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# Brief Amicus Curiae of Professors Keith N. Hylton, Kenneth G. Dau-Schmidt, Mark F. Grady, Jeffrey L. Harrison, Mark G. Kelman, and Thomas Ulen in Support of Respondents in Philip Morris USA v. Mayola Williams

Keith N. Hylton
*Boston University School of Law*

No. 05-1256

In the

# Supreme Court of the United States

**PHILIP MORRIS USA,**
*Petitioner,*
**v.**

**MAYOLA WILLIAMS,**
*Respondent.*

**On Writ of Certiorari**
**To the Supreme Court of Oregon**

**BRIEF AMICUS CURIAE OF PROFESSORS KEITH N. HYLTON, KENNETH G. DAU-SCHMIDT, MARK F. GRADY, JEFFREY L. HARRISON, MARK G. KELMAN, AND THOMAS ULEN IN SUPPORT OF RESPONDENTS**

CHRISTINE SPAGNOLI
GREENE BROILLET & WHEELER, LLP
100 Wilshire Blvd., 21st Fl.
P.O. Box 2131
Santa Monica, CA 90407
(310) 576-1200

RONALD SIMON*
SIMON & ASSOCIATES
1707 N Street, N.W.
Washington, DC 20036
(202) 429-0094

*Counsel of Record

*Counsel for Amicus Curiae*

(Additional Counsel Listed on Inside Cover)

ED BELL
BELL LAW FIRM
232 King Street
Georgetown, SC 29442
(843) 546-2408

ROGER S. BRAUGH, JR.
SICO WHITE & BRAUGH, LLP
900 Frost Bank Plaza
802 N. Carancahua St.
Corpus Christi, TX 78470
(361) 653-3300

PATRICK CARR
CARR & CARR
4416 S. Harvard Ave.
Tulsa, OK 74135
(918) 747-1000

RICHARD L. DENNEY
DENNEY & BARRETT, PC
870 Copperfield Drive
Norman, OK 73072
(405) 364-8600

JOHN ECHEVERRIA
ECHEVERRIA LAW FIRM
9432 Double R Blvd.
Reno, NV 89521
(775) 786-4800

W. HAMPTON KEEN
LYTAL REITER CLARK ET AL.
10th Floor, Northridge Centre
515 N. Flagler Dr.
West Palm Beach, FL 33401
(561) 655-1990

PETER M. KELLY
MOORE & KELLY, PC
1005 Heights Boulevard
Houston Texas 77008
(713) 529-0048

DANIEL RODRIGUEZ
RODRIGUEZ & ASSOCIATES, PLC
2020 Eye Street
Bakersfield, CA 93310
(661) 323-1400

G. LYNN SHUMWAY
6909 E. Greenway Parkway
Suite 200
Scottsdale, AZ 85254
(480) 368-0002

CHARLES SIEGEL
WATERS & KRAUS, LLP
3219 McKinney Avenue
Dallas, Texas 75204
(214) 357-6244

GERRY L. SPENCE
ROBERT A. KRAUSE
THE SPENCE LAW FIRM, LLC
15 South Jackson Street
P.O. Box 528
Jackson, WY 83001
(307) 733-7290

**QUESTION PRESENTED**

Amicus curiae will address the following question: Whether the Oregon Supreme Court correctly applied law and economics principles – specifically, deterrence theory – in affirming the punitive damage award in this case, or whether it mistakenly approved an irrational and excessive punitive damages judgment.

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## IDENTITY AND INTEREST OF *AMICUS CURIAE*[1]

*Amici* are law professors who specialize in law and economics, and university scholars who specialize in economic theory. Each has used law and economics theories and principles in writing about or studying recurrent controversies concerning punitive damages awards. *Amici* have an interest in providing the Court with an accurate assessment of how those principles apply to the award in this case. Short biographical sketches of each individual *amicus* follow.

Amicus Keith N. Hylton is the Paul J. Liacos Scholar in Law and a Professor of Law at Boston University School of Law (BUSL), where he has taught courses in antitrust, labor law, and torts since 1995. He is an honors graduate of Harvard College and the Harvard Law School, and earned a Ph.D. in Economics from the Massachusetts Institute of Technology (MIT). He joined the BUSL faculty after teaching for six years and receiving tenure at Northwestern University School of Law. Widely recognized in the area of law and economics, he has published more than 50 articles in American law journals and peer-reviewed law and economics journals, including *Punitive Damages and the Economic Theory of Penalties*, 87 GEO. L. J. 421 (1998). His textbook, ANTITRUST LAW: ECONOMIC THEORY AND COMMON LAW EVOLUTION, was published by Cambridge University Press in 2003. He has served as the Editor of the TORTS, PRODUCTS LIABILITY AND INSURANCE LAW ABSTRACTS journal since 1999, is Co-Editor of COMPETITION POLICY INTERNATIONAL, and is a current member of the American Law Institute (ALI). He also is a former director of the American Law and Economics Association (ALEA), a former

[1] The parties have filed blanket written consents with the Clerk to the filing of amicus briefs in this case. This brief was not authored in whole or in part by counsel for a party, and no person or entity, other than the amici curiae, their members, and their counsel made a monetary contribution to the preparation and submission of this brief.

chair of the Section on Torts and Compensation Systems of the Association of American Law Schools (AALS), a former chair of the AALS' Section on Antitrust and Economic Regulation, a former Secretary of the American Bar Association's Section on Employment and Labor Law, and a former member of the editorial board of the JOURNAL OF LEGAL EDUCATION.

