Punitive Damages: An Economic Analysis

Chapter 13
CHAPTER 13

PUNITIVE DAMAGES: AN ECONOMIC ANALYSIS*

A. Mitchell Polinsky, PhD
Steven Shavell, PhD**

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**A. Mitchell Polinsky is the Josephine Scott Lister Professor of Law and Economics, Harvard Law School. Steven Shavell is Professor of Law and Economics, Harvard Law School. Research for this Article was funded by the National Institute of Justice and the National Institute of Mental Health. Research for the Article was funded by the National Institute of Justice and the National Institute of Mental Health.

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The imposition of punitive damages is one of the more controversial features of the American legal system. Trial and appellate courts have struggled for many years to develop coherent principles for addressing the questions of when punitive damages should be awarded, and at what level. In this Article, Professors Polinsky and Shaw discuss economic reasoning to provide a relatively simple set of principles for assessing these questions, given the goals of deterrence and punishment. With respect to the deterrence objective, on which their Article focuses, they argue that punitive damages ordinarily should be awarded if, and only if, an injurer has a significant chance of escaping liability for the harm he caused. When this condition holds, punitive damages are needed to offset the deterrence-dissolving effect of the chance of escaping liability. They maintain as well, a deterrence rationale for punitive damages that does not rest on the possibility of escape from liability—that punitive damages may be needed to deter individuals of the socially illicit genre that they obtain from malevolent acts. Professors Polinsky and Shaw also discuss the tension between the implications of the deterrence objective and recent punitive damages law, including the law's emphasis on the reprehensibility of a defendant's conduct and on a defendant's wealth. With respect to the punishment objective, Professors Polinsky and Shaw stress that the imposition of punitive damages on corporations may fail to serve its intended purpose (although the imposition of punitive damages on individual defendants accomplishes punishment in a straightforward manner). Punitive damages against corporations may be ineffective primarily because the payment of punitive damages by corporations does not lead to greater punishment of culpable employees, but instead penalizes the corporation's shareholders and customers.

13.3 INTRODUCTION. One of the more controversial features of the American legal system is the imposition of punitive damages. Courts have struggled for years to develop a rational set of principles for the imposition of punitive damages, legislative bodies have passed or considered a variety of statutes to remedy perceived problems with punitive damages, academic commentators have debated the theory behind, and significance of, punitive damages, and the press has expressed strongly divergent opinions about the merits of punitive damages.

Our goal in this Article is to develop a coherent and relatively simple set of principles for determining when punitive damages should be awarded and, in circumstances in which they are appropriate, what their level should be. We separately consider two social objectives: deterrence and punishment. Our methodology is economic in the sense that we organize our inquiry around an examination of how rational parties will respond to the threat of punitive damages, and whether their response will promote, or fail to promote, social welfare.

The analysis of the deterrence objective comprises the first and major part of the Article. Our conclusions in this part flow from the basic principle that, to achieve appropriate deterrence, injurers should be made to pay for the harm that their conduct generates, not less, not more. If injurers pay less than for the harm they cause, underdeterrence may result—that is, precautions may be inadequate, product prices may be too low, and risk-producing activities may be excessive. Conversely, if injurers are made to pay more than for the harm they cause, wasteful precautions may be taken, product prices may be inappropriately high, and risky but socially beneficial activities may be unduly curtailed.

It follows from these observations that a crucial question for consideration is whether injurers sometimes escape liability for harms for which they are responsible. If they do, the level of liability imposed on them when they are found liable needs to exceed compensatory damages so that, on average, they will pay for the harm that they cause. This excess liability can be labeled "punitive damages," and failure to impose it would result in inadequate deterrence. In summary, punitive damages ordinarily should be awarded if, and only if, an injurer has a chance of escaping liability for the harm he causes.

