

Tactical Tip: Reviewing Punitive Awards

This one is for the Respondent who has suffered a punitive damage award in arbitration and believes that a challenge to the award as excessive in amount is appropriate. To date, the challenges to punitive damage awards have proceeded, often with success, on grounds that the arbitrators overstepped their authority under the arbitration agreement. Usually, this is based upon the existence of a New York choice-of-law provision, a la Mastrobuono or Barbier. In such cases, the “exceeding powers” provision of Section 10(a)(4) of the Federal Arbitration Act provides the best choice among the vacatur provisos within the FAA.

What if the Supreme Court nullifies this argument in its upcoming decision in the Mastrobuono case? Is there no recourse for the Respondent saddled with an excessive punitive damage award to seek reduction or vacatur, via a post-Award challenge, under the existing provisions of the FAA? Before proceeding, we emphasize that SAC’s statistical analyses of previous punitive damage awards have indicated that ar-

bitrators tend to observe modest proportionality ratios between compensatory awards and punitive awards (5 SAC 7(1)), but the threat of an excessive award, fueled by emotion or a disregard for constitutional due process requirements, cannot be dismissed.

Is there recourse to the courts? We think that the “evident partiality” proviso under Section 10(a)(2) of the FAA may provide the necessary opportunity for judicial review. The idea struck us as we read the majority opinion, delivered by Justice Stevens, in the Honda Motor v. Oberg case, 62 LW 4627, (see summary in 6 SAC 9(10)). Justice Stevens makes the point that American courts in the 19th century, “both before and after the ratification of the Fourteenth Amendment,” have reviewed punitive damage awards for excessiveness. “Judges,” the Court wrote, “would infer passion, prejudice, or partiality from the size of the award,” because of the “difficulty of probing juror reasoning,” post-verdict. Arbitration awards, as jury verdicts, are often devoid of reasoning and a reviewing court must infer from the available evidence,

sometimes just the size of the award, whether partiality was induced and demonstrated in the award.

In support of its premise that American courts in the past have exercised the power to reduce or vacate jury awards of punitive damages, where they appeared excessive in size or amount, the Court cited many cases (62 LW 4629-30) including one in which the phrase, “evident partiality,” appeared (“Belknap v. Boston & Maine R. Co. 49 N.H. 358, 374 (1870) (setting aside both compensatory and punitive damages, because ‘[w]e think it evident that the jury were affected by some partiality or prejudice...’).” (underlining added).

The frequent appearance of the word “partiality” in these citations and the ability of reviewing courts to overturn jury verdicts as excessive or born of prejudice, on the basis of the size of those verdicts, suggests the availability of judicial review of excessive punitive damage awards in arbitration under the “evident partiality” subsection of FAA’s vacatur provisions. ■

Punitive Damages in Arbitration

Update Survey of Securities Arbitration Awards

(Prior Survey: 5 SAC 7(1))

The Punitive Damages Award Survey which SAC conducted in May 1993 covered a three-year period ending in June 1992. That Survey has been cited many times, most recently, in the SIA Mastrobuono Brief and the two law review articles summarized in this edition’s “Articles & Case Law” section. We decided the time was right to update that Survey through the end of 1993. From that period forward, our new publication, the SAC Award Review, will provide quarterly updates (See, e.g., 1 SAR 2(7), “Punitive Damage Awards Issued 1st Quarter 1994”).

The May '89-Jun '92 Survey

Excessive Awards

Looking back, May 1989 through June 1992 was a period during which the controversy over punitive damages in securities arbitration (and elsewhere) grew not only in intensity and importance, but also in breadth. By the end of that period, brokerage firms were arguing against punitive damages, both in terms of questioning arbitral authority and the adequacy of due process safeguards.

It was the emergence of the latter argument, as well as cries from some that excessive punitive damage awards

were becoming commonplace in securities arbitration, which stimulated the May 1993 Survey. The focus of the Survey, therefore, fell upon the incidence with which securities Awards reflected assessments of punitive damages and, when they did, the proportionality of such awards, relative to compensatory damages.

