Punitive Damages in U. S. Maritime Law - The Current State of Play

Even "bad guys" are entitled to know what their conduct will cost

Although the published cases awarding punitive damages in the American maritime jurisprudence are few in number, the doctrine is, nevertheless, well ensconced in U. S. maritime law. As a result, the law forces maritime defendants to appraise the likelihood and the quantum of such awards when looking at their potential liabilities.

The U.S. Supreme Court's decision in the "*Exxon Valdez"* continued our courts' long standing recognition of punitive damages in the maritime context, set limits on the quantum of such awards limited to the circumstances of that case, but did not complete that Court's exploration of the appropriate constraints on such awards in broader contexts.

The *Valdez* decision first confirmed the availability of punitive damages in the maritime context; secondly, accepted that a mechanical ratio between compensatory and punitive damages accomplished the stated purpose of punitive damages - punishment for past conduct and the deterrence of future similar bad acts. But then in establishing the judicially acceptable ratio, the court carefully limited its pronouncement to the facts at hand.

Herein lies the court's unfinished business. Under the facts of *Valdez*, the court held that where the compensatory damages were substantial, the conduct, while reckless, was not intentional, and did not profit the wrongdoer, a ratio of about 1 to 1 was sufficient to accomplish the stated purpose of the award. The decision thus left for another day determination of the appropriate ratio where the compensatory damages were minor, the conduct intentional, and the wrongdoer actually profited monetarily from its conduct. In *Clausen v Icicle Seafoods* Inc., the defendant has asked for Supreme Court review in a matter raising these very issues.[1]

The issue is vitally significant because, in *Valdez*, the Supreme Court also stated a party should be able to "predict" with some degree of certainty the monetary consequences of its conduct. In fact, such "predictability" has risen to the level of a federal constitutional requirement.

But because the Supreme Court has thus far only given limited guidance defining acceptable parameters for the required "predictability" in the maritime context, defendants in the shipping world who face punitive damage claims must of necessity look elsewhere for guidance in assessing the quantum of exposure to such claims. This article will identify some rule of potential guide posts pending further pronouncements from our Supreme Court.

First, some background.

Conduct Supporting Awards of Punitive Damages

Punitive damages may be awarded were the defendant is deemed guilty of intentionally injuring the plaintiff, or doing so by acting recklessly, or with gross negligence.

[1] The Court declined to hear the matter in an order dated October 1, 2012.

Punitive damages may be added on to most maritime claims although the lower courts have produced a split of authority for claims arising under OPA 90. The First Circuit Court of Appeals in *Southport Marine v Gulf Partners, LLC*, 234 F.3d 58 ruled that Congress had precluded punitive damages under the statute, but recently the trial court overseeing the Deep Water Horizon claims has ruled to the contrary.

The Function of Punitive Damages and Court Imposed Limits on Quantum

The purpose of punitive damages is to "punish and deter." However, the foregoing concept creates its own tensions and a consequent need to balance the concerns. The penalty must be severe enough so that it is seen as a real punishment, but it should not be so severe that the punishment destroys the defendant.

The Supreme Court in its decisions both maritime and non maritime has clearly held that courts satisfy the need to" punish and deter" by applying a mechanical ratio of compensatory to punitives. Indeed the *Valdez* court examined alternatives to the ratio concept, but found that such other methodologies yielded unacceptably arbitrary and inconsistent results. The inquiry then has been to find an appropriate ratio. The *Valdez* court deemed a 1:1 ratio under the circumstances of that case producing a punitive award of $500 million sufficient to meet the "punish and deter" standard. This conclusion, though, was not universally accepted. An editorial in the June 2, 2008 edition of *The New York Times* said:

"The problem with the rule [the court's holding] is not that it is judge-made, but rather that it subverts the purpose of punitive damages, which have a venerable place in the law. They are meant to punish and deter. A $500 million award for what the appeals court called 'egregious' conduct, against a company that earned more than $40 billion last year, is unlikely to do either."

