for similar offenses.⁴³ These metrics are likely to be far more successful in constraining punitive damages verdicts than the vague and overlapping "factors" under which Alabama courts previously reviewed punitive damages verdicts.⁴⁴

Nevertheless, there remain serious questions as to how effective this form of comparison will prove in practice. Reprehensibility is a very vague concept and hardly susceptible of careful measurement. Similarly, the mathematical relationship between the compensatory and punitive damages elements is an odd judicial principle. Is there a principled reason that a ratio of 1 to 5 or 1 to 4 is *constitutionally* suspect in comparison to a ratio of 1 to 2 or less? Moreover, if the purpose of punitive damages is to deter behavior that is morally reprehensible, the relevance of the compensatory loss is not immediately evident unless an intent to affect the magnitude of loss was a specific element of the reprehensible action. Many totally inadvertent or accidental actions generate huge loss; many repugnant and reprehensible actions generate little harm, measured solely in compensatory terms of lost income, needed expense, and pain and suffering. Perhaps the most helpful metric is the relationship to statutory criminal penalties for comparable offenses. Here, legal analysis can be employed with some precision, though the question then arises why, given the existence of some criminal penalty for comparable action, punishment should be delegated to a civil jury through a punitive damages verdict in any case.

Upon reflection, it is not surprising that the Supreme Court has found it difficult to deal with excessive punitive damages. The Supreme Court's job, in general, is to define rights. Few would contest—I do not contest—that punitive damages may be appropriate in some contexts. I would not support a constitu-

41. The Alabama review procedure consists of evaluating a punitive damages verdict according to a wide and seemingly comprehensive list of relevant "factors," such as the "culpability" of the defendant's action, the relationship of the verdict to the harm imposed, etc. See Davis Law & Rachel Sanders Cochran, *Punitive Damages and Pre-Verdict Procedures*, *Life of Georgia: A Bold New Frontier*, July 1996 *The Alabama Lawyer* 225.

42. *BMW of North America, Inc. v. Gore*, 116 S. Ct. 1589 (1996).

43. *Id.*

44. On this point, see in particular, the concurring opinion of Justice Breyer in *BMW*.

tional right of immunity from punitive damages (though that may well be an important improvement over the current state of the law).

What is needed for punitive damages reform is a prudential judgment of the appropriate cap or limit to punitive damages that will allow some room for punishing egregious behavior but constrain the deleterious effects of unlimited punitive damages judgments on consumers. For example, the proportional limit of three times economic losses or \$250,000 in the recently enacted products liability legislation is a prudential judgment of that nature. But that prudential judgment is a uniquely legislative, not judicial, exercise. Regrettably, the President vetoed the legislation.

With respect to reform by the states, the question is somewhat different. Punitive damages verdicts implicate both interstate and foreign commerce in a manner that only Congress can address. Some have argued that a state without a significant manufacturing or interstate service sector could actually benefit its citizens by adopting an expansive civil liability regime at the expense of citizens of other states. Alabama may well be an example of this phenomenon. Congress is in the best position to provide a solution to this issue.

Secondly, there is one further effect of our modern punitive damages regime that should not go unnoticed: the effect on the competitiveness of American manufacturers and producers. Some have argued that large punitive damages verdicts in the U.S. are neutral with respect to competitiveness since 1) foreign courts do not award such verdicts against U.S. producers with respect to sales abroad; and, because 2) foreign producers are equally subject to such verdicts for sales in the United States. (Note that BMW is a German corporation.) Thus, for United States sales, foreign producers, just like United States producers, must add expected punitive damages and joint and several liability verdicts into the prices of products and services. (It is often lost on these observers that an increase in prices on account of punitive damages—even if operating neutrally—is not an affirmative argument on behalf of consumers.)

This analysis, however, is only partially correct. Increasingly, foreign courts are refusing to enforce extraordinary judgments from U.S. courts against foreign defendants. For example, the German Federal Court of Justice (Germany's highest court for civil and commercial matters) recently refused to enforce a \$400,000 punitive damages verdict obtained in an American court by an American plaintiff against a German defendant on the grounds that the punitive damages verdict was inconsistent with German public policy.⁴⁵ In the same case, an intermediate United States court already had reduced the pain and suffering damages component from \$200,000 to \$70,000 on the same grounds.⁴⁶

45. Judgment of June 4, 1992, BGH Gr. Sen. Z., discussed in George L. Priest, *Lawyers, Liability and Law Reform: Effects on American Economic Growth and Trade Competitiveness*, 71 U. Denver L. Rev. 115, 146-47 (1993).

46. *Id.*

Foreign judgments of this nature should be alarming both to Congress and to United States courts. First, they are strong evidence that the current course of American law does not command widespread assent among reasoned commentators—yet another grounds for general punitive damages reform. Secondly, such judgments suggest an increasing competitiveness problem facing United States producers *here in the United States*. To the extent that United States punitive damages verdicts must be enforced abroad and foreign courts refuse to enforce them, foreign producers need not add the costs of the American civil justice system, including punitive damages and excessive pain and suffering awards, into the prices of products and services sold in the United States. Thus, foreign producers can underprice American producers in sales to American consumers here in the United States.

Ironically, although American producers and their employees are harmed by this effect, American consumers benefit because they can obtain products and services at lower prices without the effects of our punitive damages verdicts built in.⁴⁷ Put slightly differently, the refusal of foreign courts to enforce large punitive damages or pain and suffering awards from American courts represents a type of tort reform, regrettably however, only available—prior to punitive damages reform—to foreign, rather than to United States, producers.

These various reasons support an argument for widespread punitive damages reform. While the punitive damages experience in Alabama may appear unusual, there is always the potential for a substantial punitive damages verdict in any jurisdiction. In addition, there is the potential for punitive damages verdicts to increase in magnitude and frequency so as to become routine, as I believe to be the case in Alabama prior to *BMW of North America, Inc. v. Gore*. It is too early to observe any effect of the *BMW* decision, and it is only speculation whether the seeming increase in precision of the three metrics defined by the Supreme Court can change the punitive damages environment in Alabama. If not, then some more drastic prudential judgment will be necessary to reduce the harm to consumers from excessive punitive damages awards.

47. The June 4, 1992 judgment, discussed *supra* notes 45-46, involved a personal assault, rather than harm caused in the context of product or service use, though the German Court made clear that its opinion was meant to extend to these broader effects. Of course, there is no benefit to American citizens where punitive damages verdicts go unenforced in the context of personal assault.