The Exxon Decision: Another Bad Call on Punitive Damages

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Punitive damages have been under attack in the U.S. Supreme Court for more than a decade. Beginning with BMW of North America Inc. v. Gore , and most recently with Philip Morris USA v. Williams , the court has announced due process standards that limit the ratio between compensatory and punitive damages and the types of evidence that a jury may consider. This summer, the court broke new ground in Exxon Shipping Co. v. Baker , ruling that the punitive damages awarded to the victims of the Exxon Valdez spill should be reduced as a matter of federal common law, even though the award was held consistent with due process.

The Exxon decision is troubling for several reasons. First, the court ignored the well-established "abuse of discretion" standard for reviewing punitive damages awards. Second, the court assumed a legislative function by imposing policy judgments about the appropriate size of punitive damages awards in maritime cases. Third, defendants may use the decision to argue for additional limitations on punitive damage awards.

The Disaster

The Exxon Valdez was more than 900 feet long and could carry over 53 million gallons of crude oil. In 1989, its captain was Joseph Hazelwood, who had completed an alcohol treatment program while employed by Exxon, as his superiors knew, but had resumed heavy drinking, according to the opinion. On March 23, 1989, shortly before the tanker left Valdez, Ala., with a full load of oil, Hazelwood downed at least five double vodkas, consuming enough alcohol to cause a non-alcoholic to pass out, the opinion noted.

That evening, the tanker navigated through the Valdez Narrows and was forced to change its path because of icy conditions in the outbound shipping lane. The tanker moved east toward clearer water, but the move directed the tanker toward an underwater reef, thus requiring a move back into the shipping lane north of the reef. Minutes before this crucial turn, Hazelwood left the bridge and went to his cabin. Before doing so, he placed the tanker on autopilot, speeding up the tanker and making the turn more difficult to execute, according to the opinion. He left the turn to be performed by a third mate who was unlicensed to navigate in those waters.

Unfortunately, the Exxon Valdez never made its turn and ran into Bligh Reef, tearing the hull open and spilling 11 million gallons of crude oil into Prince William Sound. Hazelwood returned to the bridge and tried to rock the tanker off the reef, a maneuver that, if successful, might have spilled more oil and caused the ship to sink. The Coast Guard took a blood test of Hazelwood, which showed that Hazelwood had a blood-alcohol level of .241 at the time of the accident, three times the legal limit for driving in most states, the opinion noted.

The Litigation

After the disaster, Exxon spent about $2.1 billion in cleanup efforts. It was charged with numerous criminal violations and sued by numerous private parties. The district court consolidated the civil actions and certified a class of 32,000 plaintiffs seeking punitive damages. Exxon admitted negligence and compensatory liability, leaving liability for punitive damages as the primary issue to be decided at trial. The jury awarded $5 billion in punitive damages against Exxon — approximately 10 times the $507.5 million in compensatory damages that Exxon paid to various fishermen, property owners and others.

The district court carefully reviewed and upheld the punitive damages award. It then reviewed its decision two more times in light of the Supreme Court's shifting jurisprudence on punitive damages. Ultimately, the 9th U.S. Circuit Court of Appeals concluded that the facts justified an award of $2.5 billion, a 5:1 ratio that fell well within due process parameters.

In the Supreme Court

Among the questions presented to the Supreme Court on certiorari was whether the $2.5 billion award was excessive under maritime common law. In a 5-3 decision, the court cut the award to $507.5 million — a 1:1 ratio with the compensatory damages paid by Exxon.

To explain the result, Justice David Souter distinguished between concerns about the size of punitive awards and the unpredictability of such awards. He noted that studies of punitive damages show that frequent large awards are not a serious problem. "[B]y most accounts the median ratio of punitive to compensatory awards has remained less than 1:1." But he reasoned that "the real problem" with punitive awards was their "stark unpredictability." As he explained: "Courts of law are concerned with fairness as consistency, and evidence that the median ratio of punitive to compensatory awards falls within a reasonable zone, or that punitive awards are infrequent, fails to tell us whether the spread between high and low individual awards is acceptable." The court concluded that a 1:1 ratio is a "fair upper limit" in maritime cases that involved recklessness but not conduct that was "intentional or malicious" and not "driven primarily by desire for gain." Thus, the court reduced the punitive award from $2.5 billion to $507.5 million.

Bad Reasoning, Bad Result

The Exxon decision is troubling for a lot of reasons. First, the court silently abandoned the traditional abuse-of-discretion standard for reviewing punitive damage awards. Federal courts have long held that "[i]f no constitutional issue is raised, the role of the appellate court, at least in the federal system, is merely to review the trial court's determination under an abuse-of-discretion standard." Here, there was no due process issue raised by the size of the award. The court acted solely under its common law authority. Under a straightforward common law approach, the court would have considered whether the district court and 9th Circuit abused their discretion given the scale of the damage, Exxon's recklessness and Exxon's wealth.