Due Process Standards

The U.S. Supreme Court indicated in the 1993 TXO Production Corp. v. Alliance Resource Corp. decision, 5 SAC 8(1), that it could be moved by substantive due process requirements

cont'd on page 14

UPDATE SURVEY *cont'd from page 13*

to overturn a punitive damage award that is excessive in size. Among the relative indicators of excessiveness, TXO teaches, is “the amount of money potentially at stake” in the case. That amount, it was further made clear, did not necessarily equate to the actual damages awarded by the fact-finder (In TXO, the compensatory award was \$19,000, whereas the punitive damages awarded were \$10 million — a proportionality ratio of 526:1).

TXO also made clear that the factors determining “proportionality” or “grossly excessive” would be multifold and multi-faceted. The courts would not be tied to any “bright-line” test. The only test of proportionality we could manufacture in the 1993 Survey was a ratio comparison between the punitive damage award and the compensatory damages awarded to the victor. As a measure of the “potential harm,” compensatory damages claimed might have provided a better figure for comparison, but, in almost all cases, the compensatory damages awarded would be the more conservative figure.

Proportionality Findings

That, then, is what we used. The results demonstrated that the average punitive damage award during the three-year period surveyed was only 10% greater than the average compensatory amount awarded, or a 1.1 to 1 ratio. More than 88% of all punitive damage awards surveyed stayed within a 3:1 ratio; among those punitive awards which exceeded \$250,000 in amount, 76% stayed within a 3:1 ratio and 88% stayed within a 5:1 ratio.

In securities arbitration, the largest punitive damage award of which we have knowledge amounted to \$3.5 million. That occurred during the three-year period and is counted among the \$24.4 million total that we identified. Not all of this amount was assessed against broker-dealers and in favor of customers, but the great bulk of it was. How much did customers win in toto from broker-dealers in securities arbitration during that period? We think the figure is well over \$200 million, but we

were able to account for at least \$166 million in SRO Awards in SAC’s last Customer Award Survey (same period - 5 SAC 12(10)).

In summary, then, we found that securities arbitrators were awarding punitive damages, on average, in approximately 2.1% of the cases arbitrated to conclusion, that the punitive amounts awarded demonstrated a proportionality ratio of 1.1 to 1, and that, all things considered, punitive damages comprise no more than 15% of all damages awarded to customers.

The May '89-Dec. '93 Survey**About the Survey**

This Survey updates the past Survey, with an extra one and one-half year’s of Awards. We chose only four of the seven Charts for updating: those reflecting breakdowns of punitive damage awards by type of dispute, by semi-annual period, by state situs, and by broker-dealer. Last time, we went outside the three-year Survey period for some of the Charts and included pre-May 1989 punitive Awards, in an effort to provide statistics for all of the Awards in our files.

That was a mistake. We just succeeded in confusing people by using different “universes.” This time, we used the same “universe,” i.e., all punitive damage awards in our possession, which issued during the period May 1989 through December 1993. Our focus this time will be somewhat different as well. We either demonstrated or did not the idea of rational application, or proportionality, in the last Survey. Here, we were more interested in seeing whether things have substantially changed, with the inclusion of the later Awards, and in providing other commentators and advocates with updated data.

The same caveats apply, as applied to the first Survey. NASD did not start making publicly available Awards for industry-related disputes until October 1993. Defamation and discrimination cases will, in our estimation, prove to

be areas where punitive damage awards are, in relative terms, a substantial jeopardy for brokerage firms. We shall need a better sample, though, of Public Awards to explore that territory with any assurance.

AAA Awards, concerning securities disputes filed after May 1993, are now made publicly available. SAC, as the exclusive distributor of those Awards, has been compiling data concerning them and publishing those results in the SAC Award Review. None of the AAA Public Awards, which issued prior to 1994, resulted in the assessment of punitive damages; thus, none of those Public Awards affect the updated Survey. However, other AAA Awards are represented, to the extent that subscribers have contributed copies and those Awards issued during the Survey period.