But in response to the point of view expressed in the *Times'* editorial, it also must be recognized that the award of punitives actually "punishes" in two respects. Not only is the defendant required to make a payment, but the payment deprives the defendant of the opportunity to use those funds for its business purposes such as expanding the enterprise with the purchase of additional equipment, hiring additional labor, providing for research and development, and increasing dividends to encourage investment in the business, to name only a few of the uses of assets which payment of punitives can preclude.

It is likewise no answer to say that such losses are covered by insurance. Many policies exclude payment for exemplary losses the insured incurs. Likewise, in some states, insurers are precluded as a matter of public policy from paying the insured's liability for punitive damages on the theory that such coverage would defeat the punishment and thus undermine the purpose of punitive damages. Finally, intentional conduct is the antithesis of an "accident" and thus, likewise, not covered.

Nor can the amount of the award exceed the level deemed necessary to "punish and deter" be arbitrary. It is the need to find the line separating legitimate policy goals from arbitrary sanctions that the *Valdez* decision explicitly recognized in arriving at the 1:1 ratio. [2]

[2] 554 U.S. at p.502.

But, the question remains where to find guidance when the factors leading the *Valdez* court to the 1:1 ratio are changed?

The court's pronouncements in the non marine area should provide such guidance for practitioners and claims personnel attempting to quantify the exposure to such punitive damages where the facts fit the *Icicle Sea Foods* scenario - intentional and reprehensible conduct resulting in modest compensatory damages which produce a profit to the defendant.

Before proceeding with the analysis, however, a word is in order about the relationship between the laws of the individual states and maritime law as it relates to the punitive damage issues and the differing bases for the court's decisions in *State Farm* and the *Valdez*. *State Farm* was decided as a matter of federal constitutional law under the U. S. Constitution's 14th amendment extending federal concepts of due process to the states and requiring the states to conform to these federal rules. However, *Valdez* on its face was decided using federal "maritime common law,"[3] because the parties did not raise the same Due Process arguments which would be applicable under the Constitution's Fifth Amendment in the federal context.[4]

A comparison of the principles of constitutional law set out in *State Farm* with the court's non constitutional analysis in *Valdez*, discloses that both cases accepted that a ratio between compensatory and punitive damages carried out the punitive and preventive functions assigned to punitive damages and, most importantly for present purposes, utilized the same judicial yardsticks in measuring the legally acceptable ratio between the two forms of redress.

Because of the similarity in the court's analyses of punitive damages, the principles applied in the non marine cases ought to be equally applicable in the marine matters where the court has not as yet spoken. In fact, the final *Valdez* opinion on punitive damages came after the lower court had acted in accordance with pre *State Farm* law, causing Exxon to go to the Supreme Court in order to set the punitive damages with the benefit of the court's latest pronouncements. This history alone suggests that the rulings of the two cases may be considered interchangeable when attempting to assess the quantum of exposure for punitive damages.

State Farm began its discussion with the proposition that the Constitution prohibited,
"…the imposition of grossly excessive or arbitrary punishments on a tort feasor., and that "elementary notions of fairness…dictate that a person receive fair notice not only of the conduct that will subject him to punishment, but also of the severity of the penalty…." [5] The court went on to say: *"To the extent an award is grossly excessive, it furthers no legitimate purpose and constitutes an arbitrary deprivation of property. …("Punitive damages are a powerful weapon. Imposed wisely and with restraint, they have the potential to advance legitimate state interests. Imposed indiscriminately, however, they have a devastating potential for harm. Regrettably, common-law procedures for awarding punitive damages fall into the latter category").*[6]

---

[3] 554 U. S. at pp. 481, 489

[4] 538 I/S/ at p.

[5] 538 U. S. p. 417

[6] 538 U. S> at p. 417

The "fairness" concept is then echoed in the *Valdez* opinion:

"Whatever may be the constitutional significance of the unpredictability of high punitive awards, this failure of happenstance is in tension with the function of the awards as punitive, just because of the implication of unfairness that an eccentrically high punitive verdict carries in a system whose commonly held notion of law rests on a sense of fairness in dealing with one another." 554 U.S. at 502 (emphasis added).

