New York Law Journal

NEW YORK, FRIDAY, JANUARY 19, 1996

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Limits On Punitive Damages

LAST MONTH, the Eight Circuit Court of Appeals struck down as unconstitutional a jury award of punitive damages to an employee who had complained about his employer's unlawful retaliation and invasion of his privacy. *Pulla v. Amoco Oil Co.*, 1995 U.S. App. LEXIS 35580.

The employee complained that his employer had retaliated against him for filing an administrative complaint with the Equal Employment Opportunity Commission. He also charged the employer had violated his privacy when another employee searched his credit card records to determine if he had abused his sick leave, then forwarded a report of his credit card charges to the employer's human resources department where it was placed in his personnel file.

The jury awarded the employee compensatory damages of $2 for pain and suffering and punitive damages of $500,000. The Court of Appeals reversed the punitive damage award as a violation of the U.S. Constitution's Due Process Clause.

The appellate court's opinion is interesting in several respects. First, it was written by retired Supreme Court Justice Byron White (sitting by designation). The timing may be significant. The Supreme Court is considering a constitutional challenge to the amount of punitive damages awarded in another case, *BMW of North America, Inc. v. Gore*, 646 So.2d 619 (Ala. 1994), cert. granted, 115 S.Ct. 932 (1995).[1]

Possibly as a "tenth Justice" to influence his former colleagues as they consider constitutional limits on punitive damages, Justice White wrote that the appellate court in *Pulla* chose not to withhold its judgment until after the Supreme Court decides *Gore*.

Second, and what may be particularly interesting to corporate defen-

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dants that feel targeted in litigation as "deep pockets," Justice White wrote in *Pulla*, "While a defendant's wealth may be taken into account in order to ensure that an award will adequately deter any future such conduct, a defendant's wealth cannot alone justify a large punitive damages award."

Third, and most significant, is the result. Applying an analytical framework discerned from the Supreme Court's decision in *TXO Prod. Corp. v. Alliance Resources Corp.*, 113 S.Ct. 2711 (1993) (affirming a judgment awarding punitive damages of $10 million, an award 526 times greater than the actual damages of $19,000),[2] the Court of Appeals in *Pulla* reversed the jury's award of punitive damages for three reasons:

- The employee failed to present any evidence that the employer put any other individual's privacy at risk (e.g., he did not suggest that the search of his credit card records stemmed from a company policy).
- There was no evidence that the invasion of the employee's privacy by another employee who searched his credit card records was deliberate wrongful conduct by the employer (the employer asserted that this was an "isolated and rare incident").
- The ratio of 250,000:1 between punitive and actual damages bears no reasonable relationship to the harm that occurred.

Arbitration Awards

It remains to be seen whether the Supreme Court will follow the lead of *Pulla* in striking down excessive punitive damage awards as unconstitutional. If limits are imposed on judicial awards of punitive damages, consider the effect of such limits on arbitration of employment claims, a virtual requirement in the securities industry, and of other commercial disputes.

Generally, the business community has shown a greater interest in arbitration in recent years, influenced in large part by the desire to avoid jury awards of punitive damages. However, the arbitration forum has proved to be no safe haven.

Under New York law, which prohibits arbitrators from awarding punitive damages[3], an agreement to arbitrate does not preclude a court action for punitive damages. *Mulder v. Donaldson, Lufkin & Jenrette*, 208 AD2d 301, (1st Dept. 1995) (allowing a former employee to maintain a court action for punitive damages after he had recovered compensatory damages in an arbitration).

Moreover, New York's prohibition against arbitrators awarding punitive damages is not always enforceable,

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even in arbitrations under agreements governed by New York law. Last March, the Supreme Court upheld an award of punitive damages in a NASD arbitration under a contract explicitly governed by New York law even though New York law prohibits arbitrators from awarding punitive damages. *Mastrobuono v. Shearson Lehman Hutton Inc.*, 115 S.Ct. 1212 (1995).[4]

Would a due process limitation on judicial awards of punitive damages be enforceable against arbitration awards? *Compare McMahan & Co. v. Dunn Newfund I Ltd., NYLJ*, Nov. 28, 1995, p. 26, col. 1 (Sup. Ct. N.Y. County Nov. 16, 1995) (holding that, despite the limited grounds under the Federal Arbitration Act, 9 U.S.C. §10(a)-(d), for vacating arbitration awards, "an arbitration forum must accord the parties a 'fundamentally fair hearing' "), and *Maross Constr., Inc. v. Central New York Regional Transp. Auth.*, 66 NY2d 341, ("The arbitrator's determination may even entail a misapplication of substantive rules of law and still be not subject to being vacated unless the court concludes that it is totally irrational or violative of a strong public policy.")

The increased use of arbitration and other forms of alternative dispute resolution are responses to a growing frustration with the litigation process. So too is the movement to curb excessive punitive damage awards. The law is developing in both areas. *Pulla* is one of the more significant developments.

(1) At issue in *Gore* is the excessiveness of an award of punitive damages to a BMW customer whose car had been partially refinished prior to delivery in order to correct damage sustained during shipment. The jury awarded the customer $4,000 compensatory damages and punitive damages of $4 million.

(2) Whether a punitive damages award is reasonable for purposes of due process, turns on: (1) the harm inflicted on the plaintiff; (2) the reprehensibility of the defendant's conduct; (3) the likely potential harm to others arising from the complained of conduct, and (4) the wealth of the defendant. *Pulla*, 1995 U.S. App. LEXIS 35580, *28; citing *TXO*, 113 S.Ct. at 2721 (plurality opinion); 113 S.Ct at 2726 (Kennedy, J., concurring).

(3) *Garrity v. Lyle Stuart Inc.*, 40 NY2d 354, (1976).

(4) In *Mastrobuono*, the parties' agreement was subject to the Federal Arbitration Act (FAA), which applies to all contracts "evidencing a transaction involving [interstate] commerce. . . ." 9 U.S.C. §2 (1988). The Court held that if the parties to an arbitration agreement subject to the FAA intend to exclude an award of punitive damages, their intention must be explicit to be enforceable. Because the parties' agreement provided that it is governed by New York law and also provided for arbitration pursuant to the rules of an arbitration forum, which allow an award of punitive damages, the intention to exclude punitive damages (arguably by specifying New York law) was not sufficiently clear and the arbitrators' award of punitives was enforced.

Other courts have held that punitive damages can be awarded in arbitrations by the American Arbitration Association (AAA) pursuant to an agreement enforceable under the Federal Arbitration Act, 9 U.S.C. §§1-15 (1988), in spite of a New York choice of law clause. *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056 (9th Cir. 1991) *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378 (11th Cir. 1988). *Todd* and *Bonar* construe rule 43 of the AAA authorizing an arbitrator to award "any remedy or relief which he deems just and equitable within the scope of the agreement of the parties," as authorizing an award of punitive damages. Other cases have also construed AAA rule 43 to authorize an award of punitive damages. *Raytheon Co. v. Automated Business Sys. Inc.*, 882 F.2d 6 (1st Cir. 1989); *Willoughby Roofing & Supply Co., Inc. v. Kajima Int'l Inc.*, 598 F. Supp. 353 (N.D. Ala. 1984), aff'd, 776 F.2d 269 (11th Cir. 1985) (construing specifically the Construction Industry Rules of the AAA); *Lee v. Chica*, 983 F.2d 883 (8th Cir. 1983).