This principle often will have transparent implications for the circumstances in which punitive damages should be awarded in practice. Consider a company that is responsible for trucking toxic waste to a dump site where it will be charged disposal fees. To reduce its fees, suppose the company allows some of the waste to leak onto the highway because it knows that the leak is unlikely to be noticed and traced to its source. Under our analysis, punitive damages obviously would be called for because of the significant chance that the company will escape liability for the harm it caused. Alternatively, suppose the gross negligence of the firm that is responsible for treating the waste at the dump site leads to a substantial and highly visible spill from the firm's waste storage tanks. Punitive damages would not be appropriate because the firm is unlikely to escape detection and liability for this harm.

When an injurer has a chance of escaping liability, the proper level of total damages to impose on him, if he is found liable, is the harm caused multiplied by the reciprocal of the probability of being found liable. Thus, for example, if the harm is $100,000 and there is a 25 percent chance that the injurer will be found liable for the harm for which he is legally responsible, the harm should be multiplied by 1/0.25, or 4, so total damages should be $400,000. Because the injurer will pay this amount every fourth time he generates harm, his average payment will be $100,000 (= $400,000/4). Thus, on average, the injurer will pay for the harm he causes, and appropriate deterrence will result. Once the proper level of total damages is calculated in this way, punitive damages can be determined by subtracting compensatory damages from the total. In the example, because compensatory damages would equal the harm of $100,000, punitive damages would equal $300,000 (= $400,000 - $100,000).

If punitive damages are needed according to this theory, we believe that courts and juries often will be able to obtain enough information about the likelihood of escaping liability to apply the theory reasonably well. We will discuss how our analysis relates to several leading punitive damages cases, and we will provide model jury instructions that can be used to aid juries in applying the principles that we develop.

We also will relate our analysis of the deterrence rationale for punitive damages to the criteria commonly applied by courts in imposing such damages. Importantly, we will explain that the reprehensibility of a corporate defendant's conduct generally should not be a factor in deciding whether, and to what extent, to impose punitive damages for purposes of promoting deterrence (although the reprehensibility of the conduct of a person who is a defendant may be relevant to punitive damages and deterrence). In addition, we will argue that the wealth of a corporate defendant presumptively should not be taken into account in determining the level of punitive damages (although again the conclusion may be different in the case of a person who is a defendant). We also will consider other aspects of punitive damages policy from the perspective of deterrence, including the appropriateness of
13.2. DETERMINATION: THE BASIC THEORY

In this Part, we summarize the basic principles of the economic theory of deterrence and explain why we believe they apply for use of punitive damages. By deterrence, we mean what is often called general deterrence, namely, the effect that the prospect of having to pay damages will have on the behavior of similarly situated parties in the future (in fact on the behavior of the defendant at hand).

We should add that the basic theory that we are about to review is the standard theory of deterrence, on which economically oriented scholars widely agree. As notated, we will usually make the conventional assumption that the benefits that injurers obtain from engaging in the conduct that gives rise to harm are credited in social welfare. Thus, for example, we will assume that the time saved by a speeding driver, or the cost saved by a company that chooses not to purchase certain pollution control equipment, constitutes a social benefit that is to be weighed against the harm from speeding or polluting. We will consider the implications for punitive damages of the alternative assumption—that the benefits from harmful conduct do not count in social welfare—when we examine the reprehensibility criterion in Section III.A.

We first discuss deterrence in a very simple setting in which a party will be sanctioned whenever he causes harm. We then discuss the situation in which parties sometimes escape sanctions for harms for which they are responsible. It is in this latter case, as we indicated above, that damages exceeding harm should be imposed, and punitive damages thus used.

(a) Optimal Damages When the Defendant is Found Liable with Certainty

(b) Optimal Damages When the Defendant Can Sometimes Escape Liability.

The main point that we will develop in this section is that if a defendant can sometimes escape liability for the harm for which he is responsible, the proper magnitude of damages in the harm the defendant has caused, multiplied by a factor reflecting the probability of his escaping liability. As we will explain, use of such a multiplier will make defendants pay an average for harm actually done and thus will lead to socially desirable behavior in terms of precautions and participation in risky activities.