The court then tied the existing lack of fairness to "predictability," stating:

"Thus, a penalty should be reasonably predictable in its severity so even Justice Holmes' 'bad man' can look ahead with some ability to know what the stakes are in choosing one course of action or another." 554 U.S. at 502.

The "bad man" language serving as the basis for the expression that the quantum of punitive damages must be "predictable" may be seen as echoing *State Farm's* constitutional mandate that the tort feasor must be on notice of the severity of the penalty.

State Farm then turned to a discussion of the constitutionally acceptable ratio repeating the test it had earlier laid down in *BMW v Gore.*[7] That test requires a determination of (1) the *"degree of reprehensibility"* accorded defendant's conduct, (2) the disparity between the actual or potential harm suffered by the plaintiff (compensatory damages) and the punitive damages, and (3) a comparison of the fines and civil penalties authorized or imposed in comparable cases.[8]

The court deemed "reprehensibility" the most important factor instructed lower courts that this factor required *"…considering whether: the harm caused was physical as opposed to economic; the tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others; the target of the conduct had financial vulnerability; the conduct involved repeated actions or was an isolated incident; and the harm was the result of intentional malice, trickery, or deceit, or mere accident"*[9]

In *Valdez*, the court followed this dictate stating :

"Under the umbrella of punishment and its aim of deterrence, degrees of relative blameworthiness are apparent. Reckless conduct is not intentional or malicious, nor is it necessarily callous toward the risk of harming others, as opposed to unheedful of it...Action taken or omitted to augment profit represents an enhanced degree of punishable culpability, as of course, does willful or malicious action, taken with a purpose to injure." [10]

---

[7] 517 U. S. 559

[8] 538 U. S. at p. 418

[9] 538 U. S. at p. 419

[10] 554 U. S. at pp. 493-494

So the benchmark of "reprehensibility" has now voyaged from land to sea and taken the form of "culpability." But the concepts and hence the analysis appear the same whether the case arises on land or sea.

It must be said that neither the *Valdez* nor *State Farm* directly address the "actual harm" to the plaintiff criterion in these terms. But in *State Farm*, the court limited what would be considered "actual harm" by throwing out a nationwide examination of State Farm's claims practices which it found unrelated to the Campbell's losses and so limited the harm seen as relevant to the plaintiffs' claim. In *Valdez*, it seems that the court subsumed this discussion under the rubric of "substantial" compensatory damages which it pegged at $500 million.

The third element, the difference between punitive damages and civil penalties authorized or imposed in comparable cases was considered by the *Valdez* court. It looked at Clean Water Act penalties of up to $50,000 per day for negligent violations and implicitly seems to find that the potential for large penalties based on the daily multiple of the foregoing figure supported a $500 million punitive award.[11]

The court's action in both matters certainly confirms its statement that "reprehensibility" is the most significant factor in setting the ratio.

Both the land and seaborne rules use the ratio between compensatory and punitive damages in assessing the acceptable level of punitives. However, the two lines of cases do so ostensibly for differing reasons. The land side cases as reflected in *Pacific Life v Haslip*[12], *TXO Production Corp v Alliance Resources Corp*[13] and *Gore* use the ratio to define the *"reasonable relation between the two heads of damages." Valdez* uses the ratio because there the court concluded that a ratio provided the only methodology which would over time produce "predictable" results. Different courses, though have led to the same destination and so the differing terminology appears to have no significance.

While the Supreme Court set the ratio in *Valdez* presumably because the amount of compensatory damages had not been contested, *State Farm* sent the case back to the state court system for a determination in accordance with its decision, with the admonition that rarely would a ratio beyond single digits be constitutionally acceptable. *Valdez* echoed this language. The state court ultimately approved a 9:1 ratio in *State Farm* and the U.S. Supreme Court refused further review.[14]

In light of the fact that the Supreme Court reviewed *Valdez* because of its decision in *State Farm*, and the interchangeability of the language in the two decisions, use of the *State Farm* analysis in the appropriate maritime context seems proper.

