

SUBJECT: Limiting exemplary (punitive) damages

COMMITTEE: State Affairs — committee substitute recommended

VOTE: 14 ayes — Seidlits, Alvarado, Black, Bosse, Carter, Craddick, Danburg, Hilbert, Hochberg, B. Hunter, D. Jones, McCall, Ramsay, Wolens

1 nay — S. Turner

SENATE VOTE: On final passage, February 15 — 30-0

WITNESSES: (*On Senate-passed version*)

For — Karen M. Neely, Independent Bankers Association of Texas; John H. Marks, Jr., Texas Association of Defense Counsel; Mike Gallagher and George Barry, Texas Trial Lawyers Association; Robert Howden, National Federation of Independent Business of Texas; Larry York and Claudia Wilson Frost, Texans for Lawsuit Reform; Nub Donaldson and Shannon Ratliff, Texas Civil Justice League.

Against — Susan S. Pitman, Chemical Connection; T. Gail Armstrong; Hannah Riddering, Texas Nation Organization for Women; Diane Papageorgiou; Tim Curtis, Texas Citizen Action; Lin Ehrlich; Christine Heinrich; Betty Jean Craig; Judith G. Shaw; Richard Levy, Texas AFL/CIO; Reggie James, Consumer's Union; Tom Smith, Public Citizen; Elizabeth M.T. O'Nan, Chemical Injury Information Network; Daisy Iglesias.

On — Mike Gallagher and Bill Whitehurst, Texas Trial Lawyers Association; Bill Lewis, Mothers Against Drunk Driving

BACKGROUND: Exemplary damages, often referred to as punitive damages, are a way of assessing punishment in a civil suit by awarding damages beyond the actual damages caused by the defendant. Originally intended to be used only in *intentional* torts, punitive damages have come to be used in areas such as products liability, antitrust, and, in some states, including Texas, any case in which the defendant's actions constituted more than simple negligence.

Punitive damages are generally considered to deter defendants and others from committing harmful acts, to punish the defendant and to provide additional compensation for the plaintiff. These purposes are acknowledged in the current punitive damages statute, Chapter 41 of the Civil Practices and Remedies Code.

When a tort is only negligent, punitive damages do not apply, except under special statutes, such as the antitrust laws or the Deceptive Trade Practices Act (DTPA). But if something more than simple negligence is involved, three different levels of culpability subject the defendant to punitive damages: gross negligence, fraud and malice.

- Malice is defined as acting with a specific intent to harm or an actual awareness that there is a reasonable probability that the act will result in serious harm.
- Fraud involves making a misrepresentation, or lying.
- Gross negligence had been defined as anything more than simple negligence. But last year, in *Transportation Insurance Co. v. Moriel*, 879 S.W.2d 10 (Tex. 1994), the Texas Supreme Court said the standard must be greater, involving an unjustifiable risk. The court said to find gross negligence a jury must find that the act or omission of the defendant, when viewed objectively from the standpoint of the actor at the time of its occurrence, involved an extreme degree of risk, and the defendant had an actual subjective awareness of the risk involved, but nevertheless proceeded with conscious indifference to the rights, safety, or welfare of others.

Punitive damage amounts are governed by the level of culpability. If the plaintiff proves that the defendant acted with malice, no limit applies. However, if the plaintiff proves only gross negligence or fraud, the plaintiff is limited to asking for an amount equal to four times the amount of actual damages or \$200,000, whichever is greater.

The burden of proof in cases involving punitive damages is the same as it is for any negligence case: a preponderance of the evidence, meaning anything greater than 50 percent. Other evidentiary standards are: beyond a reasonable doubt — near certainty, the highest standard; and clear and

convincing evidence — an "in-between" standard meaning the degree of proof that will produce in the mind of the trier of fact a firm belief or conviction as to the truth of allegations. (*State v. Addington*, 588 S.W.2d 569 (Tex. 1979)).

For further background information on punitive damages and tort reform see *Tort Reform: Basics of the 1995 Debate*, House Research Organization Session Focus No. 74-10, March 30, 1995.

DIGEST:

CSSB 25 would make various amendments to Civil Practices and Remedies Code Chapter 41, governing punitive damages. The bill would remove from the list of purposes of punitive damages their use as an example to others.