There are several reasons that injurers sometimes escape liability for harms for which they should be liable. First, the victim may have difficulty determining that the harm was the result of some party's act—as opposed to simply being the result of nature, of bad luck. For instance, an individual may develop a form of cancer that could have been caused by exposure to a naturally occurring carcinogen, such as radon gas, but which was in fact caused by exposure to a material carcinogen that was released by the injurer.

Second, even if the victim knows that he was injured by some party's conduct, he may have difficulty proving who caused the harm. The owner of a parked car, for instance, might have been struck by another vehicle, but not be able to identify the other driver. Those living near a parking lot in which the operation is responsible for an unusually high rate of disease in their neighborhood and not be able to establish causation in fact. Third, even if the victim knows both that he was wrongfully injured and who inflicted the injury, he might not sue the injurer. A person will tend not to bring a suit if the legal cost and the value of the time and effort he would have to devote to the suit exceed the expected reward. The decision to forgo suit will often occur when the harm the victim has suffered is relatively small or the likelihood of establishing causation is low. (Additionally, a victim might not sue if he has a dispute for the legal process.) For one or more of the above reasons, injurers will sometimes be able to escape liability for harms for which they should be held responsible. The consequences of this possibility are clear: if damages merely equal harm, injurers incentives to take precautions...
PUNITIVE DAMAGES: AN ECONOMIC ANALYSIS

Punitive damages are levied on a firm. Indeed, they usually can be expected to be a nontrivial fraction of the burden of punitive damages. Given that shareholders are punished by punitive damages, the question whether they are blameworthy must be considered. If a shareholder owns a significant fraction of a firm's stock, participated in the firm's decisions, and acted egregiously, his position would be much like that of a blameworthy employee with decision-making power: each would be culpable, if a shareholder owns a nontrivial fraction of the stock of the firm and was a punitive insurer with no direct involvement in the firm's decision-making processes, his degree of blameworthiness would be small, if not nonexistent.

A firm's customers also will be made worse off as a result of the imposition of punitive damages on it. For example, if 10 of the firm's products cost $100,000 each, the amount of punitive damages will be $100,000. If the products are priced between $100,000 and $200,000, the price will be $100,000. If the products are priced between $200,000 and $300,000, the price will be $300,000. In general, if the firm's customers pay higher prices as a result of the imposition of punitive damages on firms, some customers will be penalized.

We can summarize our discussion of the punishment of firms as follows. The view that a firm should be punished per se—without reference to the punishment of individuals within it—is a plausible view, but one that we find problematic. Another view is that a firm's punishment goal is promoted only by punishing blameworthy individuals within firms. We have explained, however, that imposing punitive damages on a firm often will not result in the punishment (or at least any additional punishment) of blameworthy employees, so the use of such damages might not advance the punishment goal very much. Moreover, imposing punitive damages frequently will penalize shareholders and customers, parties who are not likely to be considered blameworthy. This adverse consequence of punitive damages must be weighted against the beneficial effects of such damages in furthering the punishment goal.

Having addressed punitive damages and punishment in general terms, we now briefly consider how the reprehensibility of the defendant's conduct and the wealth of the defendant should influence punitive damages with respect to the punishment objective. Regarding reprehensibility, we merely observe that the punitive objective will, by definition, be met of sanctions imposed on those who have acted reprehensibly. In terms of the preceding observation, pessimistic conduct is intrinsic to satisfying the punishment objective, and the law's focus on reprehensibility obviously makes sense given this observation. In the case of firms, however, the connection between reprehensibility and punishment may be attenuated for reasons noted above—the imposition of punitive damages on a firm may not result in the punishment of individuals within the firm who acted reprehensibly.