Key Questions in Assessing the Level of Punitive Damages

[11] *State Farm* mentions minor penalties, but since it did not actually set the amount of the punitive award, sending the case back to the lower court for that determination, we do not know what role the applicable penalties applied in that case except that to support generally the award under review was excessive.

[12] 499 U. S. 1

[13] 509 U. S. 443

[14] 98 P.3d 409, 543 U.S. 874.

The assumption that the close relationship between the constitutionally based landside decisions and the federal common law maritime decisions should allow use of the principles established in land based cases in the maritime setting. This proposition should assist those responsible for estimating the exposure to punitive damages in this interim period while the maritime law continues to evolve.

The important questions bearing on such estimates include the following:
1) Was the conduct reckless, grossly negligent, or intentional?
2) Did the wrongdoer profit monetarily from the conduct?
3) Are the compensatory damages "substantial," bearing in mind that the calculation of the compensatory damages may, itself, be subject to a contest?
4) How does the proposed quantum of punitives compare with the actual or potential harm to which the plaintiff has been exposed, and civil fines and penalties which may be imposed for the conduct at issue?
5) What if the compensatory damages are minor, but effect of the conduct is hard to detect, the conduct intentional, and the defendant has profited?

One note of caution: the appropriate ratio is not the only question that the analyst must answer in arriving at the dollar amount of the exposure.

Valdez teaches that where the damages are "substantial," the conduct neither intentional nor profited the defendant, a ratio of 1:1 will be appropriate. But vary the factors and the acceptable ratio, whether viewed through the eyes of federal common law or constitutional constraints, may rise.

Defining the compensatory damages for purposes of establishing the base from which punitives are to be derived and whether that base is "substantial" can prove a fertile and hence, litigious area. For example, in the *Icicle Seafoods* matter, the unpaid maintenance and care was only $37,000. The punitive award was $1.2 million based on "compensatory damages" of about $450,000. This latter figure was established over Icicle's objection using the attorney's fees plaintiffs had incurred. It appears that these fees included the effort to obtain the punitive damages as a *"$400,000 fee to recover $37,000 seems unreasonable and should not have been allowed under the Rules of Professional Conduct for lawyers."* The rules require that all fees be "reasonable," and measuring the amount at stake against the cost of achieving the result is one indicator of "reasonableness."

In *Valdez*, itself, the parties jousted fiercely over the make up of the compensatory award. Here, the court of appeals excluded from consideration the amounts Exxon had "voluntarily" paid before the judgment for contested compensation. It did so on the grounds that (1) to do otherwise would discourage settlements, and (2) including the $2 billion in cleanup costs, $200 million in settlements with private parties, and another $1 billion in fines, penalties and natural resource damages would go far beyond sums necessary to "deter future costs." See 270 F.3d 1215, at 1244.

In addition, at least post judgment interest may be due on the award of punitive damages. In *Valdez*, the court awarded post judgment interest from the date in 1996 when the original punitive damages judgment was achieved to payment which was sometime after 2009.[15]

[15] 568 F.3d 1007, The Supreme Court refused review of this decision.

Conclusion

One principle is clear – as the compensatory damages grow and become "substantial," the ratio declines, unless, perhaps, the defendant's conduct is really "reprehensible." In any event, the ratio is unlikely to exceed 9:1. Conversely, if the compensatory damages are slight and the conduct culpable, a higher ratio may be acceptable in order to "punish" and "deter".

The Supreme Court has endorsed punitive damages in the maritime context. For those of us in the claims "trenches," we can only hope that over time the court will build on the concept of "predictability" filling the voids which this article has identified.

With thanks to Alfred J.Kuffler, Partner, Montgomery McCracken Walker & Rhoads LLP, Philadelphia and New York, for preparing this article