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Brief of Keith N. Hylton as Amicus Curiae in Support of Petitioners in Greg Johnson, et al. v. Ford Motor Company

Keith Hylton
Boston Univeristy School of Law

No. S121723

IN THE

Supreme Court of California

GREG JOHNSON, ET AL.,

Plaintiffs and Petitioners,

v.

FORD MOTOR COMPANY,

Defendant and Respondent.

AFTER A DECISION BY THE COURT OF APPEAL,
FIFTH APPELLATE DISTRICT,
DIVISION FOUR, CASE NO. B121917

APPLICATION TO FILE BRIEF AS *AMICUS CURIAE*; BRIEF OF KEITH N. HYLTON AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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December 9, 2004
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APPLICATION OF KEITH N. HYLTON TO FILE BRIEF AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

Keith N. Hylton, an economist and law professor at Boston University, respectfully requests permission to file the attached brief as *amicus curiae* in support of petitioners/plaintiffs in this matter, Greg and Jo Ann Johnson. Professor Hylton teaches torts and antitrust law, among other subjects. He has a Ph.D. in Economics from MIT and a J.D. from Harvard University, and is a member of the American Law Institute. Professor Hylton is the author of a leading textbook on antitrust law and has also published more than 40 articles in law journals and peer-reviewed law and economics journals, many of them on the subject of tort liability. For a more complete list of his professional qualifications and publications, *see http://www.bu.edu/law/faculty/profiles/hyltonk*.

Professor Hylton submits this *amicus* brief to address a point argued in the brief of respondent Ford Motor Company ("Ford Br."). Ford urges this Court to rule out, in the fixing of punitive damages in California, any consideration of the illicit profits received by a defendant through its wrongful course of conduct directed at a plaintiff and others within the state. In support of this position, Ford makes a law-and-economics argument that consideration of a defendant's illicit profits from a wrongful course of conduct is not "necessary to achieve appropriate levels of punishment and deterrence" because, Ford asserts, "substantial economic literature" shows that "the socially correct level of deterrence is created by compelling responsible parties to pay compensatory damages alone." Ford Br. at 36 & n.13. The sole authority cited on this point is an article by Professors Polinsky and Shavell, *Punitive Damages: An Economic Analysis* (1998) 111 Harv. L. Rev. 869, 906.

Ford's analysis is fundamentally mistaken. There is, in fact, little if any support in the economic literature for Ford's conclusion. Indeed, the consensus in the economic literature has been against Ford's conclusion for at least two centuries. Even the Polinsky and Shavell article cited by Ford supports the conclusion (in portions not cited by Ford) that punitive damages are socially desirable and that it is important to take into account a wrongdoer's illicit profits in a case involving the type of intentionally wrongful conduct involved in this case (as summarized in the Court of Appeals opinion). *Id.* at 874 n.8, 907 n.120, 918 & n.154, 945-47. Professor Hylton has analyzed the Polinsky and Shavell article and related publications dating back to 1764 in two papers, *Punitive Damages and the Economic Theory of Penalties* (1998) 87 Geo. L.J. 421, and *The Theory of Penalties and The Economics of Criminal Law* (10/04 draft) Law and Economics Working Paper No. 02-17 (posted at *http://www.bu.edu/law/faculty/papers/pdf_files/HyltonK100702.pdf*).

Professor Hylton submits this *amicus* brief to help ensure this Court understands the error in Ford's law-and-economics argument, and to provide the Court with a more complete view of how law-and-economics principles properly bear on the consideration of a defendant's illicit profits from a wrongful course of conduct in fixing the level of punitive damages in a particular case.

This Court last addressed the legal framework for setting the amount of punitive damages in *Adams v. Murakami* (1991) 54 Cal.3d 105. In *Adams*, this Court declined to reach the argument advanced by a pro-defendant trade association, the Association for California Tort Reform, advocating "the profitability of the defendant's misconduct" as the appropriate financial measure in fixing punitive damages. *Id.* at 116 n.7. Now is the time to address that argument. Since *Adams*, a strong consensus has developed that consideration of a defendant's illicit profits from its wrongful course of conduct — something the Legislature explicitly endorsed a quarter century ago, *see* Cal. Civil Code § 3295(a)(1) — is important to ensuring punitive damages are set in a non-arbitrary way which appropriately furthers the deterrent function of punitive damages.

Other defendants' trade associations have adopted this view; it has been discussed approvingly in several decisions of the U.S. Supreme Court and the lower California appellate courts; and substantial law-and-economics literature supports it. Indeed even the respondent here, Ford, has adopted this view. Just last year, in a California appellate brief filed on behalf of Ford by the same law firm which represents Ford in this case, Ford argued for a focus in setting punitive damages on in-state, illicit profits reaped by a defendant from wrongdoing in California. It endorsed such a focus on a defendant's illicit profit as "rationally related to the societal objective of deterrence where the defendant is a corporation." Appendix to the attached *amicus* brief at 28 (citation omitted).

For the foregoing reasons, Professor Hylton respectfully requests permission to file the attached *amicus* brief.

Respectfully submitted,

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Interest of *Amicus Curiae*

Keith N. Hylton is an economist and law professor at Boston University, where he teaches torts and antitrust law, among other subjects. Professor Hylton has a Ph.D. in Economics from MIT and a J.D. from Harvard University, and is a member of the American Law Institute. Before moving to Boston University in 1995, Professor Hylton taught at Northwestern University Law School, where he began his teaching career in 1989. Professor Hylton is the author of a leading textbook on antitrust law and has also published more than 40 articles in law journals and peer-reviewed law and economics journals, many of them on the subject of tort liability. For a more complete list of his professional qualifications and publications, *see* *http://www.bu.edu/law/faculty/profiles/hyltonk*.

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Introduction and Summary of the Argument

This Court last addressed the legal framework for setting the amount of punitive damages in *Adams v. Murakami* (1991) 54 Cal.3d 105. In *Adams*, this Court declined to reach the argument advanced by the Association for California Tort Reform advocating "the profitability of the defendant's misconduct" as the appropriate financial measure in fixing punitive damages. *Id.* at 116 n.7. For this argument to be advanced by such a pro-defendant trade association is hardly an anomaly. It appears typical, evidently based on the sensible assumption that in the setting of punitive damages, a focus on a defendant's illicit profits will frequently produce lower awards than other measures of punitive damages, such as a focus on a defendant's wealth.[1]

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[1] For example, in the *TXO* case, the late Dean Griswold filed an *amicus* brief on behalf of a major insurance trade association setting forth a position consistent with the Court's ultimate holding: that punitive damages should be assessed to "[r]emov[e] the actual or expected gain" from misconduct, on the basis of "[t]he defendant's profits from his misconduct — or, in some cases, the expected profits where the defendant fails to profit as expected." Brief of the American Council of Life Insurance, et al., as *Amici Curiae*, in *TXO Production Corp. v. Alliance Resources Corp.*, No. 92-479, at 15-16.

Also consistent with the approach ultimately adopted by the Court was the position set out in the Brief of the American Tort Reform Association, et al., as *Amici Curiae* in *TXO*, which repeatedly underscored that among the factors most relevant in fixing an appropriately sized punitive damages award is

Indeed, Ford itself argued for a focus in setting punitive damages on in-state, illicit profits reaped from wrongdoing in a California appellate brief just last year. In that brief, represented by the same law firm as in this case, Ford endorsed a focus on illicit profits as "rationally related to the societal objective of deterrence where the defendant is a corporation." Appendix hereto at 28 (citation omitted).

Since this Court decided *Adams*, other courts in a significant number of decisions have adopted this approach of making the profitability of a defendant's misconduct a key factor in fixing punitive damages, which helps ensure punitive damages are set in a non-arbitrary way. This development has reinforced the rationality of the Legislature's 1979 statutory recognition that illicit profits should be considered in setting the proper amount of "damages for the sake of example and by way of punishing the defendant." Cal. Civil Code § 3294(a). *See* Cal. Civil Code § 3295(a)(1) (noting relevance of "[t]he profits the defendant has gained by virtue of the wrongful course of conduct of the nature and type shown by the evidence."). Among these decisions:

- In upholding the punitive damages award in *Pacific Mutual Life Ins. Co. v. Haslip* (1991) 499 U.S. 1, the U.S. Supreme Court approved the consideration under Alabama law of "the profitability to the defendant of the wrongful

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"the anticipated or actual gain to the defendant," *id.* at 3, alternatively phrased as "the actual or potential gain to the defendant." *Id.* at 12. Thus, "the greater the anticipated gain from a tort, the greater the penalty needed to provide appropriate disincentives for its commission." *Id.* at 16.

conduct and the desirability of removing that profit and of having the defendant also sustain a loss." *Id.* at 22.

● In *BMW of N. Am., Inc. v. Gore* (1996) 517 U.S. 559, three justices (whose votes were essential to the result of the case) explicitly endorsed this "profitability factor" of Alabama punitive damages law for having "the ability to limit awards to a fixed, rational amount" — for example, in that case, through a focus on "the $56,000 in profits evidenced in the record" which the defendant had received from its fraudulent sale of a repainted car to the plaintiff, and from its 13 other fraudulent sales to other persons in Alabama. *Id.* at 591.

● In *TXO Prod.Corp. v. Alliance Resources Corp.* (1993) 509 U.S. 443 (plurality opinion), the Court focused on the "substantial" royalties the defendant had sought to obtain by acting "in bad faith," *id.* at 450-51 & n.10, estimating that the $10 million punitive damages award was less than ten times the royalties the defendant had illicitly sought to obtain. *Id.* at 461-62.

● In *Cooper Industries, Inc. v. Leatherman Tool Group, Inc.* (2001) 532 U.S. 424, the Court endorsed setting punitive damages by reference to the "anticipated gross profits . . . attributable to [defendant's] misconduct," as long as such profits are not estimated using "unrealistic" assumptions. *Id.* at 442 (internal quotations omitted).