Amicus Kenneth G. Dau-Schmidt is the Associate Dean for Research and the Willard and Margaret Carr Professor of Labor and Employment Law at the Indiana University School of Law. Since joining the Indiana University School of Law faculty in 1997, Professor Dau-Schmidt has taught an advanced seminar in law and economics and courses in antitrust, labor and employment law, and employee benefits law. Professor Dau-Schmidt received his bachelor's degree from the University of Wisconsin, Phi Beta Kappa, and earned master's and law degrees (Order of the Coif), and a Ph.D. from the University of Michigan. Prior to joining the Indiana University School of Law faculty, he taught at the University of Wisconsin Law School. Professor Dau-Schmidt is a nationally recognized scholar. He has published more than fifty articles, chapters, and book reviews, on subjects ranging from labor and employment law to the economic analysis of legal problems, including *Legal Prohibitions as More Than Prices: The Economic Analysis of Preference Shaping Policies in the Law*, in LAW & ECONOMICS: NEW & CRITICAL PERSPECTIVES (R. Malloy & C. Brun, Eds.). His scholarship has appeared in the Duke Law Journal and the law reviews of the University of Texas, and the University of Wisconsin, among many others. In 1991, he received the Scholarly Paper Award from the Association of American Law Schools for his work on the economic analysis of the criminal law as a preference-shaping policy. He also received awards from the School of Law for teaching excellence in 1998 and in 2003. Professor Dau-Schmidt was elected to the National Council of the American Association of University Professors (1993-96) and was appointed to serve on both the Executive Committee (1994-96) and Litigation Committee (1993-02) of that organization. Professor Dau-Schmidt has served on the Executive Committee of the Association of American Law Schools' section on Labor and Employment Law (1990-91), the Industrial Relations Research Association's section on Labor and Employment Law (1998-99), and the Labor Law Group (2000-03). He has also served as the chair for the Association of American Law Schools' section on Law and Socio-economics (2002-03) and on that section's Executive Committee (2000-03).

Amicus Mark F. Grady is Professor of Law and Director of the Center for Law and Economics at the University of California, Los Angeles School of Law ("UCLA School of Law"). Professor Grady's research focuses on law and economics and he teaches torts, antitrust, and intellectual property at UCLA School of Law. He received his A.B. degree in Economics (1970) and his J.D. (1973) from UCLA. He held postdoctoral fellowships in law and economics at the University of Chicago Law School (1977) and the Yale Law School (1982). Professor Grady began his academic career at the University of Iowa School of Law, after working for the Federal Trade Commission and the United States Senate. In 1985, Professor Grady was appointed Professor of Law at Northwestern University. In the spring of 1990, he became the first John M. Olin visiting Professor of Law and Economics at Duke Law School. In 1992, he returned to UCLA to become Professor of Law. In 1997, he took leave from UCLA to become the third dean of the George Mason University School of Law, University Professor of Law, Chairman of the Law and Economics Center, and Principal Investigator of the law school's federally funded Critical Infrastructure Protection Project, which he founded. After a successful tenure at George Mason, Professor Grady returned to UCLA in 2004. Professor Grady is a founding trustee of the American Law and Economics Association and the author of numerous books and articles on torts, intellectual property, antitrust, law and economics, and law and biology, including articles published in the Supreme Court Economic Review, the law reviews of the University of Virginia and the University of Pennsylvania, and *A New Positive Economic Theory of Negligence*, published in the Yale Law Journal. He has served as a consultant to President Ronald Reagan, presented policy papers at President William J. Clinton's White House, lectured to federal judges, given seminars to Congressional staff members, and testified to Congressional committees.

Amicus Jeffrey L. Harrison is Stephen C. O'Connell Chair and Professor of Law at the University of Florida College of Law, where he has taught Law & Economics, Antitrust, Contract, and Regulated Industries since 1983. From 1994 to 1999 he served as the Chesterfield Smith Professor of Law at the Law School. He received his Ph.D. in Economics and Business Administration from the University of Florida in 1970, and his J.D. from the University of North Carolina Law School in 1978, where served on the Law Review, won High Honors, and was awarded Order of the Coif. He is widely recognized in the field of Law and Economics and is the author of seven books and monographs (including LAW AND ECONOMICS: CASES, MATERIALS, AND BEHAVIORAL PERSPECTIVES (2002); UNDERSTANDING ANTITRUST AND ITS ECONOMIC IMPLICATIONS (4d ed., Matthew Bender, 2003) (with E.T. Sullivan); REGULATION AND DEREGULATION (2d ed. West, 1903) (with Morgan and Verkuil); MONOPSONY: ECONOMIC THEORY AND ANTITRUST POLICY (Princeton Univ. Press., 1993) (with R. Blair); and ECONOMIC REGULATION OF BUSINESS: CASES AND MATERIALS (West, 2d ed. 1985) (with Morgan and Verkuil). He is also the author of more than 40 law review or juried articles, comments, and book reviews, including articles published in the Michigan Law Review, Northwestern Law Review, Cornell Law Review, Yale Journal on Regulation, Northwestern Journal on Regulation, George Washington Law Review, UCLA Law Review, Wisconsin Law Review, Vanderbilt Law Review, the Journal of the Economics of Business, Journal of Law & Social Inquiry, and Antitrust Bulletin. He is a former Member of the Board of Editors of Law & Society Review and a former Chair of Association of American Law School's Section on Socioeconomics and the Law.

Amicus Mark G. Kelman is the William Nelson Cromwell Professor of Law and Vice Dean of Stanford Law School. Professor Kelman has taught courses on antidiscrimination law, including race and the law, criminal law and justice, distributive justice, employment discrimination, and property. In addition to being a long-time professor and researcher, Professor Kelman also has served as the academic coordinator, and academic associate dean of Stanford Law School. Before joining the Stanford Law School faculty in 1977, Professor Kelman was the director of Criminal Justice Projects for the Fund for the City of New York. Professor Kelman received a bachelor of arts degree from Harvard College in Social Studies, *summa cum laude* and Phi Beta Kappa. He received his law degree from Harvard Law School, *magna cum laude*. Professor Kelman is a prolific scholar whose jurisprudential interests range from law and economics to cognitive psychology. He has published several books, including A GUIDE TO CRITICAL LEGAL STUDIES (Harvard U.P. 1987), portions of which were reprinted in FOUNDATIONS OF THE ECONOMIC APPROACH TO LAW, and STRATEGY OR PRINCIPLE? THE CHOICE BETWEEN REGULATION & TAXATION (U. Michigan P., 1999). He is also the author of numerous articles, published in peer review journals such as Philosophy & Public Affairs and in the Journal of Legal Studies, and in the law reviews of Stanford University, the University of Virginia, and the University of Southern California, among others. His scholarly articles include *Could Lawyers Stop Recessions? Speculations on Law and Macroeconomics*, and *Problematic Perhaps, But Not Irrational*, both of which were published in the Stanford Law Review.

