
Punitive Award Survey

It begins to look as though the NASD will adopt a cap on punitive damages. David Ruder's Arbitration Policy Task Force had recommended in its January 1996 Report on "Securities Arbitration Reform" (see 7 SAC 11(6)) that NASD adopt a \$750,000 cap on the punitive portion of any Award. The Task Force also recommended a ratio cap, so that punitive damages will not exceed compensatory damages awarded by more than two to one.

NASD Regulation's Linda Fienberg, the executive officer in charge of the Association's Office of Dispute Resolution, has stated her support for a cap in both dollar and ratio terms and has moved that recommendation through the NASD Regulation Board. So, too, has the Securities Industry Association accepted punitive damage caps, which, after the Mulder and Driessens decisions, may be an attempt to grab the last train out. SIA, though, has limited its support for a dollar cap to \$250,000. At the Annual Meeting of the Public Investors Arbitration Bar Association (PIABA) this past October, it was clear that its membership would not support any cap.

The Securities Industry Conference on Arbitration (SICA) has stated a formal position on punitive damages in arbitration. Section 28(h) of SICA's Uniform Code of Arbitration states that "[t]he arbitrator(s) may grant any remedy or relief that the arbitrator(s) deem just and equitable and that would have been available in a court with jurisdiction over the matter." There are only a couple of provisions in the UCA that no SRO arbitration facility has adopted. This is one of them and it appears that it never will be adopted.

We think SICA probably had it right the first time, but, clearly the ground is shifting with the new NASD initiative. As a result, a SICA subcommittee is now rushing to draft an alternative to the "lesser of a double cap"

proposal in order, if feasible, to achieve a consensus among arbitration constituents before NASD adopts and files a final rule proposal with the SEC. SAC's role in this controversial area has always been to report to readers on rulemaking efforts and changes in the law — and to provide information from our Award Database about punitive damage awards. We thought, in this vein, we should update our past surveys of punitive damage Awards with specific focus upon the impact of the current proposals on the body of punitive awards that have already issued. (*ed: SAC's past surveys appeared in May 1993, 5 SAC 7(1) and January 1995, 6 SAC 11&12(13). Readers may want to refer to these past surveys, as our presentation here is a limited one and the overall results have not dramatically altered.*)

It would certainly be of practical relevance to the debate if a proposed limitation on arbitrators' authority to award punitive damages, designed to thwart "runaway" awards, would, when applied to our 304 past punitive awards, have caused no reduction in any Award. Assuming that the past has some predictive value for the future, we could rest easy that arbitral authority had been corralled, without injury to the wide discretion Panels had rightly been accorded in the past. This might be a desirable outcome, were there common agreement that arbitrators were not at fault in the past. On the other hand, if substantial restraint upon arbitrators were the aim, then a proposed limitation that has no impact on past Awards is likely too lenient.

We have made the point, via quantitative data from past surveys, that arbitrators, generally speaking, award punitive damages fairly infrequently and characteristically adhere to a reasonable proportionality ratio. If some caps are needed, we presume that the objective to be served is the prevention of abuses in the future. We have not

seen the evidence, in reviewing past punitive awards, which would support the need to remedy substantial past abuses of arbitrator authority. Still, if the purpose of limitations were to treat some perceived excesses, then the proposed caps, applied retroactively to the past body of punitive damage Awards, should have a reasonable and targeted impact. The more past Awards affected by a proposed limitation, the more scrutiny that proposal should be given.

The Ruder Task Force Report supplied some impact statistics, by reviewing NASD Awards between 1991 and October 1995. Page 44 of the Report states: "we have calculated that a limit of two times compensatory damages would have an effect on approximately 0.2 percent of all cases filed with NASD arbitration... [and that] a cap of \$750,000 would have reduced an award of punitive damages in only eleven cases." Our effort was not to challenge these statistics, but (1) to augment the sample and period surveyed, and, (2) to focus on the punitive awards themselves, not the cases where punitives were not an actual issue or where the cases settled. The Task Force reviewed only 200 punitive damage Awards. This latest SAC survey covers some 304 Awards from all of the active securities forums during a span of almost seven years, from May 1989 to March 1996.

In terms of overall results, we found that the 304 Awards accounted for about 2% of the total number (14,791) surveyed. The amount of punitive damages awarded totalled \$49.1 million, against a total of \$48.8 million in compensatory amounts awarded in the 304 cases. On average, this compared with our findings for the May 1989-December 1993 period covered in our last survey, when the frequency of punitive awards was also 2.0% overall and the ratio was again about 1:1, punitive to compensatory awards (*ed: At the time,*

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our survey covered 221 Awards rendered prior to 1994).