As we noted in the last Survey, arbitrators do not always assess punitive damages against respondents as a group. Sometimes, as in the case of Harper v. SLH (SAC ID # 9010104N), where Shearson drew only \$15,000 of the \$1,040,000 in punitive assessments, it is the broker who suffers the major portion of the punitive sanctions. For purposes of presentation, we treat (unless otherwise footnoted) punitive sanctions, when assessed against a broker or branch manager, as part of the total punitive awards assessed against brokerage firms.

We do not ignore these outlying numbers entirely. Due to their relative rarity, the sample we survey is small and results can be easily skewed by disproportionate results in an individual case. Where the amounts involved in a case are substantial and would have a material skewing effect, we footnote our treatment of the case. For example, Prescott Ball v. Kanuth (SAC ID #8912058), an extraordinary Award involving \$33.2 million in compensatory damages awarded and \$1 million in punitive sanctions, is omitted from the calculations, because inclusion would change the results materially.

cont'd on page 15

UPDATE SURVEY *cont'd from page 14*

Exclusion yields averages which are more likely to represent the norm.

The Survey Charts

Chart A - Type of Dispute

SAC found a total of 221 Awards in which punitive damages were granted against a party. During the survey period, 10,942 Awards issued, indicating that the incidence of punitive damage assessments remains about

2%. The great majority of those Awards (202) are granted to customers, but Chart A reminds us that disputants of all categories have won punitive damages. In fact, "members" (broker-dealer members of self-regulatory organizations) have won punitive damages from customers in five cases.

It should be mentioned that Chart A in the May 1993 Survey tallied all punitive damage Awards identified by

SAC, including some that issued before May 1989. Chart A below considers only those Awards that fall into the Survey period. Thus, the two Charts are not directly comparable. What Chart A does reveal is an increase in the number of punitive damage awards from 147 during the first Survey period to 221 in this Survey period, a 50% increase over a survey period that is 50% longer.

The pace, then, of punitive awards

cont'd on page 16

Chart A - Type of Dispute Breakdown

(May 1989 thru Dec. 1993)

Type of Dispute	# Puni Awards	Puni \$ Awarded (\$000 omitted)	Comps. \$ Awarded (Puni Awds Only)	\$ Puni Awd/ \$ Comp. Awd (Col. 2/Col. 3)
Customer/Member	176	30,360	29,488	1.0 to 1
Small Claims	20	76	59	1.3 to 1
Customer/Employee	6	127	66	1.9 to 1
Member/Customer	5	50	69	.7 to 1
Member/Member	2	90	35	2.6 to 1
Member/Employee	*5	217	90	2.4 to 1
Employee/Member	7	2,224	1,956	1.1 to 1
All Types/Dispute	221	33,144	31,763	1.0 to 1

Note: Based upon the 221 Awards surveyed, the average punitive damage award was \$149,972 and the average compensatory award in the 221 cases was \$143,724. The median punitive award was \$40,000 and the median compensatory award was \$41,000.

* In all 5 Member/Employee cases the punitive damage award was assessed against the Claimant; that is, the employee Respondent received punitive sanctions against the member on his or her counterclaim. Total punitive damages in these 5 cases aggregated \$1.215 MM, \$1MM of which was awarded in Prescott Ball v. Kanuth. The Kanuth figures were not included in this Chart, because the Kanuth compensatory award of \$33.2 million would unfairly skew the results.

UPDATE SURVEY *cont'd from page 15*

appears to remain stable, assuming the total number of cases decided has remained fairly constant. In terms of the mix, cases were added in all categories except the member-initiated cases. The biggest percentage increase apparently occurred in the Employee-Member category. This category now accounts for \$2.2 million in punitive awards.

Chart B - Time Periods

Looking down the first column of figures on Chart B, one sees a peak and gradual decline occurring in the number of punitive damage awards, when broken out by semi-annual period. The next column, which tallies the total number of Awards decided in the same

semi-annual period, also shows a rather considerable decline. This did not seem right, at first, because the SROs have consistently closed about 5,800 cases per year since 1989.