Amicus Thomas S. Ulen is Swanlund Chair and Director, Illinois Program in Law and Economics at the University of Illinois College of Law. Professor Ulen also is a research affiliate of the Environmental Council, a member of the Campus Honors faculty, and holds positions in the Department of Economics and the Institute for Government and Public Affairs. Professor Ulen received a bachelor's degree from Dartmouth College, a master's degree from St. Catherine's College, Oxford, and a Ph.D. in Economics from Stanford University. Professor Ulen has served as a Visiting Professor at the University of Bielefeld, and as the Foreign Chair in International and Comparative Law at the University of Ghent, Belgium. He has also been a Visiting Professor in Belgium, Germany, Slovenia, and a Ford Foundation Professor in Shanghai, China. Professor Ulen's scholarship has examined a variety of issues related to economics, legal scholarship, and legal education, and has appeared in the law reviews of the University of Michigan and New York University, among others. His numerous publications include *Economic and Public Choice Forces in Federalism*, George Mason Law Review, and *The Growing Pains of Behavioral Law and Economics*, Vanderbilt Law Review. His book LAW AND ECONOMICS (with Robert Cooter), now in its fourth edition, has been translated into Chinese, Japanese, Spanish, Korean, French, and Russian. A prolific writer and researcher, Professor Ulen has contributed four entries—on regulation generally, quantity regulation, price regulation, and quality regulation—for the OXFORD ECONOMIC HISTORY OF THE UNITED STATES and a chapter for LAW AND IRRATIONAL BEHAVIOR (Francesco Parisi, ed., University of Chicago Press, 2003). Professor Ulen has served as a member of the editorial board of several professional journals and was a member of the founding Board of Directors of the American Law and Economics Association.

## INTRODUCTION AND SUMMARY OF ARGUMENT

There is no dispute that the punitive damages award that was upheld by the Oregon Supreme Court in this case satisfies the most rigorous law and economic standards for rationality. The Court need not credit the analysis of the undersigned *amici* on this score; the fact that Petitioner's own *amici* – most notably law and economics scholars A. Mitchell Polinsky and Steven Shavell – have been unable to find anything economically amiss in the decision below speaks volumes.[2] To be sure, Professors Polinsky and Shavell have filed an amicus brief in support of Philip Morris in this case, just as they filed one in support of the Petitioner in *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408 (2003).[3]

Significantly, however, unlike the Polinsky-Shavell brief in *State Farm*, which repeatedly asserted that the Utah Supreme Court's decision in that case was fundamentally "irrational,"[4] Professors Polinsky and Shavell have found nothing to criticize about the decision below, nothing at all. Instead of criticizing that decision as irrational and the award upheld by the court below as excessive and as an example of overdeterrence, the only thing Professors Polinsky and Shavell find fault with in this case are the arguments advanced by *plaintiff's counsel* – which they concede were "eschewed" by the court below[5] – regarding

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[2] Brief Amicus Curiae of A. Mitchell Polinsky, Steven Shavell, and the Cato Institute in Support of the Petitioner, in *Philip Morris v. Williams*, No. 05-1256.

[3] Brief Amicus Curiae of A. Mitchell Polinsky, Steven Shavell, and the Citizens for a Sound Economy Foundation in Support of Petitioner, in *State Farm v. Campbell*, No. 01-1289.

[4] *Id.* at 3, 5, and 14.

[5] Brief Amicus Curiae of A. Mitchell Polinsky, Steven Shavell, and the Cato Institute in Support of the Petitioner, in *Philip Morris v. Williams*, No. 05-1256, at 3.

the use of "Philip Morris's wealth as a basis for upholding the punitive damages."[6] Thus Professors Polinsky and Shavell state that

> Although the Oregon Supreme Court eschewed reliance on Philip Morris' wealth as a basis for upholding the punitive damages, the plaintiff consistently relied on it in arguing that the punitive award was not excessive. Because she can be expected to do so again in this Court and because the issue of the proper role of corporate financial condition [sic] is an important and recurring one, amici believe that addressing that issue may be of assistance to the Court.[7]

*Amici* agree with Professors Polinsky and Shavell that the question of what role a defendant's wealth should play in calculating punitive damages awards is both an important and a recurrent problem. Amici further agree that it would be inappropriate for a court to rely solely on a tortfeasor's wealth in determining the appropriate size of a punitive damages award. Nevertheless, inasmuch as the Oregon Supreme Court did not rely on Philip Morris's wealth, to any degree, in undertaking its *de novo* review of the jury's award of punitive damages in this case, Professors Polinsky and Shavell have not identified and we have not found any reason in law and economics theory and practice to overturn the decision below.

## ARGUMENT

Like the Utah Supreme Court in *State Farm*, the Oregon Supreme Court relied on deterrence-based arguments in upholding a large punitive damages award in this case. Because many of the deterrence theory issues here

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[6] *Id.*

[7] *Id.*

are the same as those addressed in the *State Farm* litigation,[8] *amici* will review the areas of deterrence theory that are non-controversial and briefly touch on one topic of controversy that has been raised by the Polinsky-Shavell brief filed in this case.

Punitive damage awards have been justified for many years on the grounds that they *deter* and *punish* the perpetrators of harmful conduct. Punishment, with its roots in vengeance, is the oldest rationale for the law,[9] serving as a ready justification for the cruelest punishments of ancient legal systems. The theory of deterrence is a comparatively modern development that has served primarily as a set of rigorous arguments for putting limits on penalties. For this reason, *amici* will focus on the theory of deterrence, because the punishment goal generally supports penalties at least as severe as those suggested by deterrence theory.