Dollar Caps

In dollar terms, we examined the number of Awards and the dollar amounts involved at three breakpoints: \$100,000, \$250,000, and \$750,000. Awards in which punitive amounts involved \$100,000 or less numbered 227, or 75% of the whole. In the \$250,000 and under category, the total was 264, or 87% of all punitive awards. At the \$750,000 cap recommended by the NASD Task Force, only 14 of the Awards exceeded that level. Thus, only 4.3% of all punitive damage Awards would have been reduced by the "Ruder dollar cap."

On the other hand, those 14 Awards — less than 5% of the total — accounted for \$23 million of the \$49.1 million awarded — almost half of the total. The dollar impact of the "Ruder dollar cap" would have been significant, but it would have affected only a small percentage of the punitive awards. The effect on those Awards, however, would have been substantial in each case. There were no punitive damage amounts between \$750,000 and \$1 million, so each of the 14 Awards would have been reduced by at least \$250,000.

Overall, we calculated that the reductions necessary to bring the 14 Awards within the \$750,000 cap would have totalled \$11.5 million, about half of the punitive amounts awarded in those cases. Of course, the largest awards contributed the most to the reduction amount. There were only three punitive damage awards over \$2 million, and the largest was \$3.5 million, but those 3 Awards contributed \$6.9 million of the \$11.5 million in reductions to meet the "Ruder dollar cap."

We found it interesting, too, that while the incidence of punitive damage awards remained relatively constant throughout the seven years surveyed, only three Awards of the 14 that exceeded the "Ruder dollar cap" issued after 1992. Unlike jurors, it seems to

us, arbitrators are cognizant of developments in the law, such as the Haslip-TXO-Honda Motor line of cases and the tort reform legislative efforts. Perhaps, one can anticipate a self-governing effect from informed factfinders, just as our past surveys indicate a regard for proportionality and the extraordinary nature of the punitive remedy among arbitrators.

At the \$250,000 level recommended by SIA, some 40 Awards would have been affected by a dollar cap, or about 13% of all punitive damage awards. That does not seem terribly significant, but the dollar impact of meeting that lower "cap" is substantial. The incremental impact would have been an additional \$6.1 million over the \$11.5 million in "Ruder dollar cap" reductions, or a total of \$17.6 million in reductions to satisfy a \$250,000 cap.

Only \$15.2 million of the \$49.1 million in punitive damage awards are attributable to awards of \$250,000 and under. Only \$7.8 million of the \$49.1 million in punitive damage awards are attributable to awards of \$100,000 and under. Thus, 87% of the Awards (those \$250,000 and under) accounted for only 31% of the amounts awarded and 75% of the Awards (those \$100,000 and under) accounted for only 15.9% of the punitive amounts awarded. These dollar comparisons indicate, from our viewpoint, that, if a dollar limit is necessary and is set high enough, the impact (in savings to broker-dealer respondents) can be significant with very little impact in terms of the number of cases affected.

Ratio Caps

Ratio caps — a formulaic limitation that compares compensatory damages awarded to punitive damages awarded — is quite a different story. Here, the impact is likely to be relatively widespread and somewhat more randomized in its impact. Most inconsistently, its impact will be heavily concentrated on the low-end of the punitive-dollar scale. Of the 304 Awards, there were 73 (24%) that broke the

proposed "Ruder ratio cap." Forty-two (14%) of the Awards broke 3:1 ratio parameters and 25 (8%) broke 5:1 ratio parameters.

Fully 60 of the 73 Awards (82%) that broke the 2:1 parameters involved compensatory awards of \$100,000 or less and 67 of the Awards (92%) involved compensatory awards of \$250,000 or less. Thus, the considerable impact of ratio caps could be substantially mitigated by making them applicable only to compensatory awards over \$250,000 or over \$100,000. If one were also to raise the ratio cap to 3:1, just 3 Awards over \$100,000 in compensatory amount would have been affected by the ratio cap and only one over \$250,000 in compensatory amount awarded would have been affected (assuming a dollar cap of \$750,000).