The court's analysis abandoned the straightforward approach and fashioned a new approach based on a concern for "predictability" in the ratio between compensatory and punitive damages. In doing so, the court failed to recognize that one part of the equation — compensatory damages — are inherently unpredictable, as they depend on the harm suffered by the plaintiff. Suppose that an automobile manufacturer acted outrageously by installing defective brakes in a car. The defective brakes fail, causing the car to roll backward and impact a child. There is no predicting what the injuries might result from the impact. The child might suffer a paralyzing injury with immense compensatory damages because of the need for lifelong medical care and the horrific pain and suffering. The child might die, in which case compensatory damages could be far less. Only a toe might be crushed, so that damages would be relatively small. The injuries are different, but the defendant's conduct is the same.

In this example, suppose that a jury imposes a $50 million punitive award to punish the manufacturer for its outrageous conduct and deter wrongful acts in the future. The $50 million punitive award presents a 2:1 ratio to a $25 million compensatory award for a paralyzed child, a 20:1 ratio to a $2.5 million award to a decedent's estate and a 2,000:1 ratio to a $25,000 award to compensate a broken toe. The $50 million award may appropriately serve the policies underlying punitive damages given the defendant's outrageous conduct and wealth. But as the above scenario demonstrates, the ratio is inherently unpredictable because it depends on compensatory damages, which in turn depend on the harm suffered.

Car manufacturers know that their defective products may cause catastrophic injuries, not just broken toes. They have fair notice of their exposure to large compensatory awards and large punitive awards. The risk of both is inherent to the business of car-making. Punitive damages designed to punish and deter outrageous conduct should not be prevented from serving those functions by the manufacturer's "lucky break" that the victim suffered a broken toe rather than catastrophic injury.

These considerations apply to the Exxon Valdez disaster. The 11 million gallons spilled into Prince Edward Sound was a pittance of what might have been spilled had Hazelwood successfully rocked his boat off Bligh Reef. As bad as the spill was, it could have been far worse, and Exxon's compensatory damages could have been far greater. Exxon should not benefit twice from the "lucky break" that compensatory damages were $507.5 million, not a multiple of that number. The goals of punitive damages should not be undermined by tying the outer limits of a punitive award to a compensatory award that is relatively small compared to the plaintiffs' potential harm.

The point here is that compensatory and punitive damages derive from different sources. Compensatory damages are injury dependent. Punitive damages are conduct and wealth dependent. As these damages flow from different sources and embody different policies, common law courts traditionally have not sought to ensure a precise correlation between the two, and have limited a punitive award only when the award represents an abuse of discretion under all the circumstances presented. The Supreme Court erred when it abandoned this customary approach, and supplied no good reason for its abandonment.

Rather than apply an abuse-of-discretion standard, the court adopted a legislative approach of deciding affirmatively the "correct" ratio of punitive to compensatory damages in the case. As Justice John Paul Stevens noted in his dissent, no court had imposed an outer limit on punitive damages as a common law matter. A legislature could take the action, and legislatures are in a far better position to assess empirical data, weigh competing interests, and make judgments about the appropriate size of punitive awards in varying situations. But Congress has not chosen to restrict the availability of punitive damages in the numerous statutes that now dominate the field of federal maritime law. As Stevens also noted, the courts already can prevent "outlier" awards through the abuse-of-discretion standard, and ultimately through the due process limits imposed by Gore and its progeny.

The court's decision is troubling not only for its missteps but also for what it portends. It is only a matter of time before defendants ask the Supreme Court to consider whether its reasoning in Exxon applies to all civil cases as a constitutional upper limit imposed by due process. Indeed, in Flax v. DaimlerChrysler , the Tennessee Supreme Court recently reinstated a $15 million punitive damages award in a case involving a $5 million compensatory award — a 3:1 ratio that lies well within the due process standards articulated by the Supreme Court. DaimlerChrysler has stated it plans to seek Supreme Court review of the punitive damages verdict and argue that the award violates due process because "there is no way DCC could have anticipated that its conduct could be punished to such a degree." The argument also may arise in Philip Morris USA Inc. v. Williams , in which the Supreme Court will address whether due process requires a tight ratio between punitive and compensatory damages regardless of the reprehensibility of the defendant's conduct.

Of course, the notion that DaimlerChrysler or Philip Morris could not predict a 3:1 ratio between compensatory and punitive damage is absurd on its face. Nevertheless, defendants will attempt to shift Exxon 's common law analysis into a constitutional framework by arguing that due process mandates a maximum 1:1 ratio between compensatory and punitive damages, or that the very notion of ratios is outmoded and punitive damages should be limited to objective amounts as a constitutional matter. These arguments, if accepted, may be good for corporate treasuries. But they are terrible for all Americans who rely on the tort system to deter unsafe products and hold all accountable for bad behavior. •