As *amici* hope to make clear in this brief, the economic theory of deterrence supports the approach taken by the Oregon Supreme Court in this case. Indeed, even the views expressed by Professors Polinsky and Shavell,[10] Petitioner's deterrence theory experts, provide ample support for the Oregon appellate court's decision. The silence of Professors Polinsky and Shavell on two of the major issues presented in the Petition for Certiorari – whether punitive awards can aim to strip a tortfeasor's illicit

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[8] *Compare* Brief of Keith N. Hylton as Amicus Curiae in Support of Respondents, in *State Farm v. Campbell*, No. 01-1289, *with* Brief Amicus Curiae of A. Mitchell Polinsky, Steven Shavell, and the Citizens for a Sound Economy Foundation in Support of Petitioner, in *State Farm v. Campbell*, No. 1289. *Amici*'s views on punitive awards have been set out in Keith N. Hylton, *Punitive Damages and the Economic Theory of Penalties*, 87 GEO. L. J. 421 (1998); Keith N. Hylton and Thomas J. Miceli, *Should Tort Damages Be Multiplied*? 21 J. LAW, ECON. & ORG. 388 (2005).

[9] Oliver Wendell Holmes, Jr., THE COMMON LAW (1881), at 2-15.

[10] *See* A. Mitchell Polinsky and Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 HARV. L. REV. 869 (1998).

gains and whether harms to individuals other than the plaintiff can be taken into account in determining the appropriate level of punitive damages – is deafening, for they have argued in support of both approaches in their academic writing on punitive damages.[11]

## I. DETERRENCE THEORY SUPPORTS THE IMPOSITION OF PUNITIVE DAMAGES IN CERTAIN TORT CASES.

The theory of deterrence has been developed over 200 years, starting with the publication of Italian social philosopher Cesare Beccaria's ON CRIMES AND PUNISHMENTS in 1764. Writing at a time when torture and capital punishment were common responses to crimes of all types, from murder and rape to begging without a license or stealing letters,[12] Beccaria argued that penalties should be set at a level that removes the prospect of profit or gain from the

[11] *Id*. at 887-900 (arguing, quite forcefully, for multiplying damages to take into account losses imposed on individuals other than the plaintiff); and at 907-07 & n.120, 918 n.154 (supporting gain elimination goal).

[12] *See* E. P. Thompson, WHIGS AND HUNTERS : THE ORIGIN OF THE BLACK ACT (1975) The Black Act (9 Geo. 1 c. 22), was enacted by the British Parliament in 1723 during the reign of King George I in response to the Waltham deer poachers and a group of bandits known as the "Wokingham Blacks." It made it a felony, i.e., a hanging offence, to appear armed in a park or warren, or to hunt or steal deer, with the face blackened or disguised. The Act was later amended to deal with protestors outside the royal forests and chases, becoming a brutal adjunct to the Riot Act of 1715. Both statutes were part of the "Bloody Code," a system of laws and punishments in England from the 1700s to the mid-1800s. Although it was not called the Bloody Code in its own time, the name was given later because many felonies, including stealing anything worth 5 shillings (25p) or more, stealing letters, poaching, impersonating a Chelsea Pensioner, cutting down young trees, begging without a license if you were a soldier or sailor, being in the company of gypsies for a month, "strong evidence of malice" in children 7-14 years old, and at least 200 additional offenses were punishable by execution. The punishments were unusually harsh at this time because the laws were made by wealthy landowners who wanted to protect their property. It was thought that the best method for deterring crime was to make people too afraid of the punishments to commit crimes.

offender, and not much above that level.[13] Beccaria feared that if penalties were made unreasonably harsh, they would encourage harsh conduct on the part of offenders, perhaps by setting an example that implicitly approves the very cruelty the law aimed to suppress.

Since Beccaria, deterrence theory has largely involved refinements and qualifications of this basic economic approach. Jeremy Bentham, the eighteenth century English philosopher, introduced the notion of marginal deterrence as a reason for keeping penalties close the gain-eliminating level.[14] The theory of marginal deterrence favors modesty in setting penalties in order to avoid giving an incentive to the offender to choose the most harmful of a set of possible actions. For example, if the state imposes the death penalty for purse-snatching, purse-snatchers would have an incentive to murder their victims because it would lower the likelihood of being caught and have no effect on the final penalty. On the other hand, a more moderate penalty for purse-snatching could deter purse-snatching and at least make it within the purse-snatcher's interests to do no more than steal his victim's purse.

The next major refinement of the theory of deterrence was a 1968 law review article by University of Chicago economist (and Nobel laureate) Gary S. Becker[15] Becker

[13] Cesare Beccaria, ON CRIMES AND PUNISHMENTS 43-44 (Henry Paolucci, ed., Bobbs-Merrill 1963). Indeed, England's "Bloody Code" died out in the mid-ninetieth century because judges and juries thought that punishments were too harsh for many of the criminals, so they became less inclined to find them guilty in court. Because the lawmakers still wanted punishments to deter potential criminals, but needed them to become less harsh, transportation across the seas (typically to Australia became the more common punishment.

[14] Jeremy Bentham, AN INTRODUCTION TO THE PRINCIPLES OR MORALS AND LEGISLATION 181-84 (Prometheus Books 1998)(1781).

[15] *Crime and Punishment: An Economic Approach*, 76 J. Pol. Econ. 169 (1968).

argued in favor of replacing Beccaria's and Bentham's gain-eliminating penalties with "cost-internalizing" penalties for activities that cause harm, but, on balance, are socially useful or economically beneficial. Cost-internalizing penalties, as the term suggests, shift or internalize to the offender the losses his conduct imposes on society. If the offender gains $100 from committing an offensive act that imposes a $10 loss on his victim, the cost internalization approach would require a penalty of $10, while the gain elimination approach would require a minimum penalty of $100.

Cost-internalizing penalties are especially appropriate, in Becker's view, with respect to activities for which the offender's gain exceeds the likely loss of the victim, which is true of many economically beneficial activities that cause harms. Under Becker's scheme, an activity for which the gain exceeds the likely loss would have an incentive to continue under the cost internalization approach. Becker's approach is particularly useful in areas such as torts or antitrust, in which courts award damages to victims injured by activities that are socially desirable overall. But Becker also argued that if the offender's likely gain is less than or equal to the victim's likely loss, which is true of simple crimes such as theft, the optimal approach is to strip the offender of any and all gains. Nevertheless, because the cost internalizing penalty would have this effect anyway, Becker found this to provide additional support for cost internalization as a general approach.

