

States Grab Punitives: Tort Reform Or A Taking?

California Proposal Widens The Debate

By Sylvia Hsieh

California Governor Arnold Schwarzenegger's recent proposal to grab 75 percent of all punitive damages to help make up for a massive budget shortfall has renewed a fierce debate over the proper distribution of punitives.

Eight other states currently have "split recovery" statutes that allow the government to take a portion of punitive damages.

The California proposal comes at a time of increasing public and political concern about punitive damages - a time when jurors have become increasingly resistant to awarding punitive damages, largely because of the massive windfall plaintiffs can receive when they are injured by a large company.

Several prominent jury consultants have noted that while jurors in that state believe companies need to be punished for loathsome behavior, and that monetary punishment is needed to make them change their ways, they do not believe that individual plaintiffs should receive hundreds of thousands of dollars in punitive damages. Why, they ask, should two plaintiffs with identical injuries - one caused by a wealthy defendant and the other by one who is not - receive such hugely different awards?

Supporters of the California proposal say the solution is to have a large chunk of the punitive damages go to the government rather than to the individual plaintiffs, ensuring that the economic punishment meted out against the defendant will benefit society as a whole.

But while this logic may seem appealing at first glance, many lawyers say this system creates serious problems of its own. Will juries award punitives more often if they know the money will fund public programs that would otherwise consume their tax dollars? Will smaller consumer cases no longer be brought because the punitive damages, which were the only realistic way to finance the litigation, will now go to the state?

Not surprisingly, the California bill, which contains some highly controversial provisions, has become a lightning rod for both sides.

"Since punitive damages are generally defined as damages meant to punish a defendant, some should go to the injured plaintiff, but I also believe a certain percentage should go to the state," said Patrick Long, a second vice-president of the Defense Research Institute, who practices in Santa Ana, Calif.

But plaintiffs' attorneys, many of whom agree that punitives should be shared with other tort victims, say the law is not a revenue-raiser, but tort reform in disguise. They point to provisions in the bill that will reduce attorney fees, limit punitive damages to a single award against any defendant and cap punitives against small businesses at two percent of gross receipts.

"This is absolutely a tort reform proposal. We believe that significant portions of the proposal are unconscionable," said Jim Sturdevant, president of Consumer Attorneys of California in San Francisco.

Plaintiffs' attorneys say diverting punitives threatens the economic incentive to right wrongs, particularly in smaller cases, such as consumer fraud claims.

"In landlord-tenant or consumer protection claims, the economic loss is very small. All you've got is punitive damages to justify bringing it to trial. This would give [defendants] a free ride for committing garden variety fraud," said Charles Merten, an employment attorney in Beaverton, Ore.

Not all defense attorneys are happy either.

Some predict juries will award larger punitive damages - and will be prone to award them more often - once they realize that corporate defendants can help subsidize state services that would otherwise have to be financed by taxes.

"The difficulty I have with the bill is it risks other problems, like a jury awarding huge awards to reduce their tax burdens and the deficit. Plaintiffs' lawyers may seek even bigger awards because their share is reduced," said Theodore Boutrous Jr, a Los Angeles defense attorney.

He wants the bill to go further by putting a cap on the dollar amount of punitives a jury could award.

"It's definitely the conventional wisdom that juries would inflate their awards if they know," said Catherine Sharkey, who teaches at Columbia University Law School and wrote a law review article on split-recovery statutes. "Obviously it would just take one juror to know, but it's difficult to say whether conventional wisdom is correct."

Dan Callahan, a plaintiffs' attorney in Santa Ana, Calif., supports the idea of splitting punitives with the state but opposes certain provisions in the bill, such as one which protects a company from paying punitive damages in more than one trial for the same tort. He predicted that defense lawyers will lose their strongest argument to the jury against punitive damages.

"The best argument the defense lawyer has is that punitives are a windfall for the plaintiff. Now, the wind is taken out of the sails of that argument," he said.

The debate is likely to rage on as the bill progresses through the legislature this month. If it passes, plaintiffs' lawyers are ready to fight it, including constitutional challenges.

Constitutional challenges in other states have met with mixed success. The Colorado Supreme Court overturned a statute that diverted punitive damages to the state, saying it was a violation of the state constitution's taking clause. *Kirk v. Denver Publishing Co.*, 818 P.2d 262 (Colo. 1991).