● In *Cummings Medical Corp. v. Occupational Medical Corp. of America, Inc.* (2d Dist. 1992) 10 Cal.App.4th 1291 (rev. den. Jan. 28, 1993), the Second District noted that "[t]he defendant's profits from misconduct are objectively based and uniquely appropriate as the basis for punitive damages," that using punitive damages to remove a defendant's profit "sends a clear signal to defendants that such misconduct does not pay," and that "[a] punitive damages award specifically tailored to this objective can never be 'excessive.'" *Id.* at 1299-1300.

● In *Vallbona v. Springer* (4th Dist. 1996) 43 Cal.App.4th 1525, 1539-41 & n.19, the Fourth District relied on the *Cummings* analysis to uphold $200,000 in punitive damages based on evidence that defendants had "fraudulently obtained about $300,000 from" the roughly 120 people subjected to the bogus cellulite-removal laser treatment program under which the three plaintiffs were defrauded.

As a matter of law and economics, *amicus* strongly concurs in the position Ford took last year (see Appendix), a position reflected in these and other decisions, that in fixing an amount of punitive damages it is rational to focus on the illicit profits received by an offender from a wrongful course of conduct. *Amicus* strongly disagrees with the contrary position Ford has now taken in this Court, based on an inaccurate summary of the law-and-economics literature. Ford Br. at 36 & n.13. Effective deterrence of profit-motivated intentional wrongdoing requires that exemplary damages should routinely be set at no less than the amount needed to strip away the actual or expected profits from the wrongdoing and thus reduce the "expected gain" from such wrongdoing to zero or below zero, thereby deterring such wrongdoing in the future. For courts to reduce punitive damages awards below this level would in effect override the Legislature's commitment to the use of exemplary damages to accomplish general deterrence of intentional wrongdoing, Cal. Civil Code § 3294(a), and its explicit endorsement of consideration of illicit profits in Cal. Civil Code § 3295(a)(1).

Argument

This brief will first describe the basic framework for what level of punishment is needed to achieve "complete deterrence" of intentional wrongdoing, drawing on analysis which has been broadly accepted for more than two centuries. Second, it will describe the assumptions about this case upon which this brief's economic analysis is based, drawing on the Court of Appeals opinion. Third, using the facts of this case to illustrate the relevant principles, it will more precisely describe how, in a particular case, a punitive damages award sufficient to achieve deterrence by stripping away illicit profits should be calculated.

I. Deterrence Theory Provides a Useful Framework for Evaluating the Size of a Punitive Damages Award

As the U.S. Supreme Court has recognized, deterrence theory drawn from the law-and-economics literature can provide a useful framework for evaluating the size of a punitive damages award to determine whether it is excessive on the record of a particular case. *See Cooper Industries, Inc. v. Leatherman Tool Group, Inc.* (2001) 532 U.S. 424, 438-40; *BMW of N. Am., Inc. v. Gore* (1996) 517 U.S. 559, 592-93

(Breyer, J., joined by O'Connor and Souter, JJ., concurring). The reason is that the main purpose for imposing punitive damages is to deter the defendant and others from engaging in socially harmful conduct in the future, by making an example of the defendant to show the consequence of its wrongdoing, hence the original name, "exemplary damages."

Of course, the appropriate amount of punitive or exemplary damages in a given case is not *limited* to the amount adequate to produce general deterrence of such conduct in the future, because "deterrence is not the only purpose served by punitive damages. . . . '[C]itizens and legislators may rightly insist that they are willing to tolerate some loss in economic efficiency in order to deter what they consider morally offensive conduct, albeit cost-beneficial morally offensive conduct; efficiency is just one consideration among many.'" *Cooper Industries*, 532 U.S. at 439-40 (quoting Galanter & Luban, *Poetic Justice: Punitive Damages and Legal Pluralism* (1993) 42 Am. U. L. Rev. 1393, 1450).

Deterrence theory, then, is merely a vehicle for assessing the *minimum* amount of punitive damages appropriate in a case. Given the importance of deterrence in the desired function of punitive damages, the proper approach to understanding deterrence theory in the context of punitive damages is to start with an examination of the theory of penalties.

A. The Theory of Penalties in General

The theory of penalties aims to discover "optimal" levels of penalties. An optimal penalty avoids two significant types of costs: underdeterrence and overdeterrence. Underdeterrence results when penalties are so low that they fail to deter actors from engaging in conduct that is socially harmful. Overdeterrence results when penalties are so high that they force potential injurers or offenders to take precautions that are on balance socially harmful, or to forgo engaging in socially desirable activities. For example, if the fear of tort damages (a type of penalty) for medical malpractice forces hospitals to close their emergency wards, one might view this as an example of a penalty having substantial overdeterrence costs.[2]

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[2] For general discussions of the theory of penalties and related issues, *see, e.g.*, Keith N. Hylton, *The Theory of Penalties and The Economics of Criminal Law* (10/04 draft) Law and Economics Working Paper No. 02-17 (posted at *http://www.bu.edu/law/faculty/papers/pdf_files/HyltonK100702.pdf*); Tracey L. Meares, Neal Katyal & Dan M. Kahan, *Updating the Study of Punishment* (2004) 56 Stan. L. Rev. 1171, 1172-80; William L. Barnes, Jr., *Revenge on Utilitarianism: Renouncing a Comprehensive Economic Theory of Crime and Punishment* (1999) 74 Ind. L.J. 627; Neal Kumar Katyal, *Deterrence's Difficulty* (1997) 95 Mich. L. Rev. 2385; Kenneth Mann, *Punitive Civil Sanctions: The Middleground Between Criminal and Civil Law* (1992) 101 Yale L.J. 1795; Kenneth G. Dau-Schmidt, *An Economic Analysis of the Criminal Law as a Preference-Shaping Policy* (1990) 1990 Duke L.J. 1.

B. Early History: "An Eye for an Eye" — Limiting Penalties to Avoid Lengthy Cycles of Revenge

Before the formation of the modern administrative state, penalties appear to have been designed largely to guard against the danger of *ad hoc* retribution, meted out by clan against clan, family against family, escalating and resulting in lengthy cycles of revenge. Primitive and early societies typically had "no officials to take action against murder, theft, and other coercive acts — no police, judges, prosecutors, or jailers." Richard A. Posner, *Retribution and Related Concepts of Punishment* (1980) 9 J. Legal Stud. 71, 76. Yet they did "have norms against murder, theft, and other unjustified uses of force," norms which were enforced though "the possibility of retaliation by victim against aggressor," usually with help from the victim's family or broader group. *Id.* at 76-77.

In such primitive societies there developed the principle of "the *lex talionis* of early Roman law," and "the 'eye for an eye' precept in the Old Testament (and a virtually identical precept in the Koran), and in many other early codes . . . ." *Id.* at 71. This principle supplanted "the ancient practices of indiscriminate personal revenge," in which "[t]he measure of retaliation — left to the discretion of the victim's clan (subject to its strength) — was generally greater than the harm suffered," often as much as "a sevenfold retaliation." Francesco Parisi, *The Genesis of Liability in Ancient Law* (2001) 3 Am. L. & Econ. Rev. 82, 86.

Under the principle of the *lex talionis*, "the punishment is usually made equivalent to the crime, sometimes with distressing literalness." Posner, *supra*, 9 J. Legal Stud. at 81. As Posner explains, this retribution principle functioned

> as a substitute for or limitation on vengeance. The idea is that without some customary or legal constraints, people might react to a wrong by retaliating against the wrongdoer *disproportionally* and, especially when this is so, the original wrongdoer or his family might in turn retaliate against the original retaliator or his family. To avoid an endless cycle of injury, retaliation, and counter-retaliation — a costly system for controlling aggression — custom may prescribe that the retaliator may inflict no more severe injury than the wrong (e.g., a tooth for a tooth rather than an eye for a tooth) and that the wrongdoer may not seek vengeance against the retaliator in turn. Retribution in this view is in part a *limitation* on the severity of punishment under a pure system of retaliation . . . .

Id. at 82. *See also* Parisi, *supra*, 3 Am. L. & Econ. Rev. at 87 (the *lex talionis* replaced a system of discretionary retaliation in which "partisan bias" risked triggering "spirals of escalating violence"); *id.* at 95, 98-100 ("the *lex talionis* created an express and well-defined punitive rule" which rendered "the expected sanction fully known to the wrongdoer's group," which "served as a coordination mechanism that reduced the risk of feuds resulting from the parties' disagreement over the measure of legitimate retaliation"); Louis Kaplow & Steven Shavell, *Fairness Versus Welfare* (2001) 114 Harv. L. Rev. 961, 1282-84.

With the rise of the modern administrative state, coupling a monopoly on legitimate violence with elaborate procedural protections, *id.* at 1284, the predicate for insisting on a principle of proportional retaliation long ago vanished. Thus, we observe "[i]n a modern system of punishment" that "there need be no exact correspondence between the gravity of the crime and the severity of the punishment (a less serious crime might be punished more severely than a more serious crime if the former were easier to conceal) . . . ." Posner, *supra*, 9 J. Legal Stud. at 81-82. *See also* Kaplow & Shavell, *supra*, 114 Harv. L. Rev. at 1300 ("actual punishment is substantially higher than retributive principles would seem to require or permit when there is a low probability of apprehension, such as there is for many common categories of crime, for which the probability often is only one or two percent.") *E.g.*, Joseph B. Treaster, "Insurer Agrees to Pay Penalty in Fraud Case," *N.Y. Times*, Sept. 12, 2003, at C1 (insurer AIG forced to forfeit $100,000 in illicit profits received for helping a company defraud its investors, plus a fine of 100 times that amount, $10 million).