Another important innovation in the economic theory of deterrence can be traced to an article by Yale Law Professor (now Judge) Guido Calabresi and A. Douglas Melamed on "property rules and liability rules"[16] and an article by University of Chicago Law (now Judge) Professor

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[16] Guido Calabresi and A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972).

Richard A. Posner on the economics of criminal law.[17] The fundamental insight from these articles and decisions is that when market transactions are easily carried out, gain eliminating penalties are preferable in order to encourage use of the market.[18]

Summing up, the economic theory of deterrence distinguishes two approaches: gain elimination and cost internalization. Gain elimination is appropriate when market transactions are easily arranged, or when the conduct is virtually always socially undesirable such as theft. Cost internalization, on the other hand, is preferable when market transactions are difficult to arrange and the activity of the offender is generally socially beneficial.

Gain elimination is equivalent to a policy of complete deterrence, of aiming to reduce the frequency of the wrongdoer's injurious activities to zero. Without attempting to calculate costs and benefits, it is immediately intuitive that there are some acts that should be completely discouraged, such as fraud, theft, rape, and murder. There is no optimal degree of fraud or murder that society should wish to encourage.

Cost internalization is equivalent to a policy of resource management. The offender's conduct may have been harmful to a particular victim, but society should not set out to completely shut down the offender or wholly ban its activities. For example, a railroad may cause enormous damage to nearby farmers by spitting sparks onto their fields and thereby igniting their crops. But society benefits greatly from railroads and has no interest in setting penalties

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[17] Richard A. Posner, *An Economic Theory of Criminal Law*, 85 COLUM. L. REV. 1193 (1985).

[18] Judge Calabresi recently expanded upon this and related themes in *Ciraolo v. City of New York*, 216 F.3d 236, 242-48 (2d Cir.), *cert. denied*, 531 U.S. 993 (2000), as did Judge Posner in *Mathias v. Accor Economy Lodging, Inc.*, 347 F.3d 672, 676-78 (7th Cir. 2003)

that entirely eliminate the profits from rail service. Cost internalizing penalties, on the other hand, will provide railroads with incentives to find the optimal level of activity – the level at which the gains to society are at a maximum.

The economic theory of deterrence has clear implications for three issues at the core of this case: whether damages should be limited in a case in which the defendant's conduct is reprehensible, whether the harm to people other than the plaintiff should be taken into account in setting a punitive award, and the role of the defendant's profits or wealth in determining a punitive award.

## II. THERE IS NO DISAGREEMENT THAT PUNITIVE DAMAGES ARE ECONOMICALLY RATIONAL IN CASES IN WHICH THE DEFENDANT'S CONDUCT IS REPREHENSIBLE.

Reprehensible conduct is social or economic behavior that society has no rational interest in encouraging or allowing to persist to any degree. Although there may be limits in the amount of public resources society may be willing to invest in the apprehension of purse-snatchers or the detection of fraud, there is no optimal amount of purse-snatching, and no optimal amount of fraud. The optimal scale of such reprehensible conduct is zero. As to this proposition, there is no disagreement in the economic literature on deterrence.

This implies that the proper goal of a punishment authority in the context of reprehensible conduct is complete deterrence. This, in turn, implies that penalties should be set, at a minimum, to eliminate any prospect of gain on the part of the offender. Thus, if the offender's gain is $100, the penalty must be no less than $100.

Moreover, this implies that if the conduct is truly reprehensible, there is no deterrence-based argument for putting a ceiling on the criminal penalty or the punitive damages award. The reason for this is that society has no interest in permitting reprehensible conduct to persist. Thus, if the offender is responsible for a reprehensible act from which he gains $100, there is no deterrence-based argument against imposing a penalty greater than $100.

Professors Polinsky and Shavell, who cite their law review article on punitive damages in their brief, have argued in favor of this position, which reflects the consensus view. Their article recognizes that where "a reprehensible act is purely intentional, overdeterrence cannot occur,"[19] and that the optimal social objective is one of "deterring such acts completely."[20] Moreover, that objective, they note, requires "*a measure of damages equal to the greater of gain or harm*."[21]

This is not to say that there are no arguments at all for limiting the penalty in the case of reprehensible conduct. One might argue that it makes no sense to fine the offender $200 if it is clear that he cannot pay it. This is an acceptable economic argument, but it has nothing to do with the theory of deterrence, which focuses exclusively on the public desirability and social utility of deterring the offender's conduct. If there is no socially beneficial aspect to the offender's harmful conduct, there is no deterrence-based reason for limiting the penalty applied to it.

## III. THERE IS NO DISAGREEMENT THAT IT IS ECONOMICALLY RATIONAL TO TAKE INTO ACCOUNT THE HARMS TO A TORTFEASOR'S OTHER VICTIMS.

Suppose the offender's conduct is reprehensible and he gains $100 from it. Suppose also, that the offender gets caught by the punishment authority only half of the time he

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[19] Polinsky and Shavell, 111 HARV. L. REV. at 907 & n.120.

[20] *Id.* at 906.

[21] *Id*. at 918 n.154 (emphasis added).

engages in offensive conduct. What is the right penalty on deterrence grounds?

Because the defendant's conduct is reprehensible, he should be stripped of the prospect of gaining from it. Because he is caught only half of the time, the penalty applied in those cases must strip the offender of the gains he enjoyed from the times he was not caught. This suggests that the penalty should be no less than $200 in order to satisfy the gain-stripping goal that is uniformly understood to be appropriate under the theory of deterrence.

Increasing the penalty to ensure that the infrequently-caught offender is stripped of illicit gains – a policy that has uniformly accepted in the economic deterrence literature since Bentham – is equivalent (in economic deterrence terms) to taking into account the harms done to others by an offender when punishing that offender. In other words, imposing a penalty of a minimum of $200, because the offender gets caught only half of the time, is equivalent to imposing a penalty that compensates the plaintiff-victim and another victim who is not present before the court.

Although Petitioner Philip Morris argues that this is controversial and constitutionally suspect, it is a fundamental implication of the theory of deterrence. If punitive damages are to be effective as a deterrent, they must be allowed to serve this multiplicative function. Significantly, Professors Polinsky and Shavell do not contest this point in their brief and there is no disagreement in the law and economics literature on this proposition.