When we checked, we found that the number of cases closed in 1993 did drop from the norm to 5,363. More significantly, though, the number of "Public Customer Cases" (SICA uses this term to indicate cases involving customers, either as Claimants or Respondents) actually being decided has dropped even more dramatically, from a high of 2,844 in 1989 (see SICA Chart, 4 SAC 10(16)) to 1,617 in 1993. These figures indicate a substantial rise

in the rate of settlements, which is consistent with information coming from the forums.

Settling cases is the second-best way to avoid punitive damages. There was a significant savings in 1993, in terms of punitive-damage dollars. Whether the savings derived from a greater number of settlements or a variety of factors, it is noteworthy that punitive damage awards cost respondents almost \$12 million in 1992 and less than \$5 million in 1993.

We have one further note about this Chart. Those who compare this Survey's Chart with the corresponding

cont'd on page 17

Chart B - Distribution by Semi-Annual Periods
(May 1989 thru Dec. 1993)

Semi-Annual Periods	# Puni Awards	Total # of Awards	Puni \$ Awarded (\$000 omitted)	Comps. \$ Awarded (Puni Awd's Only)	# Puni Awd/ # Total Awd (Col. 1/Col. 2)	Puni \$/ Comp. \$ (Col. 3/Col. 4)
2d Half 1989	14	1,742	3,361	3,496	.8%	1.0 to 1
1st Half 1990	32	1,398	*2,650	*3,221	2.3%	.8 to 1
2d Half 1990	28	1,284	**4,813	2,536	**2.2%	1.9 to 1
1st Half 1991	36	1,322	2,875	3,172	2.7%	.9 to 1
2d Half 1991	28	1,237	3,064	4,337	2.3%	.7 to 1
1st Half 1992	21	1,146	6,876	5,366	1.8%	1.3 to 1
2d Half 1992	28	1,085	4,890	4,029	2.6%	1.2 to 1
1st Half 1993	17	922	1,149	2,946	1.8%	.4 to 1
2d Half 1993	17	806	3,466	2,660	2.1%	1.3 to 1
4.5-Year Tally	221	10,942	33,144	31,763	2.0%	1.0 to 1

* Not considered in the asterisked figures is the punitive damage award of \$1 million to Respondent in Prescott Ball v. Kanuth, and the compensatory damages awarded, \$33.2 million, because the compensatory damage award would unfairly skew the total figures.

** \$2.2 million of the punitives awarded in this semi-annual period are attributable to Pyle v. Securities USA, a high-ratio Award.

UPDATE SURVEY *cont'd from page 16*

Chart in the May 1993 Survey will notice the inclusion of over 1,000 additional Awards in the periods that each has in common. Most of these Awards came from NASD, as part of its review of Awards dating back to May 1989, for purposes of disclosing Arbitrator names on customer-related Awards.

These additions contribute to the completeness of SAC's Award Database, but they also emphasize our dependency upon the forums for complete public disclosure of Awards.

Chart C - State Situs

Repeating this Chart was a must, in our view, because the differences among the states, particularly in terms of the incidence of punitive damage awards, is significant. While incidence and proportionality ratios remain about the same for the states taken as a whole, the incidence range among the seven most active states starts at .8% for New York and ends with 7.7% with Georgia.

Florida remains the highest on the Chart, in terms of the number of Awards granting punitive damages, but California now ties Florida and, with its greater volume, will likely assume the

No. 1 spot. New York's incidence rate is the lowest, but its volume was sufficient to have placed it in the third spot last time. Texas is now third, reflecting 21 punitive damage awards versus 10 in the prior Survey, more than a 100% increase when the total number of Texas Awards increased only 75%.

Chart D - Top Firms

In the prior Survey, we used criteria for selecting the firms to display in this last Chart, which included all firms among the top 50 that had suffered three or more punitive damage awards or more than \$500,000 in punitive
cont'd on page 18

Chart C - State Distribution of Punitive Awards
(May 1989 thru Dec. 1993)