Because of the long history during which the observance of proportional limits on retaliation was important to social order, "it would not be surprising that everyone, . . . would be inclined to find the retributive conception of fair punishment intuitively appealing." Kaplow & Shavell, *supra*, 114 Harv. L. Rev. at 1287. However, despite its intuitive appeal, "it would make no sense" to apply this conception developed in primitive times to limit the penalties otherwise found appropriate to increase the well-being of all members of modern society. *Id.* at 1288. "Thus, it may often be desirable to employ higher punishments than those called for under the proportionality principle." *Id.* at 1290. An understanding of economic principles coupled with an understanding of "the origins and functions of retribution as a social norm makes clear that there is no good reason for treating our intuitions about retribution as if they constituted an independent basis for" limiting the punishment found to be appropriate to improve the welfare of members of society. *Id.*

C. The Beccaria-Bentham Approach: Penalties Should be Set to Eliminate the Offender's Gain

"The economic study of punishment is almost as old as (modern) economics itself." Posner, *supra*, 9 J. Legal Stud. at 73. The first modern contribution to the theory of penalties came in the eighteenth century in treatments by Italian economist and criminologist Cesare Beccaria, and by English economist and philosopher Jeremy Bentham. *See* Cesare Beccaria, *On Crimes and Punishments* (1764) (Henry Paolucci ed., Bobbs-Merrill 1963); Jeremy Bentham, *An Introduction to the Principles of Morals and Legislation* (1781) (Prometheus Books 1998). They articulated the principle that penalties should be set to eliminate the offender's gain from the offense, which in principle should be sufficient to deter the offense. This is the central operative principle behind deterrence theory; all later theoretical constructs are simply variations or elaborations upon it.

The essence of Beccaria's approach was rather simple: penalties should be set at a level that eliminates the gain to the offender, but not much above that level. Beccaria at 43-44. Setting penalties high enough to eliminate gain, Beccaria believed, will completely deter intentional harmful conduct. On the other hand, Beccaria believed, penalties should be limited to the amount adequate to deter wrongdoing because harsh punishments may by example, in a sense, teach people to act violently and with little regard for the feelings of others. *Id.* at 44. At the time, Beccaria's ideas were startling, but they generated a movement toward more lenient and individualized punishment in many European countries, and many of his ideas became widely adopted during his lifetime. *E.g.*, Francis A. Allen, *A Matter of Proportion* (2001) 4 Green Bag 2d 343, 344; Leon Radzinowicz (1948) 1 *A History of English Criminal Law and Its Administration From 1750*, at 278 n.38. Indeed, Beccaria's ideas became so influential his original insights now appear trivial. Coleman Phillipson (1970) *Three Criminal Law Reformers: Beccaria, Bentham, Romily* at 84.

Bentham, who spent a good part of his career addressing issues Beccaria had touched on, adopted Beccaria's formula that the penalty should be set at a level that eliminates the offender's prospect of gain. Bentham, *supra*, at 179. Bentham's major practical innovation was the introduction of a concern about "marginal deterrence" — a concern that having excessively high penalties for relatively minor offenses might encourage an offender, in the process of committing an offense, to commit a more harmful act which carried the same, or only slightly harsher, punishment. *Id.* at 168. For example, imposing the death penalty for purse-snatchers might well encourage the purse-snatcher to kill his victim, both to take the purse with less effort and to eliminate a witness, as committing this additional wrong would not add to the penalty imposed.

Bentham's concern about marginal deterrence — about the need to deter offenders from "stepping up" their offense because of a lack of concern for additional consequences — led Bentham to join Beccaria in reasoning that penalties should not be set appreciably above the level adequate to remove the offender's prospect of gain from an offense. By keeping penalties moderate, Bentham's view was that society could reserve room for imposing additional penalties on offenders who step up to higher levels of misconduct, therefore hopefully deterring those offenses at the margin. *Id.* at 181.

Another important innovation made by Bentham was his suggestion that where the probability of punishment of an offender is low, penalties may need to be increased to offset the dilution of deterrence that results when an offender realizes that the probability of the gain-stripping penalty actually being imposed is remote. *Id.* at 181-84. *See* A. Mitch Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis* (1998) 111 Harv. L. Rev. 869, 876 n.12.

D. The Becker Caveat: Sometimes Imposing Penalties Which Merely Internalize the Cost to Others Leads to a Socially Optimal Result

The Beccaria-Bentham approach to the theory of penalties, often termed the "classical deterrence" approach, was essentially the sole basis of deterrence theory until 1968, which saw the publication by economist Gary S. Becker of *Crime and Punishment: An Economic Approach* (1968) 76 J. Pol. Econ. 169. Becker's theory of sanctions offered in this article was an important contribution, being responsible in part for Becker being awarded the Nobel Prize in Economics in 1992. For our purposes, Becker's approach applied, in essence, a caveat to the Beccaria-Bentham approach to stripping the gains from an offender for an offense. Becker suggested that rather than focusing on eliminating any prospect of gain by offenders, punishment should aim at ensuring that offenders internalize all social costs of their offense. This is often termed the "cost internalization" approach to punishment.

The most important aspect of Becker's analysis, as to which it functions as a caveat to the Beccaria-Bentham approach, lies in areas where the offense involved is not viewed as a particularly serious one, and there are large gains to the offender and very little harm to the victim of the offense, so that imposing a penalty which merely forces the offender to absorb the cost to the victim and permits the offender to go forward may lead to a result where society is better off.

As an example of how Becker's approach would work in practice, consider the case of *Jacque v. Steenberg Homes, Inc.*, 563 N.W.2d 154 (Wis. 1997). There, during the winter the defendant needed to deliver a mobile home to a parcel of land. The easiest way to do it was simply to haul the mobile home across a narrow strip of land owned by the Jacques, to the parcel of land. The only other way was to haul the mobile home down a long, winding road, which could only be done after removing at least seven feet of snow covering parts of it. But the Jacques refused permission to use their land, evidently out of the mistaken belief that granting permission might impair their property rights under the law of adverse possession. If the cost of delivering the mobile home down a snow-filled, long, winding road were $5,000, and the injury to the Jacques of moving it across their land were $100, the Becker approach would permit the trespass and impose only a $100 penalty, to force the defendant to internalize the cost to the Jacques, thereby permitting the defendant to keep the $4,900 gain, and by permitting this more efficient delivery of the mobile home, making society better off.

Becker made clear, however, that his approach is only properly applicable where the gain to the offender exceeds the harm to society of the offense (as in the above example). Where the harm to society imposed by an offense exceeds the gain to the offender, Becker's approach agrees with the view of Beccaria and Bentham that the optimal approach is to completely remove any incentive to commit the offense by stripping the offender of his expectation of gain (gain-stripping penalty). Indeed, in such an instance, the Becker approach leads to a *higher* punishment than the Beccaria-Bentham approach: Beccaria and Bentham would only remove the gain to the offender, but Becker would force the offender to pay an amount equal to the cost to society, an even higher amount.

Because the "cost internalization" approach is more effective than even the Beccaria-Bentham approach in deterring offenses where the cost to society exceeds the gain to the offender, Becker urged that the "cost internalization" approach should be the general policy toward punishment. Another reason Becker recommended this approach is administrative simplicity. The internalizing penalty is administratively easy to apply because it does not require the enforcement authority to determine whether the offender's gain is less than society's loss — all it need do is determine the cost to society, and force the offender to pay that cost.

E. The Posner Clarification: Except Where a Market Mechanism Is Available to Attain The Same Result, If It Is Indeed Socially Optimal

The next important contribution to the theory of penalties was Richard A. Posner's *An Economic Theory of Criminal Law* (1985) 85 Colum. L. Rev. 1193. The key contribution of Posner was to introduce the role of the market in the design of penalties for deterrence purposes. In particular, Posner introduced a needed clarification to the Becker "cost internalization" approach in situations where the result which the offender seeks to achieve can be achieved through a market transaction with his victim, if indeed it is the socially optimal result, rather than through forcible imposition on the victim.

Posner suggested that penalties should be set at the gain-stripping, or complete deterrence, level whenever the offender had the option, at low cost, of entering into a consensual transaction for whatever good or entitlement he sought from the victim. *Id.* at 1195-96, 1201-03. Gain stripping makes sense whenever a consensual transaction is available as an alternative, because potential offenders should be encouraged, in most cases, to use the market rather than take things from victims. In particular, if the transaction cost of using the market is lower than the cost of enforcing the law against an offender, then society's costs are held to the lowest level by forcing potential offenders into the market whenever consensual transactions are a relatively inexpensive means of transferring entitlements. As Posner explains: "Market bypassing in such situations is inefficient — in the sense in which economists equate efficiency with wealth maximization — no matter how much utility it may confer on the offender." *Id.* at 1195.

The effect of Posner's clarification can be illustrated by returning to the example of *Jacque v. Steenberg Homes, Inc.*, involving the delivery of a mobile home during a snowy Wisconsin winter. Under Becker's "cost internalization" approach, the defendant should be permitted to trespass over the Jacques' land, even after the Jacques refused permission, and the only penalty to the defendant should be the $100 cost to the Jacques (plus the cost to society of enforcing that sanction), with the defendant keeping the remainder of the $5,000 in profit, on the theory that permitting this offense rather than imposing a penalty that offsets the entire profit makes society better off.

Under the principle articulated by Posner, however, the penalty imposed on the defendant should not be capped by the "cost internalization" approach. Rather, the penalty imposed should be calculated to remove any hope of profit from such an intentional trespass, applying a "complete deterrence" or "classical deterrence" approach, to force the defendant to use the market and bargain with the Jacques over a price to be permitted to use the land, and thereby divide the profit to be gained by using the Jacques' land. To use a "cost internalization" approach to cap punishment, Posner would argue, would merely encourage people to intentionally violate the rights of others, rather than bargain with them, ultimately making society worse off.