Indeed, Professors Polinsky and Shavell recognize and support the use of multipliers in calculating punitive damage awards. Thus, the core proposition of their law review article on punitive damages is that "*if a defendant can sometimes escape liability for the harm for which he is responsible, the proper magnitude of damages is the harm the defendant has* *caused, multiplied by a factor reflecting the probability of his escaping liability*."[22] As their first illustration of how a defendant might escape liability, Professors Polinsky and Shavell note that

> the victim may have difficulty determining that the harm was the result of some party's act – as opposed to simply being the result of nature, of bad luck. For instance, an individual may develop a form of cancer that could have been caused by exposure to a naturally occurring carcinogen, such as radon gas, but which was in fact caused by exposure to a manmade carcinogen released by the injurer.[23]

Rather strikingly, Professors Polinsky and Shavell offer a hypothetical that appears to describe this case as their first illustration of an instance in which it is appropriate to multiply damages in order to provide the economically optimal level of deterrence. And Professors Polinsky and Shavell, after proposing the foregoing hypothetical anticipating this case, conclude that damages should be multiplied because "*if damages merely equal harm, injurers' incentives to take precautions will be inadequate and their incentive to participate in risky activities will be excessive*."[24] Yet Petitioner now stands before this Court to argue that it is never appropriate to multiply damages, and that the damage award should be limited to the harm suffered by the individual plaintiff.

## IV. ALTHOUGH THERE IS SOME CONTROVERSY ABOUT WHETHER IT IS APPROPRIATE TO USE A

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[22] Polinsky and Shavell, 111 HARV. L. REV. at 887 (emphasis in original).

[23] *Id*. at 888.

[24] *Id* . (emphasis in original).

**DEFENDANT'S OVERALL WEALTH IN ASSESSING PUNITIVE DAMAGES, THERE IS NO DEBATE THAT IT IS ECONOMICALLY RATIONAL TO USE PUNITIVE DAMAGES TO STRIP AWAY A TORTFEASOR'S ILLICIT PROFITS OR GAINS.**

Perhaps in view of these broad areas of consensus, Professors Polinsky and Shavell focus in their amicus brief on a question that, as noted above, is *not* at issue before this Court: the role of wealth in determining the size of a punitive award. Thus, as noted above, Professors Polinsky and Shavell acknowledge that "the Oregon Supreme Court eschewed reliance on Philip Morris' wealth as a basis for upholding the punitive damages."[25]

Furthermore, Professors Polinsky's and Shavell's discussion of wealth is not only irrelevant to this case but generally incomplete and therefore not terribly helpful. Professors Polinsky and Shavell distinguish between conduct that has a nonmonetary motivation and conduct that has a monetary motivation. For conduct motivated by nonmonetary considerations, Polinsky and Shavell argue that the defendant's wealth may be an appropriate factor to take into account in determining the penalty. They offer as an example the case of an individual who, for spiteful pleasure, destroys his neighbor's flower garden.[26] They note that the wrongdoer should "face a threat of damages that is sufficiently high to offset the spiteful enjoyment he would experience from destroying the flower garden. That level of damages will ordinarily be higher for a wealthy individual than for a poor one, for dollars usually have less significance to the wealthy than to the nonwealthy."[27]

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[25] Brief Amicus Curiae of A. Mitchell Polinsky, Steven Shavell, and the Cato Institute, at 3.

[26] *Id.* at 7.

[27] *Id.*

For conduct motivated by monetary considerations, Professors Polinsky and Shavell argue that the defendant's wealth is not an appropriate factor to take into account in the determination of the penalty. They say that "when a party's motivation is monetary, the party will be induced by the threat of damages to compare the monetary gain he would obtain from his act against the dollar damages in the same way regardless of his level of wealth."[28]

Although the distinction Professors Polinsky and Shavell draw between monetary and nonmonetary motives and their conclusion with respect to nonmonetary motives is quite reasonable, their analysis of the case of monetary motives appears to be incomplete. The analysis of monetary motives should distinguish between the case in which the offender's conduct is reprehensible and the case in which it is not.

If the offender's conduct is reprehensible, society has no interest in allowing it to occur at any scale. It follows, then, from the theory of deterrence that the penalty should be at least as large as the minimum of the illicit gain expected by the offender. Consider a variation of the example used by Professors Polinsky and Shavell: suppose the offender steals valuable flowers from his neighbor's garden in order to enjoy them from a closer vantage point. The gain to the offender is the value of the flowers to him: the maximum amount that he would have been willing to pay for the flowers. The offender's maximum willingness-to-pay for the flowers, however, is unquestionably influenced by his wealth. The wealthy offender will be willing to pay more for the flowers than will the nonwealthy offender. Given this, it is entirely appropriate to take the offender's wealth into account in determining the optimal penalty for this case of reprehensible conduct. A penalty that is set too low would fail to eliminate the illicit gain of

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[28] *Id.*

the offender, and therefore fail to act as a deterrent to theft. If the offender's gain, which is equal to the maximum that he would be willing to pay for the flowers, exceeds the victim's loss, setting a penalty equal to the victim's damages would be too low to serve as an effective deterrent.

To take another variation, suppose the offender steals his neighbor's flowers with the intent to sell them for a substantial profit. In this case, the offender's motivation is clearly monetary. Suppose the flowers are worth $100 to the victim, but the offender has found an unusually wealthy buyer who will pay $1000 for the flowers. The appropriate penalty, in order to completely deter the conduct, is a sum no less than the offender's profit, which is $1000. Thus, in the case in which the offender's reprehensible conduct is motivated by a desire for monetary profit, the penalty should be large enough, at a minimum, to wipe out the profit gained by the conduct.