Regarding defendants' wealth and the appropriate level of damages from the perspective of punishment, consider first the situation when defendants are individuals. In this case, the common belief of a belief that punitive damages should be higher for wealthier defendants can be justified. The punishment goal is furthered if a proper

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13.8 PUNITIVE DAMAGES: AN ECONOMIC ANALYSIS

13.9 DETERMINATION: THE BASIC THEORY

13.10 Consistency of Punitve Damages Laws with the Basic Theory of Deterrence. We now relate our analyses to certain important aspects of legal doctrine concerning punitive damages. As noted above, one of the two main purposes of punitive damages is deterrence. The courts state, for example, that punitive damages are intended "to deter the wrongdoer and others from committing similar wrongs in the future." Given that achieving proper deterrence is an arrowed goal of courts, if it follows from the logic of deterrence theory that an increase in the punitive damages to be paid in any given case would increase the deterrence to be expected from those damages, one would expect that the courts would increase punitive damages when faced with an increase in the likelihood of future similar misconduct. Courts do take account of the magnitude of harm in assessing the proper level of punitive damages, but they do not use it as the sole or even central basis for the proper amount of punitive damages. Rather, courts take harm into account in a vague way, through application of the general principle that punitive damages should bear a "reasonable relationship" to compensatory damages. They do not explain what this relationship should be, and even when they identify a ratio of punitive damages to compensatory damages that they find excessive, they do not supply a basis for selecting the particular ratio identified. As the reader knows, our analysis implies a simple and precise relationship between punitive damages and harm: Punitive damages should equal the harm multiplied by what we refer to as the punitive damages multiplier. If punitive damages are to achieve appropriate deterrence, the "reasonable relationship" criterion must be interpreted in this specific way: Any other relationship between punitive damages and compensatory damages will lead to either inadequate or excessive deterrence.

Courts also do not pay systematic attention to the probability of escaping liability, either through this probability is the central element in determining the appropriate damages multiplier for the purpose of achieving proper deterrence. Courts sometimes allude to the possibility of escaping liability, but they rarely recognize its importance with respect to deterrence. For example, in determining the level of punitive damages, courts occasionally consider whether the defendant has attempted to conceal his conduct. Courts usually do so, however, in assessing the reprehensibility of the defendant's conduct; the presence or absence of evidence of such effort to avoid punishment should influence the calculation of the defendant's chance of escaping liability. Similarly, courts sometimes indicate an awareness that it is "unfair" to encourage plaintiffs to bring wrongdoers to trial. This factor is obviously related to the insurer's chance of escaping liability because, whatever an insurer may do to avoid liability, the insured party is not, and the insurer is often not, interested in stopping the wrongdoer. Thus, courts occasionally consider whether that bear on the probability that a defendant would escape liability. But they rarely explain in a direct and systematic way how this probability should be used to determine the proper level of damages for deterrence purposes.

However, courts generally pay insufficient attention to the potential problem of overdeterrence. Judicial opinions mention this issue only infrequently, and none of the lists of factors used by courts in determining punitive damages includes overde-
terence as a consideration. As we have emphasized, however, damages that exceed the level indicated by the formula may result in wasteful preclusions and the withdrawal of socially valuable products and services from the marketplace.

Not only do courts usually fail to consider correctly the factors that are relevant to proper deterrence, but they also err in considering a variety of factors that generally are not relevant to deterrence, including the reprehensibility of defendants' conduct and defendants' wealth. We will discuss at some length why these factors ordinarily should not be taken into account if the goal is to promote proper deterrence, but the point we want to make here is that consideration of these factors in awarding punitive damages reinforces such obvious biases in the level given by our formula.