The result reached by the Wisconsin Supreme Court in *Jacques*, upholding a $100,000 punitive damages award against the defendant for intentional trespass, even though there was no evidence of harm to the Jacques as reflected in the $1 nominal damages award, illustrates the logic and wisdom of the Posner clarification to Becker's approach. There the Wisconsin Supreme Court emphasized that "punitive damages must be in excess of the profit created by the misconduct so that the defendant recognizes a loss." 563 N.W.2d at 165. *See also* Keith N. Hylton, *Punitive Damages* *and the Economic Theory of Penalties* (1998) 87 Geo. L.J. 421, 445-46.[3]

The fundamental principle supported by Posner's approach, one quite relevant to this case (see Part II, below), is that whenever an honest transaction in the market is available as an alternative to simply taking something by force or fraud, penalties should be set to strongly encourage the honest market transaction. The framework presented here is consistent with that of Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral* (1972) 85 Harv. L. Rev. 1089. The famous Calabresi-Melamed framework holds that "property rules," which prevent violations by stripping gains, are

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[3] There are other theoretical grounds for reaching the result advocated by Posner, that in any situation where the market is an alternative to the offender committing an offense against the victim for profit, the optimal penalty aims to completely deter, to force actors into the market, by stripping the offender's expectation of gain. One could just as easily reach this conclusion by carefully considering the costs of excessive penalties and the costs of inadequate penalties. *See* Hylton, *supra*, 87 Geo. L J. at 430-39. Another approach which supports the same conclusion is found in the literature that stresses the "secondary costs" (e.g., costs of avoidance and self-protective efforts) generated by intentional offensive conduct. See Fred S. McChesney, *Boxed In: Economists and Benefits from Crime* (1993) 13 International Rev. Law & Econ. 225; Richard L. Hasen & Richard H. McAdams, *The Surprisingly Complex Case Against Theft* (1997) 17 International Rev. Law & Econ. 367. For an application of the secondary-costs theory to punitive damages, see David D. Haddock, Fred S. McChesney, & Menahem Spiegel (1990) *An Ordinary Economic Rationale for Extraordinary Legal Sanctions*, 78 Calif. L. Rev. 1.

appropriate whenever transaction costs are low; and "liability rules," which internalize costs, are appropriate when transaction costs are high. *See generally* Louis Kaplow & Steven Shavell, *Property Rules Versus Liability Rules: An Economic Analysis* (1996) 109 Harv. L. Rev. 713.

One function of punitive damages is to maintain the distinction between property rules and liability rules — or, equivalently, to prevent property rules from being converted into liability rules. Punitive damages set at a level high enough to remove the profit from a wrongful course of conduct are essential to deterring potential wrongdoers from turning the rules against fraud and other intentional wrongs from sanctions strictly prohibiting certain conduct into mere "prices" for engaging in the conduct, amounting to simply a "cost of doing business."[4] Setting the penalty higher than necessary to accomplish this purpose is not socially costly unless there is substantial uncertainty over whether the offender's conduct is properly labeled as wrongful, or over whether the offender in fact committed the wrong.

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[4] For an analysis of this point applied to the area of punitive damages, *see* Robert D. Cooter, *Prices and Sanctions* (1983) 84 Colum. L. Rev. 1523. *See also* Uri Gneezy & Aldo Rustichini, *A Fine Is a Price* (2000) 29 J. Legal Stud. 1; Robert Cooter, *Models of Morality in Law and Economics: Self-Control and Self-Improvement for the "Bad Man" of Holmes* (1998) 78 B.U. L. Rev. 903, 914-19; Robert Cooter, *Expressive Law and Economics* (1998) 27 J. Legal Stud. 585.

F. The Polinsky-Shavell View of Punitive Damages Corroborating the Posner Approach, and Explicating the Application of the Becker "Cost Internalization" Approach in the Tort Field

A substantial body of law-and-economics analysis of punitive damages has developed in recent years, based in part on the Beccaria-Bentham approach to penalties, generally adopting as a starting assumption that one objective of punitive damages should be to deter offenders by imposing penalties sufficient to offset the gain to an offender (either monetary or non-monetary) from acts deemed socially wrongful, thereby deterring like acts in the future.[5] An

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[5] *E.g.*, Dorsey D. Ellis, Jr., *Fairness and Efficiency in the Law of Punitive Damages* (1982) 56 S. Cal. L. Rev. 1; Robert D. Cooter, *Economic Analysis of Punitive Damages* (1982) 56 S. Cal. L. Rev. 79; Gary T. Schwartz, *Deterrence and Punishment in the Common Law of Punitive Damages: A Comment* (1982) 56 S. Cal. L. Rev. 133; Jason S. Johnston, *Punitive Liability: A New Paradigm for Efficiency in Tort Law* (1987) 87 Colum. L. Rev. 1385; Dan B. Dobbs, *Ending Punishment in "Punitive" Damages: Deterrence-Measured Remedies* (1989) 40 Ala. L. Rev. 831; David D. Friedman, *An Economic Explanation of Punitive Damages* (1989) 40 Ala. L. Rev. 1125; Robert D. Cooter, *Punitive Damages for Deterrence: When and How Much?* (1989) 40 Ala. L. Rev. 1143; David D. Haddock, Fred S. McChesney & Menahem Spiegel, *An Ordinary Economic Rationale for Extraordinary Legal Sanctions* (1990) 78 Cal. L. Rev. 1; Richard Craswell, *Damage Multipliers in Market Relationships* (1996) 25 J. Legal. Stud. 463; Paul H. Rubin, John E. Calfee, & Mark F. Grady, BMW v. Gore: *Mitigating the Punitive Economics of Punitive Damages* (1997) 5 Sup. Ct. Econ. Rev. 179; Robert D. Cooter, *Punitive Damages, Social Norms, and Economic Analysis* (1997) 60 Law & Contemp. Probs. 73; Mark F. Grady, *Efficient Negligence* (1998) 87 Geo. L.J. 397; Keith N. Hylton, *Punitive Damages and the Economic Theory of Penalties* (1998) 87 Geo. L.J. 421; Jane Mallor &

important exception is a law review article published by Stanford economist and law professor A. Mitch Polinsky and by Harvard economist and law professor Steven Shavell, *Punitive Damages: An Economic Analysis* (1998) 111 Harv. L. Rev. 869. This is the article relied on by Ford in its brief to this Court in arguing that "substantial economic literature" supposedly shows that there is little need for punitive damages because "the socially correct level of deterrence is created by compelling responsible parties to pay compensatory damages alone." Ford Br. at 36 & n.13.

The Polinsky and Shavell article does not support this conclusion. What the article in fact focuses on is spelling out the implications for punitive damages of the Becker "cost internalization" approach to penalties, under which generally the offender's gain from the offense is not a relevant aspect of the analysis. However, like Posner, Polinsky and Shavell recognize an important caveat to the Becker approach which makes their analysis largely irrelevant to a case such as this, as this case involves *an intentional tort* by Ford committed against the Johnsons and many other California consumers pursuant to official corporate fraud policy (see Part II, below).

Polinsky and Shavell explicitly recognize in their article that where "a reprehensible act is purely intentional, overdeterrence," the central concern of their article, "cannot

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Barry Roberts, *Punitive Damages: Toward a Principled Approach* (1999) 50 Hastings L.J. 969; Richard Craswell, *Deterrence and Damages: The Multiplier Principle and its Alternatives* (1999) 97 Mich. L. Rev. 2185.

occur," and therefore the logical social objective is one of "deterring such acts completely." *Id.* at 906-07 & n.120; *see also id.* at 874 n.8, 918 & n.154, 945-47. That objective, they state, warrants "a measure of damages equal to *the greater of* gain or harm." *Id.* at 918 n.154 (emphasis added). Under the "complete deterrence" or "classical deterrence" approach, which Polinsky and Shavell accept in the context of an intentional tort, the objective is to deter such intentional wrongdoing by removing completely the offender's prospect of gain from a wrongful course of conduct, which of course makes it important to consider the defendant's profit from a wrongful course of conduct.[6]

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[6] If a plaintiff can "actually prove[] in court" that a corporation has "engaged in a *pattern* of misconduct, of which any given case is merely illustrative," then the "cases of corporate wrongdoing [that] are brought to light . . . might be punished all the more severely in order to offset corporate gain from undiscovered cases. * * * In that case, the entire course of misconduct rightly may be considered." Kenneth S. Abraham & John C. Jeffries, Jr., *Punitive Damages and the Rule of Law: The Role of Defendant's Wealth* (1989) 18 J. Legal Stud. 415, 420. *Compare Roth v. Farner-Bocken Co.* (S.D. 2003) 667 N.W.2d 651, 667-69 ("no evidence that the conduct reflected a company policy or practice," and thus no evidence of potential harm to other victims that might result if similar future behavior were not deterred, based on the dangerousness inherent in defendant's conduct). *See also Vallbona v. Springer* (4th Dist. 1996) 43 Cal.App.4th 1525, 1539-41 & n.19*; Hawkins v. Allstate Ins. Co.* (Ariz. 1987) 733 P.2d 1073, 1080-81, *cert. denied,* 484 U.S. 874; Jane Mallor & Barry Roberts, *Punitive Damages: Toward a Principled Approach* (1999) 50 Hastings L.J. 969, 997; Hylton, *supra*, 87 Geo. L.J. at 431-33, 458; David D. Haddock, Fred S. McChesney & Menahem Spiegel, *An Ordinary Economic Rationale for Extraordinary Legal Sanctions* (1990) 78 Calif. L.

Of course, in the context of imposing punitive damages for wrongful acts by a defendant falling short of an intentional tort, the approach of Polinsky and Shavell represents an important advance in analysis of the "cost internalization" approach. In such a case, Polinsky and Shavell argue, total damages should be determined by dividing the actual harm (or compensatory damages) by the probability that the offender will be found liable when he should be. If the total damage award is equal to the actual harm divided by the probability of the defendant being found liable, then the total award effectively makes the offender pay for all of the costs he imposes on society, because it forces the offender to pay for those cases in which he "gets away" without being held liable for his conduct. *Id.* at 889-90. The punitive damages portion of the award, under this algorithm, is simply the difference between this measure of total damages and the actual harm. For example, if the offender imposes a loss of $100 on each of his victims but is held liable in only one out of every three such instances, then the total damages award in that one case should be $300: the $100 in compensatory damages plus $200 in punitive damages. In a regime in which some offenses escape liability, the Polinsky and Shavell algorithm guarantees full internalization of victim losses.