If the offender's conduct is not reprehensible, then the analysis of Professors Polinsky and Shavell is appropriate. They offer the following example:

> Suppose that an individual could save $100 by not purchasing a safety device. Clearly, the individual would be induced to spend $100 on the device if he would have to pay more than that amount in damages, such as $200, for failure to do so. And importantly, the individual would buy the device under these circumstances whether he is poor or rich: regardless of his wealth, he would prefer to spend $100 on the device than to pay $200 in damages.[29]

Even in this example, whether the goal of damages should be gain-stripping or cost-internalization depends on

[29] *Id.* at 8 (footnote omitted).

the nature of the individual's act. In many cases, failure to purchase a safety device may not be reprehensible. For example, the failure of an automobile driver to buy and install a rear-facing television camera that would permit him to observe objects behind his car would not be considered a reprehensible act. If damages are appropriate at all for such a failure, they should only serve the purpose of cost internalization. In some cases, however, failure to invest in safety may be considered reprehensible. Suppose a car rental firm knows that the steering mechanism on many of its cars is defective, and yet continues to rent the cars because it knows from experience that car renters involved in accidents are unlikely to determine that the defective steering mechanism caused the accident. In this case, the goal of the damage award should be to completely deter the firm's conduct, which requires setting the damage award at the greater of the firm's gain or victim's loss.

Summing up, the economic theory of deterrence does not support the argument that wealth should never be a relevant consideration in the calculus of a punitive damages award when the defendant's motives are monetary in nature. The important distinction is not whether the defendant's motivation is monetary; rather, it is whether the defendant's conduct is reprehensible. If the offender's conduct is reprehensible, deterrence theory suggests that the appropriate penalty should seek to deter the conduct completely, which usually requires a penalty that is sufficiently large to eliminate the prospect of gain to the offender. In some cases, such a penalty will depend, at least in part, on the wealth of the offender or the profitability of his misconduct.[30]

## V. THE ONLY TROUBLING ISSUES RAISED BY THIS CASE AND BY *STATE FARM* ARE QUESTIONS OF

[30] As discussed above, the size of the optimal punitive damages award may also depend on the likelihood that the offender's conduct will be detected and that a civil suit will be successfully prosecuted.

**APPLICATION AND DETAIL, NOT QUESTIONS OF BASIC ECONOMIC THEORY.**

The basic economic theory of deterrence is largely settled, and the common law regarding punitive awards in many states is rather consistent with the theory.[31] Thus, following this Court's statement in *TXO Production Corp. v. Alliance Resources Corp.*[32] that "[i]t is appropriate to consider the magnitude of the potential harm that the defendant's conduct would have caused to its intended victim if the wrongful plan had succeeded, as well as the possible harm to other victims that might have resulted if similar future behavior were not deterred," many states permit courts to take into account the actual and potential harm to nonparties in setting a punitive damages award.[33] Many states also permit courts to examine the wealth of the offender[34] and the profitability of his conduct in setting such awards.[35] These are all basic considerations in the rational design of punishment for deterrence purposes, and a decision by this Court prohibiting courts from taking such factors into account would effectively destroy the deterrent effect of punitive damages.

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[31] Hylton, 87 GEO. L. J. at 445-60.

[32] 509 U.S. 443, 460 (1993).

[33] *See, e.g., Gilbert v. Security Finance Corp. of Oklahoma, Inc.*, ___ P.3d ___, 2006 WL 1836019, *8 (Okla. 2006); *Hayes Sight & Sound, Inc. v. ONEOK, Inc.*, 136 P.3d 428, 452 (Kan. 2006); *Sweet v. Roy*, 801 A.2d 694, 715 (Vt. 2002).

[34] *See, e.g., Simon v. San Paolo U.S. Holding Co., Inc.*, 113 P.3d 63, 78 (Cal. 2005); *Frazier v. Badger*, 603 S.E.2d 587, 593 (S.C. 2004); *Vendelin v. Costco Wholesale Corp.*, 95 P.3d 34, 51 (Idaho 2004); *Darcars Motors of Silver Springs, Inc. v. Borzym*, 841 A.2d 828, 843 (Md. 2004).

[35] *See, e.g., Liberty Mut. Ins. Co. v. Land,* 892 A.2d 1240, 1253 (N.J. 2006); *Gilbert v. Sec. Fin. Corp.*, 2006 WL 1836019 at *7; *Johnson v. Ford Motor Co.*, 113 P.3d 82, 93 (Cal. 2005); *Marie Deonier & Associates v. Paul Revere Life Ins. Co.*, 101 P.3d 742, 749 (Mont. 2004).

Whatever troubling issues may be raised by this case and by *State Farm* are questions of application and detail, not questions of basic economic theory. In this case, the punitive award was apparently designed to substantially reduce much of the gains Philip Morris had enjoyed from intentionally defrauding many Oregon consumers over many years, deliberate misconduct that had the additional consequence of killing many of the defrauded consumers.[36]

In terms of the economic theory of deterrence, the Oregon court's approach toward the punitive damages award appears to be entirely appropriate. Fraud is a classic example of reprehensible conduct. Given this, the appropriate response is to set a penalty that not only deters the misconduct but deters it completely An award that wipes out the gain to the offender from defrauding a particular consumer is the least that can be done.

Moreover, when the offender is caught, prosecuted, and punished infrequently, deterrence theory counsels that the award should seek to wipe out the illicit gains enjoyed by defrauding many consumers. This is apparently the approach that the Oregon courts have taken in this case. As a matter of theory, there is nothing controversial or questionable about this approach.

As noted above, whatever troubling issues are raised by a case of this type are matters of application and factual detail. Perhaps the named plaintiff or the other alleged fraud victims never received or did not really rely on the mass-marketed fraudulent statements. Perhaps the alleged tortfeasor never sold products in a particular state. Perhaps the allegedly fraudulent statements were not misleading at all. At bottom, although these kinds of issues may lie at the core of a particular lawsuit, they have little to do with the

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[36] The $79.5 punitive damage award represented approximately two-and-a-half weeks of Philip Morris's annual profits in the year in which the verdict was rendered.

fundamental design and function of punitive damages. However, details matter greatly in the real world implementation of any theory.

Consider the issue of penalizing a tortfeasor for the harms suffered by other victims of its fraudulent conduct. How can punitive damages serve a deterrent purpose, and at the same time prevent defendants from being forced to pay a penalty for victims who may not exist?

On one hand, one could argue, consistent with deterrence theory, that this is not an issue that should trouble a court. If the defendant has been found guilty of reprehensible conduct, it should suffer a penalty that completely deters such conduct. The penalty should be, at a minimum, sufficient to eliminate the gain from that misconduct. If it happens to be larger than that minimum, that is not "a problem" from the perspective of deterrence theory. The reason is that if the conduct is reprehensible, there is no risk of "overdeterring" the conduct. In other words, there is no cost to society from over-deterring fraud or theft.