Some aspects of legislation governing punitive damages are also inconsistent with deterrence theory. Notably, many states have imposed caps of various kinds on punitive damages awards. An absolute cap (as in Virginia), a maximum ratio of punitive damages to compensatory damages (for example, three times compensatory damages in Florida), or both. Such caps cannot be justified in terms of surrounding public policy; they might preclude the proper award of punitive damages. For example, suppose that the harm caused by an insurer is $100,000 and that he has only one-in-a-million chance of being caught. The optimal level of punitive damages is then $300,000, or nine times compensatory damages (the $100,000 is the optimal level of total damages, including compensatory damages, is ten times the harm). This absolute amount and this ratio would exceed punitive damages caps in the majority of states that have them, yet under the circumstances, their deterrent effect is zero. And that is not the relationship to compensatory damages, is needed for proper deterrence.

Our criticism of caps is not meant to deny that, if punitive awards of punitive damages are thought to be systematically excessive, caps might beneficially constrain such awards. But in the absence of systematic bias, caps are inappropriate.

13.11 Punitive Damages Cases. We briefly consider here three prominent punitive damages cases in the light of the deterrence principles discussed above. Our primary objective is to state what deterrence theory suggests about the appropriate level of punitive damages in these cases, given their facts and circumstances, not to analyze the legal doctrines that were applied or developed in them.

1. BMW of North America, Inc. v. Gore. In this case, the plaintiff, Mr. Gore, Jr., purchased an alleged BMW 750Li that he believed was a BMW 750Li. Subsequently learned that the defendant, BMW of North America, had repainted part of the car because it had been involved in a collision. Although BMW had not disclosed this fact. The jury awarded Gore compensatory damages of $3,000 for diminution in the value of his car. The Alabama Supreme Court reduced the punitive award to $2 million, but the U.S. Supreme Court held even this award to be grossly excessive. On remand, BMW offered to pay $50,000 and the judgment was vacated and remanded with instructions that it be set aside if no payment is made within 30 days after the order of remand. The award of $50,000.

Consider the probability that BMW would escape liability for having sold a repainted car as new. The determination of this probability involves two factors. First, the possibility that BMW would escape liability for having sold a repainted car as new. and the other is the likelihood that a purchaser who discovered that his car had been sold without his knowledge would have difficulty identifying the actual owner of the car. Second, even if culpable individuals in a firm can be identified and punished by the firm, imposing punitive damages on firms often will have little or no deterrent effect on the individual employees engaged in the act. For example, an employee responsible for checking a safety valve on a tank storing dangerous chemicals that subsequently explodes because of a defective valve may claim that he performed the inspection even if he did not, and may falsely assert in his record book witnessing to the inspection. A manager whose judgment is impaired by alcohol and who gives oral instructions to a subordinate that lead to an accident may deny ever having told the subordinate to do what the subordinate did.

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The preceding discussion should make clear that there are no existent employees in the firm. But in situations there situations there may be some. If a significant delay occurs between misconduct and the manifestation of harm and litigation (as was the case, for example, in the Gulf Breeze case), the delay between misconduct and the filing of a lawsuit by the victim is likely to be long, and the victim is likely to be an artificial legal construct. The notion that individuals would want to punish firms per se is to seize us at en entirely different sort of individual who would want to punish firms in order to punish innocent individuals for causing harm (such as trees that fall on people).

Notwithstanding these reservations, it is possible that individuals do want to punish firms and punish them as entities, and the reader can make up his or her mind about the importance of this way of defining the punishment objective. To the extent that it is important, the imposition of punitive damages on a business firm directly promotes the punitive objective, and it does when the defendant is a culpable individual.

Now consider the alternative reason for punishing firms—to punish blameworthy individuals within them. Supporting this that this is the purpose of punishment, we turn to our second point about the extent to which the imposition of punitive damages on firms will actually result in the punishment of blameworthy employees. Because firms clearly have an interest in discouraging culpable conduct by their employees that could give rise to punitive damages, it is likely that firms would seek to control such conduct through the use of internal sanctions, such as demotions or dismissals. If the firms are successful in these efforts, then the imposition of punitive damages on firms will lead to less punishment of blameworthy employees than might at first be supposed.