But the Oregon Supreme Court rejected a similar argument. *Demendoza v. Huffman*, 51 P.3d 1232 (Or. 2002).

And on June 11, Utah trial judge Frank Noel declared that state's split recovery statute an "unconstitutional taking of property" in a case in which the state planned to take half of a \$5.5 million punitive damages award, according to the Salt Lake Tribune. But the judge made his ruling from the bench and the state had not decided whether to appeal.

The California Bill

Buried in Gov. Schwarzenegger's May revised budget was a proposal to take three-quarters of punitive damages awarded in all cases.

The rationale was that punitive damages are meant to punish, not to compensate, so they should "more appropriately be awarded to the state where it can be used for public good purposes."

But critics say the amount of money that will be raised by the bill has been grossly exaggerated. Based on previous punitive awards, the proposal estimates that taking 75 percent of future punitives will add \$450 million to the state coffers in the next fiscal year.

Critics say the projection is way off, noting that the estimate included an aberrational punitive damage award of \$4.2 billion, and didn't take into consideration that many large punitive awards are reduced on appeal. Fiscal analysts recently dropped the figure to \$60 million, according to the San Francisco Daily Journal.

The average punitive verdict is \$43,000, according to Robert Peck, an attorney with the Center for Constitutional Litigation in Washington, D.C. He said that figure is based on the latest Department of Justice figures.

Merten said that when states take a portion of punitive damages, it provides an incentive for both sides to settle and call the damages compensatory - plaintiffs don't want to give up a portion to the state and defendants don't want to be liable for punitives which are not covered by insurance.

The bill also includes several controversial provisions, including:

* 'Public benefit' fund.

The California bill would deposit the funds into a "Public Benefit Trust Fund," for "purposes consistent with the nature of the award, but in no case shall be used to fund the courts or any judicial programs."

This provision is a mistake, according to Sturdevant. He said that because trial court funding has been sharply reduced, any money garnished from punitive awards should go back into the state courts.

Long agreed.

"Since the governor has taken a great deal of money out of the budget to fund the courts, if you approve of the concept of a portion of damages going to the state, it ought to go specifically to fund the state's courtrooms," he said.

The wording of this provision is also quite vague, although most observers interpret it to mean the money is going into the state's general fund, especially since the governor is promoting it as a deficit-reduction mechanism.

Three states - Alaska, Georgia and Utah - already have such a mechanism, which puts the state's portion in a general revenue fund that allows legislators to spend the money wherever they see the greatest need.

Four other states put the money into various types of special funds geared towards compensating victims of criminal or civil wrongdoing. Indiana uses the money for victims of violent crimes, Iowa has a civil reparations fund, Missouri distributes the funds to under-compensated tort victims and indigent legal services, and Oregon has a criminal injuries compensation fund.

Illinois leaves it up to the trial judge to apportion punitive damages among the plaintiff, his or her attorney and the state department of human services.

* Single punitive award.

Another controversial provision in the bill states that "a defendant should only be held to pay punitive damages once for a wrongdoing, broadly construed, regardless of how many separate lawsuits or legal claims are asserted."

Long said that the goal is "to persuade defendants to modify their conduct in the future. If one award would have the effect of making a particular defendant stop behaving in a particular way, maybe one would be enough."

But plaintiffs' attorneys said it would have exactly the opposite effect.

"Take the famous Ford Pinto with the exploding gas tank. A manufacturer does the cost-benefit analysis and decides they're not going to spend extra money to put a rubber bladder in, so they go ahead and get hit with a punitive award. Then, they're off the hook entirely. They can continue to manufacture in the same fashion," said Peck.

"One award would cause a race to the courthouse by a defendant to secure the best venue or state that if it did result in punitives, it would be the smallest possible award," said Sturdevant.

Callahan said that "collusive settlements are a real risk," where a defendant could settle for \$1 in punitives and never risk paying punitives again.

Under the bill, a court is required to consider whether a punitive damages award should be reduced because of a prior award in another state.

* Attorney fees.

Perhaps the most radioactive provision in the bill requires that the state take its share before attorney fees are paid.