CSSB 25 would raise the level of culpability required to be held liable for punitive damages. Only acting with fraud or malice could subject a defendant to a punitive damage award. However, in cases governed by Art. 16, sec. 26 of the Texas Constitution (which creates a cause of action for wrongful death and defines a punitive damage standard for such actions as gross neglect), gross neglect would be defined as malice.

Replacing a cap of four times the award on gross negligence and fraud, and no cap on malicious acts, CSSB 25, would in most cases, cap damages at two times the award of economic damages, plus an amount equal to any non-economic damages, up to \$750,000, or a total award of \$200,000, whichever was greater. Exemptions from the new limits would be created for felony offenses that require the criminal act be done either intentionally or knowingly. If the requisite state of mind was proven, there would be no cap on punitive damages.

CSSB 25 would also modify the level of proof required in punitive damage cases. A plaintiff proving a case on negligence and actual damages would still be held to the preponderance of the evidence burden. However, in seeking punitive damages, the plaintiff's burden of proof would be by clear and convincing evidence.

The bill also would:

- create a bifurcated trial system to allow the jury to hear and determine evidence relating to a punitive damage award separately from evidence relating to a compensatory award;
- define considerations in making awards,
- set out specific provisions to be given to the jury in their instructions,
- require court of appeals decisions either upholding or overturning punitive damage awards to be written and state clear reasons for the determination; and
- create a list of evidence that may be considered when determining the amount of punitive damages to be awarded. A jury could consider the net worth of the defendant when making an award.

The bill would delineate when harm resulting from the criminal act of another could subject a defendant to liability for punitive damages. The defendant could only be subjected to punitive damages if:

- that defendant committed the criminal act;
- the criminal act was committed by an employee or agent of the defendant and the act was authorized or ratified by the defendant, done within the scope of managerial employment, or committed by an employee whom the defendant acted with malice in employing;
- the criminal act occurred at a location that the defendant maintained where there was a common nuisance that the defendant had made no effort to correct, or
- the criminal act was a result of a landlord's intentional or knowing violation of a statutory duty to take certain security measures (i.e. rekeying locks, etc.).

CSSB 25 would apply to causes of action that accrued after September 1, 1995. A cause of action filed before the effective date would be tried to completion using the standards in place before that date.

**SUPPORTERS  
SAY:**

CSSB 25 would help curb abuses of the Texas tort system, under which filing a lawsuit has become the first action contemplated when a harm is done, not a last resort. Awards of exemplary or punitive damages, which often bear no relationship to the amount of real harm done, are soaring.

Studies performed by the National Center for State Courts, the American Insurance Association and the Texas Public Policy Foundation show Texas tort filings rose over 70 percent from 1981 to 1989 and there were 50 percent more major product liability suits filed in Texas than the national average. In the same period in Harris County the average punitive damage award increased from \$402,559 to \$3,092,958. Punitive damages awards in the last 10 years have increased from an average of \$59,000 to \$1.1 million in Dallas County and from \$279,000 to \$2.1 million in Harris County.

Businesses and professionals must divert considerable portions of their resources to trying to avoid lawsuits, spending money to defend them and paying huge insurance premiums in case they lose. The tort system is unfairly weighted in favor of the plaintiff, which is causing an economic drain. The Texas Public Policy Foundation estimates that Texas loses \$12 billion annually directly from the operation of its civil justice system.

Many business are denied their day in court because of punitive damages. The threat of large punitive damage awards is so great that many prudent business owners agree to settle a case that they would rather take to court. Appeals from punitive damage awards are cited as substantially lowering the total awards, but that is often of little consequence to the business owners who may lose the backing of creditors and bankers before an appeal is decided.

**Clear and convincing evidence.** CSSB 25 would raise the burden of proof required when proving up a case for punitive damages from a preponderance of the evidence to clear and convincing evidence. Punitive damages are quasi-criminal in nature, and in criminal cases the standard is always beyond a reasonable doubt. Setting the standard in a middle ground

between a preponderance and beyond a reasonable doubt would acknowledge the quasi-criminal nature of punitive damage awards and also help to deter frivolous punitive damage filings. Truly meritorious plaintiffs will be able to prove the required elements for punitive damages by clear and convincing evidence.

**Gross negligence.** The use of such an amorphous and relatively low standard as gross negligence for imposing punitive civil sanctions raises serious concerns. While punitive damages might be acceptable in cases of malicious or intentional conduct, which were at issue in two recent cases in which the U.S. Supreme Court upheld state punitive damage awards in the face of due process challenges, it is clearly not true of lesser standards of conduct like gross negligence. Today, only five states other than Texas authorize punitive damages for gross negligence.