From the context of their article, and their explicit exclusion from their analysis of intentional torts, it is clear

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Rev. 1, 13, 18; Dan B. Dobbs, *Ending Punishment in 'Punitive' Damages: Deterrence-Measured Remedies* (1989) 40 Ala. L. Rev. 831, 866-67, 874-88.

that the "cost internalization" approach to punitive damages urged by Polinsky and Shavell should be followed only when the offender has not evaded the market (i.e., a market transaction is difficult to arrange, as in most accident settings) and the offender's gain is likely to be greater than society's loss. Thus, like Posner's approach, the approach of Polinsky and Shavell would not excuse the trespass that occurred in *Jacque v. Steenberg Homes*.

An example of where the "cost internalization" approach of Polinsky and Shavell would properly work to cap a punitive damages award is a case in which an employee or agent of a firm steals from a customer, in violation of the firm's policies but while acting within the scope of employment. Consider, for example, an insurance agent who steals customers' premium payments rather than remitting them to the insurer, as in *Pacific Mutual Life Insurance Co. v. Haslip*, 499 U.S. 1 (1991). Since the agent has committed a theft, any damage award against him alone should aim, at a minimum, to strip his gain. The damage award against the insurer, however, should be limited by the "cost internalization" principle. The reason is that the firm itself has not adopted a policy of theft. The firm itself, on which the punitive damages award is being imposed, did not commit the intentional tort. In order to provide the right incentives for the firm to monitor its employees (and in some cases agents), it may be necessary to set total damages at a level which divides the actual harm by the probability the defendant firm will be successfully sued and held liable when it should be. The punitive damages in

Haslip, which apparently were four times the compensatory damages, are thus defensible assuming there was perhaps only a one in five chance the insurer would be successfully sued. To award higher punitive damages might create overdeterrence, forcing firms to make wasteful expenditures in monitoring the activity of all employees and agents, presumably nearly all of whom are honest, to guard against massive punitive damages being imposed merely because of the isolated acts of a single errant employee or agent, a fear which would in the end make society worse off. Daniel R. Fischel & Alan O. Sykes, *Corporate Crime* (1996) 25 J. Legal Stud. 319, 348. *See generally* Richard Craswell & John E. Calfee (1986) *Deterrence and Uncertain Legal Standards*, 2 J. L. Econ. & Org. 279.

On the other hand, as Polinsky and Shavell recognize, and as much recent scholarship corroborates, see note 5, *supra*, in a case involving an intentional tort or other intentional, reprehensible wrongdoing by the defendant, it is appropriate under deterrence theory to seek to completely deter such acts by eliminating any prospect that the offender will gain from them. Here, the primary concern of the penalty designer should be to make sure that the penalty is not so low that it fails to deter harmful conduct. Overdeterrence is not a concern because the reason for gain stripping is to totally deter or eradicate the injurer's conduct, not to constrain it to some "optimal" level that leaves room for conduct that potentially has social value. It follows that for intentional wrongdoing, the punitive component of a damages award should be no less than the amount necessary to strip the offender of profits obtained from wrongful conduct.

TXO Production Corp. v. Alliance Resources Corp., 509 U.S. 443 (1993), provides a good illustration of the proper application of the theory of penalties discussed thus far. Geologists employed by TXO determined that recovery of oil and gas under a roughly 1000-acre tract of land known as the "Blevins Tract" would be profitable. They recommended that the company acquire the rights to develop the oil and gas under the tract. The owner of those rights was Alliance Resources Corporation. TXO made an offer that Alliance considered "phenomenal." Alliance accepted the offer, and assigned its interest in the Blevins Tract to TXO in exchange for a payment and a share of future royalties from the oil and gas produced from the tract.

Having acquired this prized acreage by promising phenomenal royalties, TXO then promptly launched a series of fraudulent efforts, which included attempting to suborn perjury, designed to suggest to Alliance it had not passed good title, but instead that TXO had obtained title through another chain of title, all in an effort to trick or coerce Alliance into forfeiting much of its bargained-for royalty interest. When Alliance refused to capitulate, TXO filed a declaratory judgment action in an effort to establish, based on evidence it knew was fraudulent, that Alliance did not have title. Alliance counterclaimed for slander of title. The jury ruled for Alliance, finding that TXO had slandered Alliance's title, and it awarded Alliance $19,000 in compensatory damages (its attorneys' fees for defeating the declaratory judgment action) and $10 million in punitive damages.

The "cost internalization" approach would require the court to divide Alliance's loss, $19,000, by the probability, assessed at the time of its wrongdoing, that TXO would be successfully sued and held liable. The probability that TXO would be held liable is the product of the probability that Alliance would file suit and the probability that the court would find in favor of Alliance. Since both probabilities were high, the Polinsky and Shavell approach suggests the optimal punitive damages award in *TXO*, if the "cost internalization" approach were proper for that case, would have been a very small multiple of the $19,000 in compensatory damages.

How, then, does one explain, relying on economic principles of optimal deterrence, the U.S. Supreme Court's decision upholding punitive damages of 526 times that amount? The explanation is that, as Polinsky and Shavell note in their article, the "cost internalization" approach does not apply where the defendant has committed an intentional wrong against the plaintiff for illicit benefit — here, TXO's effort by fraud to obtain all or much of the lucrative stream of royalties TXO had promised to pay Alliance. Instead, the "complete deterrence" or "classical deterrence" approach should be used to remove any incentive for members of society to commit such wrongs.

Thus, the Court properly upheld the $10 million punitive damages award in full after concluding that although TXO did not actually receive any illicit profits (as its scheme was quickly thwarted), it had expected to realize substantial profits through its fraud. Suggesting that Alliance's estimate that TXO anticipated illicit profits of $8.3 million might be too high, the Court held that the $10 million punitive damages award was defensible even if TXO had only anticipated $1 million in illicit profits, *TXO*, 509 U.S. at 450-51 n.10, 459-62 (plurality opinion), particularly given "the possible harm to other victims that might have resulted if similar future behavior were not deterred." *Id.* at 460. The result in *TXO* strongly corroborates the logic and wisdom of applying a "complete deterrence" or "classical deterrence" approach to profit-motivated corporate misconduct.

II. Based on the Court of Appeals' Analysis, This Is a Typical Case Calling for Punitive Damages to Be Set at a Level Sufficient to Eliminate Any Expectation of Profit From an Intentionally Tortious, Wrongful Course of Conduct

That the traditional "complete deterrence" or "classical deterrence" approach, not the alternate "cost internalization" approach, is the proper one for this case appears evident from the following aspects of the Court of Appeals' opinion.

First, as the Court of Appeals found, this is a case involving "intentional fraud" against consumers. Opinion at 7; *see also* Opinion at 11 (defendant was "engaged in a scheme to defraud consumers"). As the court stated: "Such intentional conduct is highly reprehensible." *Id.* at 13. This is important because only where the misconduct involved is of the sort which society regards as never acceptable at any level (as compared with, for example, mere negligence, or a breach of a contract obligation) is it economically appropriate to set the penalty for an infraction high enough to deter all such misconduct. Applying such a framework to less serious misconduct might chill conduct that has social value.

Fraud like Ford's has no social value. Thus society's objective is and should be to deter such intentional wrongdoing completely, by removing any incentive to engage in it. As Judge Easterbrook has aptly noted: "The optimal amount of fraud is zero . . . ." *Ackerman v. Schwartz* (7th Cir. 1991) 947 F.2d 841, 847. *See* Richard S. Gruner, *Just Punishment and Adequate Deterrence for Organizational Misconduct: Scaling Economic Penalties Under the New Corporate Sentencing Guidelines* (1992) 66 S. Cal. L. Rev. 225, 235.

Second, the misconduct involved was not the result of errant actions by low-level employees acting in pursuit of their own self interest. Rather, the defrauding of the plaintiff "was typical" of many similar transactions carried out by Ford each year, because Ford itself "intended, as a matter of policy, to short-circuit lemon law claims" through the fraud. Opinion at 8; *see also id.* at 9 (wrongdoing "a matter of policy"); *id.* at 10-11 (Ford's "entire customer response program was structured precisely" to carry out the fraud scheme). The intentional wrongdoing was the corporation's official policy. In situations where only isolated wrongdoing by low-level employees is involved, lower levels of exemplary damages are appropriate, for example, in a situation such as in the *Haslip* case.

Third, there was "[c]ompelling evidence" produced at trial of this official Ford policy, and of its wrongfulness. *Id.* at 8. Further, the jury found that Ford had committed official and intentional misconduct by "clear and convincing" evidence, and this finding was upheld by the trial judge and appellate court. This circumstance is important because the framework set out above, of using exemplary damages to remove any possibility the offender will profit from misconduct, may not be appropriate in a case where the bare minimum of evidence has been presented to support liability.

If legitimate doubt exists in a court's mind as to the basis for liability, the "complete deterrence" framework may present a risk of overkill and of chilling social conduct that is potentially beneficial, or that at least is not clearly wrong, and that concern must be taken into account in a pragmatic analysis of the best deterrence approach to apply. But where no legitimate doubt exists that the defendant engaged in intentional wrongdoing, as appears to be the case here, the gain-stripping, "complete deterrence" approach is highly appropriate, as its purpose is to deter completely defendants from engaging in clear misconduct which they know is wrong, as such misconduct has no social value at any level.