This means that a plaintiff's attorney working on a contingency fee basis will be paid a percentage of the compensatory damages and the remaining 25 percent of punitives only - not on the whole award.

Opponents argue this approach would actually reduce the amount of money going to the state.

"There's an incentive to cut off the state's portion. To induce plaintiff to settle, the defendant needs only to offer the plaintiff's expected share or offer to divide the amount that would otherwise go to the state," said Sharkey. ot c

She added that "one of the possible unintended consequences is plaintiffs' attorneys would more vigorously pursue pain and suffering damages and not put efforts as strongly into punitive damage awards."

Bernard Brown, an attorney in Kansas City, Mo., who handles a lot of consumer fraud cases against car dealers, supports his state's split-recovery statute, but said the California arrangement would put him out of business.

"It's an extreme, ridiculous cap and practically speaking would prevent the plaintiff from getting anything," because of the costs of going to trial, he said.

"A plaintiffs' attorney would be committing malpractice to assert any punitive damages. How could you tell your client, 'I'm going to get paid a third of the recovery. However, if you get punitives, I'm going to take a third out of the 25 percent you get'?" he asked.

Brown added that in a typical two-week trial against an auto dealer for selling a rebuilt wreck, where the plaintiff might get \$50,000 in punitive damages, the attorneys fees paid from the \$12,500 left to the plaintiff would not cover expenses for the trial.

* Jury not to know.

The bill specifies that juries cannot be told about the law.

"A jury shall not be informed by any party or the court that a portion of any punitive damage award will be deposited in a government fund," the bill says.

Defense attorneys say if jurors were told it could influence how much they award.

"I generally think that a jury should never be given an explanation as to what happens with their awards, because that shouldn't play upon what is the proper award. If you told the jury some percentage is going to the state, that conceivably could make certain jurors award more," said Long, adding that it could also make some jurors, who believe in small government, award less.

But Merten disagreed.

"If punitives are designed to punish the wrongdoer and prevent them from doing it in the future, and therefore it's proper for the state to take some of that money, fine. At least tell the jury what you're doing. You ought to tell the jury that this case is brought to benefit the state," he said.

In Oregon, he added, it's reversible error to tell a jury that the state gets 60 percent of punitive damages.

A Taking?

Some experts predict that the bill will be subject to a number of constitutional challenges.

One argument against punitives going into a general fund, rather than a specific fund for tort victims, is that it violates the Excessive Fines Clause of the Eighth Amendment.

Although the U.S. Supreme Court has indicated that the Excessive Fines Clause does not apply to punitive damages in civil cases, it left open whether it would apply if the state receives a portion of the damages, said Sharkey.

In Iowa, where the state collects 75 percent of punitive damages and puts them into a "civil reparations" fund, the supreme court upheld the statute, based largely on the fact that the money was not going into a general revenue fund, Sharkey noted.

Three states, Alaska, Georgia and Utah, put the state's portion in a general revenue fund. A federal district court in Georgia overturned the state statute on excessive fines grounds, but the state supreme court basically ignored that ruling, Sharkey said.

Opponents also make a constitutional argument that garnishing a plaintiff's punitives is a taking without compensation.

Although punitives are directed at the defendant and don't necessarily belong to the plaintiff as a right, the U.S. Supreme Court has said that punitive damages must be calculated as a multiple of the injuries in the plaintiff's particular case alone.

Whether punitives are property of a plaintiff may also depend on state law.

In Colorado, where the state statute was ruled an unconstitutional taking, the entire award was entered in the plaintiff's name. But other state statutes were drafted so that the state's interest arises at the time of the verdict, Sharkey explained.

Opponents also argue the bill constitutes a taking of the attorney's property.

"If a plaintiffs' lawyer secures a punitive award of \$10 million and has a fee interest in a contractual agreement with the client for one-third of any recovery, and now \$7.5 million is taken by the state, so he's not getting his fee, I think that could be a taking," said Callahan.

The provision for allowing only a single punitive award against any defendant could raise separate constitutional questions about whether other plaintiffs are getting the right to a trial by jury.

"In every state, the jury has the right to decide what the appropriate punitive damages are. This proposal says if there's already one award, the jury's discretion is taken away," said Peck.

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