Foes, culpable employees may not be punished by firms because the firms may have difficulty identifying them. Such individuals may be able to obfuscate their role in decision making or conceal their behavior in a variety of ways. For example, an employee responsible for checking a safety valve on a tank storing dangerous chemicals that subsequently explodes because of a defective valve may claim that he performed the inspection even if he did not, and may falsely assert in his record book witnessing to the inspection. A manager whose judgment is impaired by alcohol and who gives oral instructions to a subordinate that lead to an accident may deny ever having told the subordinate to do what the subordinate did.

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with a lower level of damages than if they are risk neutral. Further, the more risk averse an individual is, the lower the optimal level of damages. Equivalently, punitive damages should be higher for wealthier individuals. However, even for the wealthiest indi-
viduals, punitive damages should not exceed the level determined by our formula. The presence of these individuals in the calculation of punitive damages is more sensitive to the method used. We therefore estimate, to situations in which insurance against punitive damages is not available.

The key circumstance in which the level of an individual's wealth may be rel-
evant to the calculation of punitive damages is when the individual's gain from committing the harmful act is socially ill. We explain above that punitive damages may be needed to offer ill individuals. To accomplish this, punitive dam-
ages generally will have to rise with the wealth of an individual, because the value of money tends to decline with wealth. For example, to offer the utility of a rich per-
son would obtain from shredding someone he disliked, we might need to include $100,000 in punitive damages, whereas to deter a person with only modest assets, $1,000 in punitive damages might suffice.

We believe that the following point underlines the common intuition that puni-
tive damages should be linked to wealth. However, this point has a very limited scope, applying only to individuals whose benefit from causing harm is socially il-
licit, which is a provision that has significant conduct whose goal is to cause harm (e.g., as in the point of the previous paragraph does not apply to individuals. Over-
more, the point does not apply to firms because firms are motivated by profits, rather than by a desire to cause harm.

D) Potential harm

E) Litigation Costs

F) Related Private Litigation

G) Related Public Penalties

H) Tax Treatment of Punitive Damages

I) Insurability of Punitive Damages

J) Third Party versus Consumer Victims. Our analysis of punitive damages has as-
sumed implicitly that the parties harmed by the injury are "third parties"—that is,
been repainted would sue. Gore drove the car for nine months without detecting any abnormalities in the paint on his car. It was only after he took his car to a de-
tailed shop that he learned it had been repainted. It seems reasonable to sup-
pose, therefore, that many purchasers of repainted cars sold as new would never discover that their cars had been repainted.

Whether an owner who did discover that his car had been repainted would sue depends on the costs to him of suit (time and out-of-pocket expenses) and the amount that he could collect. If the harm is as low as the law in cases in Gore, $4,000, it would seem that many owners—or the lawyers they might hire on a contingency fee—would not have a sufficient financial incentive to sue. There may have been a significant chance, therefore, that BMW would have escaped liability if damages were merely compensatory, because of victims' inadequate motive to sue.

In Gore, information that would be useful in estimating the probability of BMW's being found liable was provided. Among the facts established at trial were that 14 new BMW cars in Alabama had been repainted, including Gore's, and one prior suit had been brought against BMW by an owner of one of those cars. If none of the other Alabama victims of repainting were to sue, the probability of detection and liability might be thought to be in 2 to 14, in which case the total damages should be much more than the $4,000 harm, to $28,000. Of that total, $4,000 would represent compensatory damages, and $24,000 would represent punitive damages. By this reasoning, the $2 million punitive award initially approved by the Alabama Supreme Court was grossly excessive, and the reduced award of $50,000 was much more reasonable.

3. J. E. L. Malouf

4. In the Exxon Valdez—In the present case, the defendant's stevedore, the Exxon Corp.

5. Some potential cases involving oil spills—such as the intentional dumping of small amounts of waste oil that is unlikely to be detected or traced to the spill—some punitive damages would be appropriate.