**Redefining malice.** A key factor in how the levels of culpability for punitive damages have changed is the redefining of malice. While the actual term gross negligence has been removed from the standards for allowing punitive damages, the spirit of gross negligence, as defined by the Texas Supreme Court in the *Moriel* decision, has been preserved in the new definition of malice. Gross negligence was a relatively ambiguous standard that gave little guidance to juries. Now that the standard is reformulated as an aspect of malice, using the definition of the *Moriel* decision, the conduct that gross negligence was designed to cover would remain subject to punitive damages, while improperly included conduct would be eliminated.

**Gross neglect.** CSSB 25 differs from SB 25 in allowing punitive damages to be recovered under a gross neglect standard in actions under Art. 16, sec. 26 of the Texas Constitution. Art. 16 sec. 26 creates a cause of action for wrongful death against the person who committed a homicide. Rather than waste the resources needed to amend this section of the Constitution to comport with the new punitive damage language under SB 25, CSSB 25 would simply provide that gross neglect will be defined to the jury as gross negligence was defined by the Texas Supreme Court in *Moriel*.

**Economic damages versus non-economic.** A major complaint about the unpredictability of punitive damage awards is that the maximum limit is based on the total of actual damages (economic plus non-economic). Non-

economic damages, sometimes referred to as "soft-damages," are very difficult to quantify and, therefore, nearly impossible to predict. They include such things as pain and suffering, emotional distress, loss of consortium, as well as any other unquantifiable damage award. CSSB 25 would set a limit of \$750,000, not on how much non-economic damages may be awarded as compensation to the plaintiff, but on how much of the award of non-economic damages could be used in determining the limit on punitive damages a jury could award.

**Liability for criminal acts of others.** CSSB 25 contains clear standards for when defendants can be held liable for the criminal acts of third parties that occur on the defendant's property. This section is perhaps one of the most important for ensuring that legitimate businesses are not subjected to punitive damages for not doing anything wrong. Current law subjects many businesses, like laundromats, that operate public facilities in low income areas with minimal supervision to punitive damage awards for criminal acts of others that occur on their property. Business owners that operate facilities like these have been placed in a catch-22 situation by the punitive damage laws. On the one hand, juries have said placing such businesses in high crime, low-income areas is an unjustifiable risk, but on the other hand, those areas are places where such businesses are needed. This bill would create a climate allowing such businesses to continue to operate in low-income areas, and other businesses will be attracted to those areas.

**Criminal acts by defendant.** A person who commits a criminal act that is a third degree felony or higher that requires the actor to either act intentionally or knowingly, would not be subject to punitive damage limits. The committee substitute ensures that punitive damages for actions that are only done "knowingly" (as defined by the Penal Code) are not limited. Also the substitute cleans up the provisions, including theft and other third degree felonies in the same subsection as all other crimes exempted from damage limits.

**Antitrust, DTPA, or Insurance Code.** The punitive damages limits proposed by CSSB 25 would not apply to antitrust, DTPA, or bad-faith insurance actions. Each of these provisions have their own established limits and standards for awarding punitive damages.

**Caps.** The punitive damage limits set both in absolute dollars and as a multiple of actual damage awards represent a good faith effort to try to set some middle ground between allowing the defendant to be punished and creating a windfall for the plaintiff.

**Procedural safeguards.** CSSB 25 would establish a number of procedures and guidelines designed to make suits for punitive damages fair to both sides and allow the jury to get a clear picture of when punitive damages should be awarded. These provisions include creating a bifurcated trial system (allowing the jury to hear and determine evidence relating to a punitive damage award separately from evidence relating to a compensatory award), defining considerations in making award, setting out specific provisions to be given to the jury in their instructions, requiring court of appeals decisions either upholding or overturning punitive damage awards to be written and state clear reasons for the determination, and a list of evidence that may be considered when determining the amount of punitive damages to be awarded.

OPPONENTS  
SAY:

Plaintiffs have always been considered the disadvantaged party in a lawsuit. A plaintiff is considered the injured party and must prove something to the court, while the defendant must merely refute the allegations of the plaintiff. Giving greater strength to the defense, as this bill would, would not favor justice.