On the other hand, in view of the possibility of courtroom errors, there is a risk that punishing conduct that has been deemed fraudulent might overdeter legitimate or even desirable conduct. Overdeterrence, in the context of products, is observed in instances in which products that consumers desire are withdrawn from the market or sold at excessive prices. Although this hypothetical risk is noted in the Polinsky-Shavell brief, given that cigarettes have no social benefit whatsoever one might certainly question whether society loses anything at all if damage awards force cigarette sellers to raise their prices, (Many empirical studies indicate that cigarette price increases reduce cigarette consumption, to the benefit of the public's health).[37] Finally,

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[37] *See* Congressional Budget Office, *The Proposed Tobacco Settlement: Issues From A Federal Perspective*, at 3 (April 1998)

although the possibility that a series of excessive damage awards might overdeter legitimate and socially useful conduct might be a valid concern in some cases, the applicability of this point is highly attenuated in the special case of cigarettes.

The best answer to the hypothetical problem of overdeterrence is not to eliminate punitive awards altogether or to disallow consideration and disgorgement, of a defendant's illicit profits – which would be the practical effect of refusing to permit courts to penalize the defendant for harms done to victims other than a named plaintiff – but to allow the jury to be informed about earlier awards or to authorize the court to provide offsets for successive punitive damage awards.[38]

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http://www.cbo.gov/ftpdocs/4xx/doc407/tobacco.pdf ("Considerable research supports the proposition that increasing the price of cigarettes would be the most effective way to reduce their use.").

[38] Another possible solution might be to permit the defendant to offer statistical evidence that the award is excessive, perhaps because of the rare or unique nature of the victim's harm. In a case in which the defendant has been found guilty of engaging in reprehensible conduct, it should not be the plaintiff's or the court's responsibility to prove that the award is not excessive. It is the defendant who has been found guilty of reprehensible conduct, and it should be solely his burden, after such a finding, to present evidence sufficient to persuade a court that a punitive award is excessive. This is an appropriate balance that preserves the deterrent function of punitive damages, and at the same time permits defendants to persuade courts that certain awards should be reduced or eliminated because of excessiveness.

If the responsibility is placed on the plaintiff or on the court to prove that a particular award is not excessive in a case in involving reprehensible conduct, then it will become unlikely that punitive awards will be able in practice to serve the deterrent function suggested by theory. Individuals who engage in reprehensible conduct will know that even though they face the theoretical risk of a punitive award, in practice it is unlikely that any plaintiff or court will be able cost-effectively to produce evidence that proves that the award should withstand scrutiny on appeal. And indeed, the individual engaged in reprehensible conduct would have every incentive to take steps to obscure the record and

**CONCLUSION**

Inasmuch as the Oregon Supreme Court did not rely on Petitioner Philip Morris's wealth in undertaking its *de novo* review of the jury's award of punitive damages against that company, and insofar as Professors Polinsky and Shavell have not identified and we have not found any reason in law and economics theory to believe that the Oregon Supreme Court incorrectly applied law and economics principles – especially deterrence theory – in upholding of the punitive damage award in this case, *amici* respectfully submit that there is no reason why that court's judgment should not be affirmed.

Respectfully submitted,

RONALD SIMON*
SIMON & ASSOCIATES
1707 N Street, N.W.
Washington, DC 20036
(202) 429-0094

CHRISTINE SPAGNOLI
GREENE BROILLET & WHEELER, LLP
100 Wilshire Blvd., 21st Fl.
P.O. Box 2131
Santa Monica, CA 90407
(310) 576-1200

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prevent potential plaintiffs from producing sufficient evidence to uphold a punitive award. In the case of reprehensible conduct this would produce a set of perverse incentives in which bad actors can reasonably expect to prevail, in the sense that the penalties assessed by the courts will almost always be insufficient to wipe out their illicit profits. But the situation should be the reverse: those who engage in reprehensible conduct should expect to lose. Moreover, those who engage in reprehensible conduct should be aware that it will be their burden to prove that a punitive award, that seems appropriate to the court on the basis of the evidence introduced in the case, is excessive, rather than the plaintiff's burden to produce additional evidence to support the award.

ED BELL
BELL LAW FIRM
232 King Street
Georgetown, SC 29442
(843) 546-2408

ROGER S. BRAUGH, JR.
SICO, WHITE & BRAUGH, LLP
900 Frost Bank Plaza
802 N. Carancahua St.
Corpus Christi, TX 78470
(361) 653-3300

PATRICK CARR
CARR & CARR
4416 S. Harvard Ave.
Tulsa, OK 74135
(918) 747-1000

RICHARD L. DENNEY
DENNEY & BARRETT, P.C.
870 Copperfield Drive
Norman, OK 73072
(405) 364-8600

JOHN ECHEVERRIA
ECHEVERRIA LAW FIRM
9432 Double R Blvd.
Reno, NV 89521
(775) 786-4800

W. HAMPTON KEEN
LYTAL REITER CLARK
FOUNTAIN & WILLIAMS
10th Floor, Northridge Centre
515 N. Flagler Dr.
West Palm Beach, FL 33401
(561) 655-1990

PETER M. KELLY
MOORE & KELLY, PC
1005 Heights Boulevard
Houston Texas 77008
(713) 529-0048

DANIEL RODRIGUEZ
RODRIGUEZ & ASSOCIATES, PLC
2020 Eye Street
Bakersfield, CA 93310
(661) 323-1400

G. LYNN SHUMWAY
6909 E. Greenway Parkway
Suite 200
Scottsdale, AZ 85254
(480) 368-0002

CHARLES SIEGEL
WATERS & KRAUS, LLP
3219 McKinney Avenue
Dallas, Texas 75204
(214) 357-6244

GERRY L. SPENCE
ROBERT A. KRAUSE
THE SPENCE LAW FIRM, LLC
15 South Jackson Street
P.O. Box 528
Jackson, WY 83001
(307) 733-7290