Fourth and finally, this case involves profit-motivated wrongdoing engaged in by a corporation. In a case involving wrongdoing motivated by individuals driven by spite or other subjective motives, it can be very difficult to assess what level of exemplary damages is sufficient to deter similar wrongdoing in the future, or is appropriate to accomplish retribution in the particular instance (by inflicting the appropriate amount of pain on the individual wrongdoer). Such an analysis involves comparing apples and oranges. By contrast, a corporation is an artificial entity created to seek profits for its owners. Assuming corporations are in general owned and managed by rational individuals, setting exemplary damages for a wrongful course of conduct that is profit motivated at a level high enough so that the "expected gain" from such a course of conduct is zero or negative should ensure no corporation will engage in such conduct in the future — just as setting punishment below this amount will encourage such misconduct in the future.

III. The Court of Appeals' Analysis, Capping the Punitive Damages at a 3-to-1 Ratio to the Compensatory Damages Received by the Johnsons, Is Clearly Inadequate to Completely Deter Corporate Fraud Policies Like Ford's

Despite these findings, the Court of Appeals capped the punitive damages at an arbitrary 3-to-1 ratio to the compensatory damages that happened to be awarded to the particular plaintiffs in this case. In so doing, it engaged in no analysis of whether this level of punitive damages was adequate for deterrence in light of Ford's official policy of defrauding consumers regarding problem vehicles, and did not even mention the profit factor which was explicitly approved for consideration by the Legislature in 1979.

Given the circumstances of this case, under economic principles of deterrence, exemplary damages in this case should be set high enough to strip Ford of all profits derived from its fraudulent policy of using "Owner Appreciation Certificates" (OACs) to foist problem vehicles on unsuspecting consumers, rather that ensuring that all problems regarding vehicles are disclosed to consumers so that a market transaction with informed consumers can be carried out regarding each problem vehicle. Eliminating Ford's illicit gain from one fraudulent transaction generated by its wrongful course of conduct carried out pursuant to official policy is insufficient to completely deter what the Legislature was concerned about deterring when it endorsed consideration of the profit factor: the defendant's entire "wrongful course of conduct." Cal. Civil Code § 3295(a)(1). The fact that Ford adopted a fraudulent *policy* is strong evidence that it expected the policy to be profitable, and that it would be profitable precisely because in all likelihood, Ford thought, it would go unpunished in the vast majority of fraudulent transactions.

There are two approaches a court could take to stripping the gains from Ford's fraudulent policy. One, which can be called the "total profit stripping" approach, is to estimate the total profit obtained by Ford from the fraudulent policy. The other, which can be called the "multiplier" approach, is to estimate the likelihood Ford would be held liable in any single instance of fraud, and to divide the plaintiff's compensatory award by that amount — perhaps after making adjustments for the size of the plaintiff's award relative to the average case of fraud, and the time between the commission of the fraud and the imposition of the punitive damages award.

It is easy to apply the "total profit elimination" approach in this case, based on factual assumptions which apparently are supported by the record (based on *amicus*'s review of the analysis in the Court of Appeals opinion and in the parties' briefs, not based on any independent examination of the record; obviously, it is ultimately for this Court to decide what factual conclusions are supportable on this record).

Ford's fraudulent policy can apparently be traced at least as far back as 1996, when the amended California lemon law went into effect. Ford evidently issued more than 1,000 OACs every year, for an average savings of $8,000 per certificate relative to the cost and lessened profit which would be triggered by full disclosure of all problems with a vehicle as set out in the lemon law. This implies a profit of at least $8 million per year in California attributable to the fraud scheme.

Assuming an annual interest rate of 3 percent, the total profit earned by Ford from its fraudulent scheme between 1996 and the time of the plaintiff's award in December, 2001 (assuming for simplicity that the scheme began in December, 1996, and each year's profit was received at the end of each year beginning in December, 1997), would appear to be roughly $42.5 million. This sum reflects the annual stream of $8 million ($40 million) and the interest income earned on it (roughly $2.5 million). If this profit amount had not been diminished or taxed away through other penalty or damage assessments against Ford before the Johnsons' award in this case, then $42.5 million is the amount necessary to strip Ford of the total profit earned from its fraudulent scheme.

The "multiplier" approach to estimating a gain-stripping penalty is also easy to illustrate in this case, though it requires additional information. Under the "multiplier" approach, the court would first estimate the likelihood that Ford would be held liable for its fraudulent scheme as the result of a particular fraudulent transaction. The court would then divide the compensatory damage award (or average harm estimate) by the estimated probability of liability in order to arrive at a total damage award level that forces Ford to pay for the instances in which its fraud went undetected or otherwise unpunished. See note 6, *supra*. As fraud simply involves the transfer of money from victim to offender, a focus on the plaintiff's loss is equivalent to a focus on the defendant's gain. The total award suggested by the "multiplier" approach, in a case involving fraud, serves as the minimum necessary to strip the offender of gains obtained through wrongful conduct. This approach to setting punitive damages was favorably discussed in an opinion joined by three justices in *BMW of N. Am. v. Gore* (1996) 517 U.S. 559, 592-93 (Breyer, J., joined by O'Connor and Souter, JJ., concurring).

Thus, if 1,000 OAC certificates are issued each year as part of Ford's fraudulent policy, if Ford gains an average of $8,000 from each fraudulent transaction, and if consumers sue, uncover the fraud scheme, and obtain punitive damages in one out of 5,000 instances of fraud, then the "multiplier" approach suggests an appropriate total award of punitive damages of at least $40 million. If the award is corrected to include interest income earned on fraudulent gains, the suggested total award comes to the $42.5 million estimated under the "total profit elimination" approach.

The intuition behind the "total profit elimination" approach and the "multiplier" approach is simple. If a corporation receives an additional $42.5 million over a period of five years from a fraudulent policy, then any legal regime under which the sum of damage awards and penalties assessed against that corporation over the same period is less than $42.5 million will be inadequate to deter the corporation from continuing its fraudulent conduct, and will be inadequate to deter other corporations from engaging in like conduct. The $10 million in punitive damages awarded to the Johnsons in this case is inadequate under these assumptions. However, a $10 million award does at least raise a credible threat that Ford's fraudulent policy may turn out to be unprofitable in the end, and may be enough to give pause to other corporations considering similar misconduct.

The remitted punitive damages award of $53,435 ordered by the Court of Appeals fails to present even a credible threat that Ford will be prevented from profiting from its fraudulent policy. In order for the award in this case (even counting the compensatory damage award and even the attorneys' fee award) to serve as part of an adequate deterrent against fraud, other damage awards and penalties against Ford for its fraudulent policy during the 1996-2001 period, assuming it received $42.5 million (including interest) as a result of its fraud, would have to total more than $42 million. There is no suggestion of other sanctions against Ford remotely approaching this level,[7] so that one has to regard the 3-to-1 punitive-to-compensatory ratio chosen by the Court of Appeals as certain to fail on deterrence grounds. To adopt this approach would essentially gut any deterrent effect of punitive damages, countermanding the Legislature's directive that the device of punitive damages is to be used to deter wrongful courses of conduct, based in part on an evaluation of the illicit profit received by offenders from their wrongdoing.

To correctly evaluate the deterrent effect of a punitive damages award, we must consider the incentives of the wrongdoer on the date on which it decides whether to put a fraudulent scheme into effect. In this case, we should consider Ford's expected profits on the date on which it decided to adopt its policy of using OACs to foist problem vehicles off on unsuspecting consumers without making the disclosures required by California's lemon law. Assuming Ford was aware that it would use roughly 1,000 OACs for this purpose each year, and that the average amount saved would be $8,000, Ford could anticipate a stream of illicit profits of $8 million each year. If we consider the period between 1996 and 2001 (the date of the judgment in the present case), the

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[7] Although Ford mentions actual or possible additional litigation against it resulting from its fraudulent policy, including a class action which was settled for an amount Ford does not disclose, *see* Ford Br. at 32-36, Ford does not suggest the sum total of its payouts in other litigation constitutes even a substantial fraction of the additional $42 million in total profit-stripping penalties which optimal deterrence theory calls for in a case such as this.

"present value" of that stream, evaluated in 1996, is roughly $36.64 million using a discount rate of 3 percent.[8]

Ford would find the fraudulent scheme attractive as long as the present value of the scheme, after taking into account anticipated future penalties, is positive.

Consider the respective present value of Ford's scheme under the punitive damages judgment of the trial court, and under the Court of Appeals' judgment. Since the $10 million trial court judgment did not arise until Ford had practiced its scheme for five years, the present value in 1996 of that expected sanction, imposed five years later, is about $8.63 million. Thus, the net present value of the fraud scheme to Ford in 1996 would still be approximately $28 million (the present value of the expected profit, $36.64 million, minus the present value of the expected sanction, $8.63 million). Under the Court of Appeals' judgment, the present value of Ford's scheme, net of the $53,000 punitive damages award, is approximately $36,595,000.[9]

The "present value" perspective is the correct perspective to take in a case such as this where the penalty arrives many

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[8] The "present value" method evaluates dollars received in future years in terms that are comparable to the present year. Doing so requires some consideration of the time value of money. Thus if the interest rate is 3 percent, viewing the present value in December 1996 of a dollar received in December 2001, five years in the future, the present value of that dollar would be calculated as $1/(1.03)^5$.

[9] To find this, subtract the 1996 present value of a $53,435 penalty imposed in five years ($46,093) from the 1996 present value of Ford's ill-gotten gains, $36.64 million.

years after the fraudulent scheme is put into effect. *See* Yair Listokin, *Crime and (with a Lag) Punishment: Equitable Sentencing and the Implications of Discounting*, Yale Law School Working Paper Series (Oct. 10, 2003) (*http://ssrn.com/abstract=434640*) at 1-4, 11-16. The present value perspective shows that the $10 million punitive damages award is far from excessive. Even when taking the $10 million judgment into account, the present value of Ford's scheme remains high. Indeed, Ford could anticipate keeping more than three-quarters ($28.01 million) of its total 1996 expected receipts from fraud on a present-value basis ($36.64 million) even if it knew in advance that the $10 million in punitive damages would be imposed in 2001 (at a present-value cost of $8.63 million), and expected the award would be upheld on appeal. In order for punitive damages awards issued in 2001 to eliminate Ford's present-value based expectation of fraudulently gained profit in 1996, courts would have to issue at least five punitive damage judgments each in the amount of $10 million in the year 2001; the Johnsons' $10 million punitive damages verdict alone would not be remotely sufficient.