Texas actually ranks 46th in the nation for civil filings per capita, and filings by consumers with injury claims amounted to less than 6 percent of new case filings in district and county courts. Statistics cited by tort reform advocates concerning an average increase in the punitive damage awards are misleading. Median award statistics show where the middle of the awards falls. During 1988-90 median punitive damage awards in Harris County were \$110,000, in Dallas, \$53,750 and in Bexar, \$62,813.

Punitive damage awards are on the decline. During the past four years, the percentage of punitive damages claims paid by insurance companies has decreased by 50 percent, while during that same period the number of punitive damage claims filed has also decreased by 39 percent. Only 6.9 percent of all claims dollars paid in 1989 were for punitive damages. In 1992 that number dropped to 5.7 percent.

Many of the sensational punitive damages awards that tort reform advocates tout as showing the abuses of the system would still be the same under CSSB 25. For example, in the *Penzoil v. Texaco* case, the largest award in history, punitive damages were assessed at \$3.5 billion. This award would still stand under CSSB 25 because it was less than the total award of economic damages. Additionally, the median punitive damage awards in the three largest counties would fall below the cap set by CSSB 25.

The cap on punitive damages would benefit only large businesses. Most Texas businesses are small operations that do not have the same resources as the large corporations. When a cap is set on punitive damages, that cap may still represent all of the assets of a small business, but large businesses are helped by having even lower awards. One possible alternative would be to create a sliding scale of punitive damage caps that would take into account the financial status of the defendant and would set the punitive damage cap at a percentage of that wealth. Such a sliding scale would ensure that small businesses are not decimated by a single large punitive award and large businesses would be able to be properly punished for their misdeeds.

**Punitive damages as a deterrent.** Punitive damages serve a valuable purpose as a deterrent. This purpose is most often expressed by the example of a car manufacturer who belatedly discovers a defect in a new line of cars and who might decide that the cost of recalling and refitting the cars would exceed the price of paying for the injuries that the defect might cause. The threat of punitive damages, they say, could shift the balance so it would be more costly not to fix the defect, and lives would be saved. Punitive damage awards help guarantee that a defendant does not profit from harming someone.

Punitive damages can sometimes help to curtail the activities of unsafe operations, not only because huge awards would put them out of business, but more often because they know that one day they will likely end up in court having to pay dearly in a lawsuit for conducting their business in such a fashion. By allowing these operations the protection of a bill like this, more fly-by-night, high-risk businesses will be drawn to Texas, which would actually hurt the Texas economy by lowering consumer confidence in Texas products.

A recent case cited constantly by tort reformers is the McDonald's coffee spill case. In fact, that case shows how the punitive damage system helps to protect consumers. While it may have sounded terrible in a 30-second sound bite to say that a woman was awarded \$2.7 million in punitive damages for being burned by coffee, that amount (which was later reduced to three times the actual damage award) was specifically designed to punish McDonald's for its disregard of consumer safety. The award, representing only two days of coffee sales for McDonald's, was made after the jury found that McDonald's had a specific policy of heating coffee to 185 degrees (40 degrees above the normal temperature for coffee) and had been warned on numerous other occasions that this temperature would severely burn anyone who spilled coffee before it had cooled. This week, a survey of coffee temperature at McDonald's locations found that the temperature of coffee had been lowered between 20 and 40 degrees. Without punitive damages, these safety accomplishments will become even rarer.

Persons on both sides agree that CSSB 25 would promote predictability in determining the final amount of a punitive damage award. Predictability, however, invites unscrupulous companies to determine exactly what their misdeeds will cost them and use that figure in determining whether it would be cost effective to make their products safe.

**Increased litigation.** CSSB 25 could also produce an increase in punitive damage trials, possibly adding to courthouse congestion. The number of plaintiffs seeking punitive damage awards will probably not decrease, as they will simply allege that the defendant acted with malice rather than gross negligence. What would be changed, though, is the settlement strategy of defendants. Bolstered by CSSB 25, more defendants might choose to fight their cases out in court, and the amount of court time devoted to these cases would increase. Punitive damage cases also tend to take up more time than other cases. Because more money would be at stake, each side would strain mightily to win their case, while the bifurcated trial system for punitive suits could lengthen trials.