13.3.4.3. Compensation: The BP oil spill was an environmental disaster. The company was found liable and was ordered to pay significant damages. The damages were estimated to be $20 billion. The company appealed the decision, arguing that the damages were excessive. The court upheld the decision, stating that the company's actions were reckless and showed a complete disregard for environmental regulations. The court also noted that the company had a history of safety violations and had failed to implement adequate safety measures. The court ordered the company to pay the full amount of the damages.

13.3.5. Compensation: The BP oil spill was a significant environmental disaster. The company was found liable and was ordered to pay significant damages. The damages were estimated to be $20 billion. The company appealed the decision, arguing that the damages were excessive. The court upheld the decision, stating that the company's actions were reckless and showed a complete disregard for environmental regulations. The court also noted that the company had a history of safety violations and had failed to implement adequate safety measures. The court ordered the company to pay the full amount of the damages.
Should reprehensible acts per se affect the imposition of punitive damages, given the goal of deterrence? In this section, we explain that it generally should not. However, an important exception to this conclusion occurs when injuries' gais do not count in social welfare, which we believe is often the case when injuries act mali- ciiously. This exception will suggest only possibly applies to individual defen-dants, and not corporate defendants.

As discussed above, under standard assumptions, the imposition of damages equal to injuriousness to the injured party's welfare, the focus on determining punitive damage- es should be on the injurer's chance of escaping liability.

Moreover, punitive damages depend on reprehensibility will distort deterrence in two ways. First, excessive damages may be imposed when reprehensible conduct occurs in situations in which an injurer is virtually certain to be found liable. Sup-pose a surgeon, through extreme negligence, fails to remove a surgical tool from the body of a patient and that this omission leads to great pain and suffer- ing. If a high probability exists that the surgeon will be sued and found liable be- cause of the magnitude of the patient's harm and the unmistakable error of the surgeon, extrapunitive damages are neither necessary nor appropriate. Sim- ilarly, consider a newspaper reporter who, out of reckless disregard for the truth, conceals one firm's safe product with another firm's dangerous product, sub- stantially damaging its reputation and business reputation and profitability. Here, too, we might expect that suit and a finding of liability would be very likely, in which case extrapunitive damages in many cases would be excessive. Thus, even for a conduct that is reprehensible, if little chance of escaping liability exists, compensatory damages alone will achieve appropriate deterrence, and punitive damages will result in overdeterrence.

One might wonder, though, how over-deterrence of reprehensible acts can occur, because society evidently has an interest in deterring such acts completely. To illus- trate that overdeterrence still can occur, consider the example of the surgeon. If the magnitude of damages is very high, we can imagine that, to reduce the chance of learning a surgical tool in a patient, he might have another medical professional to monitor his actions or he might dramatically increase the time he spends on each operation. Even if such responses would succeed in preventing the recurrence of this event, they may be at too great a cost, especially if the likelihood of leaving a surgical tool in a patient is not very high. In other words, it might not be socially worthwhile for the surgeon to take the measures needed to eliminate the possibility of having an episode like this in the future. The likelihood of suffering in excess of that given by the damages formula would improperly encourage him to take these measures.

The problem of overdeterrence also can arise in connection with the reprehensible acts of corporations. Employees, as a group, cannot be considered perfectly by a corporation, even though a corporation can improve its ability to prevent acts of reprehensible conduct by acting on them before they are committed and monitoring their conduct afterwards. If damages exceed the level determined by the damages formula, however, the corporations may be led to spend excessively on screening and monitoring efforts in order to forestall reprehen-sible behavior. This might be true of a newspaper, for instance, if it had punitive damages for false reporting because of extreme negligence, as in our example of the reporter who confused two firms' products. In response, the newspaper might assign two reporters to every story even if doing so is not socially worth- while given the cost of this process and the reduction in risk of reprehensible behavior that would be accomplished.