The present value perspective also shows that the $53,435 punitive damages award upheld by the Court of Appeals is so trivial that it would have no practical effect on Ford's calculation at the outset whether to engage in the wrongdoing. Taking that award into account, Ford still retains more than 99.85% of its anticipated ill-gotten gains. In order for such awards to provide a complete deterrent to

Ford's fraudulent policy, courts in 2001 would have to issue roughly 775 such awards. Since 775 punitive damages awards are quite unlikely to be observed in any court, in any period of one to five years, the present value perspective shows that it is virtually impossible for the Court of Appeals' punitive damages judgment to be a part of any meaningful system of deterrence as envisioned by the Legislature, or indeed as envisioned by this Court in its own punitive damages jurisprudence.

The "total profit elimination" and "multiplier" approaches to calculating a punitive damages award are designed to completely deter a wrongful course of conduct by eliminating the gains that result from it. The two approaches suggested here have the additional benefit of preventing courts from issuing punitive damages awards contaminated by passion or prejudice, a concern expressed in several California opinions reviewing punitive damages awards. *E.g.*, *Neal v. Farmers Ins. Exchange* (1978) 21 Cal.3d 910, 927-928; *Fortman v. Hemco, Inc.* (2d Dist. 1989), 211 Cal.App.3d 241, 259; *Fagerquist v. Western Sun Aviation, Inc.* (4th Dist. 1987) 191 Cal.App.3d 709, 727. Indeed, without explicitly describing it, the Court in *Vallbona v. Springer* (4th Dist. 1996) 43 Cal.App.4th 1525, 1539-41 & n.19, approved of the "total profit elimination" approach when it noted that the $200,000 in punitive damages awarded to the three plaintiffs had the effect of eliminating the profit from the defrauding of 120 medical patients, including the three plaintiffs, all of whom paid between $2000 to $3000 for a bogus procedure.

Finally to be considered are questions of replicability and notice that must accompany any system for awarding punitive damages to completely deter fraudulent conduct. Any approach taken by a court in calculating an economically optimal punitive damages award should be replicable in the sense that other courts and potential litigants can apply the same approach to accurately estimate the punitive damages award necessary to completely deter wrongful conduct. A method for estimating punitive damages awards that satisfies this criterion will also provide notice to potential defendants of the likely penalties they will face if their fraudulent policies are uncovered and punished.

A replicable algorithm for calculating punitive damages awards for long-running fraudulent policies should seek to strip the defendant of gains obtained from the fraudulent policy. Such an algorithm should take into account the average gain in each instance of fraud, rather than the particular gain or loss realized in the case before the court. The algorithm should also take into account the interest income earned by the defendant on earlier fraudulent gains. In particular, in cases in which the punishment is imposed many years after the defendant has put its fraudulent scheme into effect, punitive damages awards should be evaluated on a "present value" basis. In addition, the algorithm should take into account any other penalties or punitive damages awards that may have diminished the defendant's profits from fraud. *See Stevens v. Owens-Corning Fiberglas Corp.* (1st Dist. 1996) 49 Cal.App.4th 1645, 1666-68.

The court will often have a choice between the "total profit elimination" and "multiplier" approaches. Both should produce the same result: stripping the wrongdoer of gains from fraud. However, each approach has strengths relative to the other. The "total profit elimination" approach is often easier to apply and requires less information. To apply it, the court needs an estimate of the average gain in a fraudulent transaction and the number of fraudulent transactions. In contrast, the "multiplier" approach requires information on the rate at which victims sue or regulators punish the firm. However, one advantage of the "multiplier" approach is that it encourages the court to examine the evidence for ways in which the offender might have escaped liability or punishment. Punitive damages should be increased to reflect any particular method adopted by the defendant in order to escape liability. For example, a defendant that destroys evidence of wrongdoing in order to evade liability should have the punitive damages imposed on it increased in order to cancel its efforts to escape detection and punishment.

The more consistently courts apply these policies to cases of fraud, the less likely it becomes that any particular wrongdoer can complain reasonably about a lack of notice in connection with the likely size of any punitive damages award. If potential wrongdoers know that they face the prospect of losing all profits earned from fraudulent conduct, and that this penalty has been widely accepted and articulated by courts as appropriate, they will have all the notice they need and deserve, and they will become quite hesitant to engage in fraudulent practices. Moreover, a clear policy of gain-stripping for instances of fraud will encourage potential offenders to focus their complaints about the law on the statutory provisions and case law which define fraud in the first place. As the Court of Appeals aptly noted in this case:

> If the manufacturer believes the law is too vague to implement or requires of it inconsistent actions, the courts are available to the manufacturer to challenge the law. If it simply does not like the law or thinks it practically unworkable, the manufacturer has the right to petition the Legislature. It should go without saying, however, that the manufacturer does not have the right simply to ignore the parts of the law it finds objectionable.

Opinion at 13.

If indeed the State of California wants those like Ford who do business within its borders to actually comply with the existing rules prohibiting fraud unless and until they are changed, then the courts of the State must avoid helping businesses ignore these rules by reducing punitive damages awards below the level required by the "complete deterrence" approach.

If stated with sufficient clarity and if adequately understood and acted on by potential wrongdoers, such a "complete deterrence" regime would in an ideal world produce the result that no intentional torts are committed, no one is victimized, no offenders are punished, and no resources need be expended by society to catch and punish offenders. Louis Kaplow & Steven Shavell, *Fairness Versus Welfare* (2001) 114 Harv. L. Rev. 961, 1251-57. For a court to shirk from applying, and forcefully articulating, a "complete deterrence" approach to punitive damages for intentional torts out of an abstract concern for "fairness" and "proportionality" on the facts of a particular case would leave all members of society worse off. *See id.* at 1234-59, 1281-1304. And for this Court to do so would contravene the Legislature's endorsement of the "complete deterrence" approach through its 1979 enactment explicitly authorizing consideration of a defendant's illicit profits from a wrongful course of conduct, as part of a determination of what amount of punitive damages is necessary to deter such wrongful conduct in the future.

Conclusion

This Court should reject Ford's argument that consideration of a defendant's illicit profits from a wrongful course of conduct is not "necessary to achieve appropriate levels of punishment and deterrence" because, supposedly, "substantial economic literature" shows that "the socially correct level of deterrence is created by compelling responsible parties to pay compensatory damages alone." Ford Br. at 36 & n.13. This Court should uphold the Legislature's explicit indication in 1979 that evidence of the defendant's profits from a wrongful course of conduct should be considered in setting punitive damages, a legislative judgment that comports with more than two centuries of scholarship in the field of economics, with leading court decisions, and with Ford's own position articulated in an appellate brief last year.

Respectfully submitted,

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December 9, 2004 *Of Counsel*

CERTIFICATE OF COMPLIANCE WITH CALIFORNIA RULE OF COURT 29.1(f)

Pursuant to California Rule of Court 29.1(f), I certify that the attached Brief of Keith N. Hylton as *Amicus Curiae* in Support of Petitioners (corrected) is proportionally spaced, has a typeface of 13 points, and contains 11,892 words.

Dated: December 18, 2004

Michael J. Piuze

APPENDIX

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The Honorable Justices of the Court of Appeal
Fifth Appellate District, State of California
2525 Capitol Street
Fresno, CA 93721-2227

Re: *Romo v. Ford Motor Co.*
Case No. F034241

Dear Honorable Justices:

Ford Motor Company respectfully submits this letter in response to the Court's June 30 letter inviting the parties to answer six questions in light of the United States Supreme Court's order granting certiorari, vacating the judgment, and remanding this case to this Court for further consideration in light of *State Farm Mutual Automobile Insurance Co. v. Campbell*, 123 S. Ct. 1513 (2003). Ford has set forth below the Court's questions and provided answers to each.

State Farm dramatically changed, strengthened and refocused the due process standards first established by *BMW of North America, Inc. v. Gore*, 517 U.S. 559 (1996). The decision requires this Court to modify virtually every aspect of its original due process analysis. For example, while this Court upheld the punitive damage award here despite its 63:1 ratio to the total compensatory damage award assessed against Ford (and 29,000:1 ratio to the wrongful death awards), the Supreme Court in *State Farm* ruled that due process, in all but the rarest of cases, prohibits a ratio that exceeds 9:1. The Court also held that where, as here, plaintiffs have obtained a "substantial" compensatory damage award, a 1:1 ratio "can reach the outermost limit of the due process guarantee." 123 S. Ct at 1524.

The *State Farm* decision addressed and rejected numerous other fundamental premises of the original opinion's analysis. Among other things, the Court held that "[g]reat care must be taken to avoid use of the civil process to assess criminal penalties." *Id.* at 1526. Thus, a large punitive damage award cannot be justified by analogizing the defendant's conduct to a crime. *Id.* at 1520, 1526. Nor can a punitive damage case be used as a platform to vindicate the rights of third parties not before the court; rather, the punitive damage award must, as a matter of due process, be closely tied to and proportionate to the defendant's conduct toward the plaintiffs and the resulting damages and harm to the plaintiffs. *Id.* at 1523.

The *State Farm* Court also made clear that, from a constitutional perspective, the defendant's wealth bears no relationship to the reasonableness and proportionality of a punitive damage award. Therefore, although wealth is a traditional state-law criterion for calculating punitive damages, it does not provide "fair notice" that a huge penalty will be imposed for particular conduct. *Id.* at 1525. The Court further held that it is improper to punish a company based on its out-of-state business practices, even those that are allegedly "unlawful." *Id.* at 1522-23. The Court announced that a "jury must be instructed" regarding the territorial limits on the jury's power, *id.* at 1523, even though State Farm had not requested such an instruction at trial.