Not only does applying the ratio cap to all punitive awards have a disproportionate impact on the lower-dollar compensatory awards, the savings from applying the cap to the lower-dollar awards is relatively small. The 73 Awards that exceeded the "Ruder ratio cap" comprised \$20.3 million of the \$49.1 million in punitive damages awarded. That is a substantial percentage (41%) of the total dollar amount of punitive awards.

On the other hand, the savings that would have resulted from impinging upon arbitral authority on so many occasions would not have been especially plentiful. As to the 60 Awards involving \$100,000 or less in compensatory amounts awarded, a reduction of only \$3.3 million would have been achieved. As to the 67 Awards involving \$250,000 or less in compensatory amounts awarded, the impact of a reduction would total \$6.7 million (about \$2 million of that additional \$3.4 million is attributable to one Award).

Conclusions

Please keep in mind that, by presenting these statistics, we do not intend to endorse a dollar cap and, espe-

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cially not, an overall 2:1 ratio cap. These are the proposals on the table and we are simply reacting to them. Our reaction, though, based upon this review of past punitive damage awards (and given that the proposed limitations are designed to prevent future abuses, rather than to address remedially past abuses), is that dollar caps seem best suited to the task of preventing "runaway" awards. A dollar cap would presumably provide the desired protection for small broker-dealers without unduly strapping arbitral discretion and without impacting adversely an unnecessarily large number of punitive awards.

Ratio caps, on the other hand, have more of a blunderbuss effect. As a device to prevent "runaway" awards that could put a small broker-dealer out of business, ratio caps are not sufficiently targeted or logical. The data we reviewed here demonstrates that the ratio caps have more of a "shotgun" effect, spraying the area generally and, as a result, impacting most the more numerous smaller-dollar awards. But, these are the punitive Awards least likely to threaten a small broker-dealer with financial disaster. It seems to us that, if there are going to be ratio caps, they should not be formulated in a fashion that assures they will most restrict arbitrators in instances that are least subject to the abuse we intend to prevent.

As to the 14 high-end Awards, we found that, if all were reduced to satisfy the "Ruder dollar cap," only 3 would still exceed the "Ruder ratio cap" of 2:1. Were the ratio cap raised to 3:1, just one of the 14 Awards would require considerable further reduction, after application of the \$750,000 cap. That Award, Harper v. SLH, SAC ID#9010104N (3/6/92), is somewhat anomalous, but the anomaly itself illustrates an interesting issue regarding ratio caps. In Harper, the compensatory amount awarded Claimant was only \$25,000, while the punitive award was \$1,040,000. In the original claim, however, Claimant Harper had requested compensatory damages of \$238,040. During the arbi-

tration, Respondents entered into stipulations with Claimant which allowed, subject to arbitrator approval, certain monies to be deemed offsets to the claimed compensatory damages.

Comparing the \$25,000 in compensatory amounts awarded to the \$1,040,000 punitive award leads to a ratio of more than 40:1. On the other hand, the Harper Panel might reasonably have considered the original compensatory claims of the "harm done" as its "lodestone" from which to calculate the appropriate punitive sanction (Incidentally, \$1,000,000 of the \$1,040,000 in punitives was assessed against the Respondent broker, not Shearson). If that were the comparison, then Harper, too, would display a ratio of only about 3:1, after application of the "Ruder dollar cap."

One of the virtues of a dollar cap is that, while arbitrary, it is certainly simple to understand and apply. Ratio caps, on the other hand, are both subject to manipulation and debate. Any rulemaking efforts to prevent that manipulation or anticipate that debate will only add to the complexity of the solution. Since the ratio caps possess considerable potential for complicating the solution and could limit arbitral authority unnecessarily, we think the focus should be upon more targeted (or flexible) application of ratio restrictions, if they are to be used at all.

The "Ruder dollar cap" may be part of the answer, but the virtue of simple solutions is also their drawback. That is, the dollar cap is simple and definite, but it is also arbitrary. We understand that the SICA drafters are considering a proposal that would mitigate this arbitrary effect. It would permit arbitrators the latitude to exceed a set cap with the consequence, however, that a review process would be triggered. Thus, the dollar cap would not be a barrier, but a trigger point.

This could work with ratio caps, we suppose, but, again, our findings suggest only at the high-end. The cost,

delay and inefficiency of an additional review mechanism would not seem either cost-beneficial or practicable for the low-end punitive award. SAC has made the statistical results of our survey available to the SICA drafters. A draft proposal is expected to be presented at SICA's scheduled meeting in January, so we shall hope to report more definitively the extant proposals early in the new year.

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