**Contingency cases.** Many tort claims are brought by financially pressed plaintiffs who enter into a contingency fee agreement whereby an attorney will take their case in exchange for a percentage of the verdict. If punitive damages become more difficult to win and the limits are lowered, fewer

attorneys will take on such cases, limiting the right of injured parties to receive compensation. Without punitive damages, money will be taken from a plaintiff's compensatory award to pay an attorney's contingent fee.

**Clear and convincing evidence standard.** Raising the burden of proof for punitive damages issues would be unfair to those plaintiffs with meritorious claims. The general standard of proof for civil cases has always been a preponderance of the evidence. Changing the standard, especially in the same phase of the trial, will only serve to confuse the jury. Clear and convincing evidence is still an ambiguous standard that is very difficult to quantify

**Redefining malice.** One of the most important possible repercussions of removing gross negligence as a standard of punitive damage recovery would be that cases involving drunk drivers might not be subject to punitive damage liability. With the new standard of malice, it might be very difficult to prove that an intoxicated driver had a subjective awareness of the risk involved or had a specific intent to cause the harm (the definition of malice).

**Gross neglect.** The problem with allowing the constitutional standard of gross neglect to be defined as the Supreme Court defined gross negligence is that in many places throughout the Texas Constitution and civil statutes the term "gross negligence" is used as it is defined in the current punitive damages statute. If that definition were removed by SB 25, the only statement of what gross negligence means would be the *Moriel* case. However, the definition of gross negligence in *Moriel* is now part of the definition of malice under CSSB 25. Rather than clearing up any confusion caused by *Moriel*, the bill might make it possible to interpret that gross negligence is still a possible standard.

**Effective date.** Every change in tort law made during this legislative session will create a disparity between those who file claims before the effective date and those who wait to file after such dates. However, in some cases, particularly breast implants, Norplant devices, and asbestos exposure, injuries and symptoms will not manifest in many individuals before the effective date, even though the injury occurred before that date. As originally written, this provision was left open to a possible

interpretation allowing those injured before the effective date to still use the punitive damages law in effect when they were injured. However, the substitute makes it clear that a claimant who wants to use the current punitive damages law must file before September 1, 1995.

OTHER  
OPPONENTS  
SAY:

The U.S. House of Representatives has passed a measure that would set punitive damage limits at three times the award of economic damages where CSSB 25 would set that limit at two times economic damages. The U.S. House Bill (HR 956) would preempt any existing state laws that conflict with its provisions. Therefore, any actions taken on tort reform by this Legislature could be moot if HR 956 is enacted. It would be premature for this Legislature to enact this bill before determining what portions of state tort law may be preempted by federal action.

A major complaint about punitive damage awards is that they can be a windfall to an undeserving plaintiff. In order to correct that perception, punitive damage awards should instead be paid to the state. By doing so, there will be no windfall gained by undeserving plaintiffs, and awards could be based on what would actually be punitive to the defendant.

NOTES:

The committee substitute differs from SB 25 in that it:

- includes gross neglect as a possible level of culpability for purposes of applying Art, 16, sec. 26 of the Constitution which creates a cause of action for wrongful death.
- clarifies that provisions of sec. 41.005 apply to suits against a defendant for criminal acts committed *by another*.
- adds agents of the defendant to persons whose actions can subject a defendant to punitive damages for the criminal acts of other persons.
- includes theft and other third degree felonies in the same subsection as other crimes not subject to punitive damage limits.
- adds knowingly done criminal acts to those that will not be subject to punitive damage limits — the Senate version only included intentionally done criminal acts.

- adds bad faith insurance claims to DTPA and antitrust claims that are not covered by chapter 41 limitations.

The Senate made changes in the original SB 25 that include:

- Evidentiary standard lowered from beyond a reasonable doubt to clear and convincing evidence
- No limits for certain criminal acts
- Separate economic and non-economic damages and placing an absolute cap of \$750,000 on how much of a non-economic damage award can be used in determining caps on punitive damages
- Introduced version specifically precluded consideration of the net worth of the defendant
- Introduced version specifically exempted owners and operators of land from punitive damages for criminal acts of others committed on their property — Senate version clearly states under what circumstances they may be held liable
- Introduced version exempted from punitive damage liability and product or conduct regulated by a state or federal agency.

Two proposed committee amendments tabled by the House State Affairs Committee included:

- Amendment by Danburg — proposing a sliding scale cap on punitive based on defendant's net worth.
- Amendment by S. Turner — including all actual damages, not separate economic and non-economic damages, in determining a cap for punitive damages.