More broadly, the *State Farm* Court decreed a mandate for "[e]xacting appellate review" that takes into account the lack of adequate state-law standards and procedural protections. *Id.* at

1520-21. "The principles set forth in *Gore* must be implemented with care, to ensure both reasonableness and proportionality." *Id.* at 1525-26. These due process restrictions, the Court explained, were necessary because of the dangers of vague and uncertain punitive damages procedures and standards, the use of the defendant's wealth and other inflammatory and tangential evidence to inflate the fines, and the resulting risk of juror bias. *Id.* at 1520-21.

As discussed below, *State Farm* requires that the $290 million punitive damage award be eliminated or reduced to no more than the amount of the compensatory award assessed against Ford—$4.6 million—or that a new trial be granted. Alternatively, this Court should remand this case and order the trial judge to conduct review under the new *State Farm* standards, and to make specific factual findings concerning the due process "reprehensibility" guidepost.

RESPONSES TO THE COURT'S QUESTIONS

1. Specify each particular portion of the original opinion that must be modified in light of *State Farm* and discuss the manner in which that case changes the analysis. To the extent the original opinion relies on an analysis or application of *Gore* in connection with a particular point, the parties shall assume the original analysis or application is correct and shall address only the manner, if any, in which *State Farm* changes or refocuses the *Gore* analysis.

State Farm requires modification of the following portions of the original opinion.[1]

a. The Original Opinion's Standard Of Review Must Be Modified.

While this Court, like the Utah Supreme Court in *State Farm*, noted that some form of *de novo* review applies, 99 Cal. App. 4th at 1149-50, its approach cannot be squared with *State*

1 Pursuant to this Court's instruction, Ford "shall assume the original analysis or application [under *Gore*] is correct and shall address only the manner, if any, in which *State Farm* changes or refocuses the *Gore* analysis," but Ford's petition for certiorari to the Supreme Court specifically argued that this Court incorrectly applied the *Gore* analysis to the record here and Ford hereby preserves those arguments and all other arguments.

2. Discuss, with specific reference to the record on appeal, whether and by what standard "a more modest punishment for [defendant's] reprehensible conduct could have satisfied the State's legitimate objectives," and describe in detail the point at which this court "should have gone no further." (Quotations from *State Farm* at 123 S.Ct. p. 1521.)

State Farm delineates several clear and objective standards that demonstrate the "point at which this court 'should have gone no further.'"[9] First, the substantial compensatory damage award is more than four times the substantial compensatory award in *State Farm* and itself includes a significant punitive component. And liability is premised on conduct that is the subject of reasonable debate and disagreement. Under such circumstances, no additional sanction beyond compensatory damages is necessary "to achieve punishment or deterrence." *State Farm*, 123 S. Ct. at 1521; *see Southwestern Tel. & Tel. Co. v. Danaher*, 238 U.S. 482, 490 (1915) ($6,300 civil penalty violated due process where defendant was "well justified in regarding [its conduct] as reasonable and in acting on that belief" and *even assuming* that defendant "should have known that the Supreme Court of the State . . . might hold the [conduct] unreasonable"). If some amount of additional punishment is to be imposed, then under *State Farm*, a 1:1 ratio between punitive and compensatory damages is the most that the Constitution will permit in this case. *See* 123 S. Ct. at 1526 (remanding for calculation of award but stating: "An application of the *Gore* guideposts to the facts of this case, especially in light of the substantial compensatory damages awarded (a portion of which contained a punitive element),

[9] It was plaintiffs' burden, not Ford's, to establish the proper amount of punitive damages pursuant to the proper legal standards. 99 Cal. App. 4th at 1149 ("The fact that such damages are a windfall is not irrelevant: it was a major consideration in the Supreme Court's decision to place the burden of proof for punitive damages upon the plaintiff.") (citing *Adams v. Murakami*, 54 Cal. 3d 105, 120 (1991).

likely would justify a punitive damages award at or near the amount of compensatory damages.").

Ford argued both in the trial court and in this Court that in light of the large compensatory damage award only a small ratio, at most, was proper in this case. *See, e.g.*, Cross-Respondent's Br. at 36 ("Citing common law and historic statutory penalties, the U.S. Supreme Court has noted approvingly that for over 720 years "double, treble, or quadruple damages" have been viewed as adequate to achieve sufficient punishment in the context of civil cases. Those standards stretching back more than half a millennium serve as a benchmark for the limits set by due process in punitive damages cases."); *id.* at 36-37 (the "Supreme Court indicated that an award of punitive damages that was more than four times the compensatory damages was constitutionally 'close to the line'"); *id.* at 37 ("Justice Brown, in a concurring opinion joined by Justice Chin, has explained that 'punitive damages should rarely exceed compensatory damages by more than a factor of three, and then only in the most egregious circumstances clearly evident in the record'"; this "is an uppermost limit, and most punitive damage awards should fall well below that limit") (quoting *Lane v. Hughes Aircraft Co.*, 22 Cal. 4th 405, 423 (2000) (Brown, J. concurring); *see also* Ford's Opening Br. at 44-45; Supp. CT 31-33. Ford also argued that "'where the jury imposes a large compensatory damage award, that award may, in and of itself, provide a fully sufficient deterrent.' *See Mirkin v. Wasserman*, 5 Cal. 4th 1082, 1106 (1993) (actual damages can fulfill deterrent functions); *Lane*, 22 Cal. 4th at 424-25 (Brown, J., concurring) (same)." Cross-Respondent's Br. at 39.

Second, the comparable penalty factor also provides a clear standard that indicates that the punitive damage award should not exceed the compensatory damage award. As Ford previously argued in this Court, the $290 million punishment is *290,000 times greater* than the statutory fine that could have been imposed as a result of the manufacture of the Romos' individual vehicle, and *362 times greater* than the $800,000 maximum statutory fine that could have been imposed on Ford as a result of *all vehicles* it sold throughout the nation with the related alleged defect. *See* 49 U.S.C. § 30165(a) (1974 version) (establishing $1,000 penalty per vehicle, with $800,000 cap). Ford's Opening Br. at 45-46; Supp. CT 29-30. This standard suggests that an award in the $1 million to $4.6 million range would permit the State to achieve its legitimate objectives and that the Court should go no further than that amount.

Third, in analyzing the excessiveness of a punitive damage award against a corporation, the relevant financial information, if any, is the monetary "gain," within the State, attributable to the defendant's specific wrongful conduct. Scholars and courts have recognized that this figure, unlike overall wealth, is rationally related to the societal objective of deterrence where the defendant is a corporation. *See, e.g.*, 2 American Law Institute, *Enterprise Responsibility for Personal Injury: Reporter's Study* 254-55 (1991) ("In determining the size of the award that is sufficient for [deterrence], what is relevant is not the defendant's overall wealth, but rather profit it realized from the particular tortious activity in question.").[10]

In *Cooper Industries*, for example, the Supreme Court expressly recognized that a punitive damages award must be tethered very specifically to the profits generated by the misconduct at issue, not the defendant's entire profits on the sale of a product. In that case, the

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[10] *State Farm* indicates, however, that the Due Process Clause prohibits a State from permitting multiple plaintiffs within the State to each recover all of the defendant's statewide gain from the wrongful conduct. 123 S. Ct. at 1523.

wrongful conduct was using a photograph of a competitor's product to market the defendant's similar product. The district court, in affirming a $4.5 million punitive award, might have relied upon the plaintiffs' calculation that the defendant anticipated "gross profits of approximately $3 million" from its sale of its product in the first five years. 532 U.S. at 442. But, as the Supreme Court recognized, that was not the proper analysis, because "it would be unrealistic to assume that all of [the defendant's] sales . . . would have been attributable to its misconduct." *Id.* In other words, the defendant's "wrongdoing surely could not be treated as the principal cause of [the defendant's] entire sales volume for a 5-year period." *Id.*

Here, the original opinion relied on Ford's *total* profits on sales of 1978-1979 Broncos, and reinstated a fine that deprives Ford of nearly triple that amount. 99 Cal. App. 4th at 1149. But there is no evidence that Ford's allegedly defective roof design was the principal cause of its entire sales volume of the 1978 and 1979 Broncos, and use of that total profit figure creates problems of extraterritoriality and duplicative punishment. The record reflects other information, however, that is more useful in calibrating the award. Specifically, plaintiffs' own evidence, at best, reflects that Ford's total "gain" from choosing the design it did over the alternative preferred (in hindsight) by plaintiffs' experts amounts to less than $1.8 million nationwide, and far less in California. *See* Exh. 133.10 (Ford sold 72,700 1978 Broncos and 75,800 1979 Broncos); RT 9532 (cost of design change plaintiffs advocated is $10 to $12 per unit). This measure further confirms that a punitive damage award that exceeds a range of $1 million to $4.6 million would be grossly excessive and that an award within this range would be sufficient to achieve the State's legitimate objectives.

3. In this products liability context, in which the jury was presented with design and development evidence common to a mass-produced vehicle but was not presented with

PROOF OF SERVICE

I, the undersigned, declare:

1. I am employed in the County of Suffolk, State of Massachusetts. I am over the age of eighteen years and am not a party to this action. My business address is 45 Broad Street, 2nd Floor, Boston, Massachusetts, 02109.

2. On December 18, 2004, I served the documents named below:

APPLICATION TO FILE BRIEF AS *AMICUS CURIAE;* BRIEF OF KEITH N. HYLTON AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS (corrected)

by placing a true copy thereof in a sealed envelope with postage thereon fully prepaid, addressed as follows:

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NOTARIZED BY:

____
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My Commission Expires: June 30, 2011