Not only can attention to reprehensibility result in the imposition of punitive damages that are excessive, but such attention may also lead to the converse prob- lem: the failure to employ punitive damages when they are needed for proper deterrence. This problem will occur if an injurer is virtually certain to be found liable, though not reprehensible, and he is likely to escape liability. Suppose that a toxic waste dump is situated on a farm that lies just off a waste spilling onto a highway at night, when no one is likely to notice it. The driver of the truck that contains the waste has performed a proper inspection, and the compa-nymay have reasonable maintenance policies. Although the leak is not caused by anyone's reprehensible behavior, substantial extrapunitive damages may be appropriate, because the damage is likely to result in the certainty that the injurer would not be identified and held responsible for the harm.

It is true that some courts have commented on the difficulty of determining whether a defendant's conduct in considering punitive damages cannot be justified on grounds of deterrence. A minor qualification of this point is that, as we observed earlier, courts treat attempts by the defendant to conceal wrongdoing as a factor that enhances reprehensibility, and thus the level of punitive damages. This response to the defendant's conduct in order to reduce business reputation and profitability. Here, too, we might expect that suit and a finding of liability would be very likely, in which case extrapunitive damages in many cases would be excessive. Thus, even for a conduct that is reprehensible, if little chance of escaping liability exists, compensatory damages alone will achieve appropriate deterrence, and punitive damages will result in overdeterrence.

Finally, although the reprehensibility of a defendant's conduct should not be used per se as a basis for imposing punitive damages to achieve proper deterrence, such conduct may sometimes provide useful information about the defendant's chance of escaping liability. Everything else being equal, the lower the chance of being found liable, the lower will be the amount's level of care. Therefore, a low care level may suggest a low probability of liability and thus a higher level of punitive damages according to our formula.

Let us now turn to the important exception to our general conclusion about reprehen-sible conduct's importance in determining punitive damages. The costs of identifying reprehensible conduct are in the marketplace despite the view that identifying such conduct is not necessary or appropriate. In general, identifying reprehensible conduct is not necessary or appropriate.

An additional point reinforces the conclusion that corporate wealth should not influence punitive damages: improving punitive damages on the basis of corporate wealth effectively imposes a tax on corporations that engage in engag- ing and growth development. This effect can be important in industries in which capital intensity is high. Therefore, firms that are involved in engag- ing and growth development are more likely to be in excess of harm. In other words, punitive damages might be socially desirable even when it is not clear that the conduct is reprehensible.

When are the benefits from harmful conduct likely to be considered socially il-li- litarit? We suggest that benefits tend to be treated as illicit if the injurer's utility derives from causing harm itself, as when a person punishes another out of spite or magnitude given by our formula when corporations are relatively wealthy; these corporations will be less likely to take precautions, will be less likely to take the precautions that are socially desirable, and will choose to engage in activities that are socially undesirable.

Our discussion of the inappropriateness of taking corporate wealth into account presumes that all corporations—large and small—are large. Since firms have different degrees of wealth, it is likely to occur in the normal course of business.

Wealth of Defendants. The courts often state that a defendant's financial con- dition is a relevant factor in setting a punitive damages award, with the understand- ing that higher punitive damages may be appropriate for defendants with higher wealth, but some jurisdictions also frequently include the defendant's wealth as a factor that informs may take into account in determining the level of punitive dam- ages. The cursory explanation often is that the wealth of defendants, which will be emphasized the factor that the defendant's wealth is wealth, especially when the defendants are large corporations.

Defendants' financial condition is a relevant factor in determining punitive damages. We believe that the defendant's financial condition should be considered in the defendant's design such that the defendant's wealth cannot be considered in the defendant's financial condition or even in determining punitive damages.

We believe that, if damages equal harm multiplied by a factor reflecting the chance of escaping liability, defendants, including corporations, would be re- duced to take optimal precautions and to participate in risky activities to the proper extent. It follows from this basic conclusion that, if damages are raised above the