Situs State	# Puni Awards	Total # of Awards	Puni \$ Awarded (\$000 omitted)	Comps. \$ Awarded (Puni Awds Only)	# Punis/ # Awards (Col. 1/Col.2)	Puni \$/ Comp. \$ (Col. 3/Col.4)
Florida	43	841	11,835	7,984	5.1%	1.5 to 1
California	43	1,537	3,135	5,557	2.8%	.6 to 1
Texas	21	388	2,892	3,989	5.4%	.7 to 1
New York	18	2,185	1,273	3,018	.8%	.4 to 1
Georgia	15	194	2,121	832	7.7%	**2.5 to 1
Illinois	8	498	760	570	1.6%	1.3 to 1
Missouri	7	142	457	526	4.9%	.9 to 1
All States	221	10,942	*33,144	*31,763	2.0%	1.0 to 1

* The asterisked figures do not consider \$1 million in punitive damages awarded to Respondent in Prescott Ball v. Kanuth, and the compensatory award of \$33.2 million, as the compensatory amount awarded would unfairly skew the result.

**The high proportionality ratio for Georgia is due in main part to one Award, Harper v. SLH, in which punitive damages of \$1.040 million and compensatory damages of \$25,000 were awarded.

UPDATE SURVEY *cont'd from page 17*

assessments. There were more firms which met the "three-Award" criteria for this Survey than we wanted to list, so Chart D reflects the eight firms with the highest dollar amount of punitive assessments. In tabulating results, we disregarded the Shearson-Smith Barney and PaineWebber-Kidder Peabody combinations, as these occurred toward the end of or beyond the Survey period.

Prudential Securities remains the brokerage firm with the highest amount of punitive sanctions, in dollar terms. Shearson received the highest number of punitive damage awards, but it also reflects the highest number, by far, of decided Awards. As a result, it has the second lowest incidence rate. Paine Webber moved from seventh position to third. Percentage-wise, its punitive-dollar total went up ninefold, from \$274,300 to \$2.6 million, although it

only took four Awards to make it happen.

Merrill Lynch only added one punitive damage Award, according to our tally, and remains the only top firm with an incidence rate of 1% or less. Raymond James, on the other hand, stood out in our prior Survey with an incidence rate of 20%. With 15 more Awards added to its volume and one additional punitive damage Award, the firm's rate remains the highest by far, but dropped on an overall basis to 14%.

Observations

We had begun this update with the vague perception that punitive damage awards were falling off a bit and that the awards made were moderated somewhat. The Survey fails to support either speculation. There are, indeed, fewer punitive damage awards in more recent

times, but there are also fewer decided cases. New York and Illinois produced very few new Awards, granting punitive damages, but the law in those two states do not favor punitive damages in arbitration.

Georgia and Texas, in particular, displayed increases in their relatively high incidence rates and there are now some 24 states, in which SRO arbitration Panels have awarded punitive damages since May 1989. In fact, we found eight Arbitrators, who awarded punitive damages in "non-hearing" cases — those decided on the papers alone. Overall, the incidence rate fell one-tenth of a percent and the proportionality ratio stayed the same. This, then, is the current state of punitive damages in securities arbitration prior to the Mastrobuono decision. ■

Chart D - Broker-Dealer Punitive Awards

(Ranked by Total Puni \$ - May 1989 thru Dec. 1993)

Selected Broker-Dealers	# Puni Awards	Total # of Awards	Puni \$ Awarded (\$000 omitted)	Comps. \$ Awarded (Puni Awds Only)	# Puni/# Awards (Col. 1/Col. 2)	Puni \$/Comp. \$ (Col. 3/Col. 4)
Prudential Securities	22	946	5,704	7,739	2.3%	.7 to 1
Shearson Lehman Brothers	27	1,728	3,167	3,069	1.6%	*1.0 to 1
PaineWebber, Incorporated	9	578	2,609	2,069	1.6%	1.3 to 1
Merrill Lynch, Pierce Fenner & Smith	6	832	2,130	1,932	.7%	1.1 to 1
Dean Witter Discover	14	625	2,107	2,266	2.2%	.9 to 1
Bear Stearns	4	178	1,245	1,808	2.2%	.7 to 1
Raymond James & Associates	5	35	363	162	14.3%	2.2 to 1
Kidder Peabody	4	141	319	1,003	2.8%	.3 to 1

Note: There were 11 instances among the 221 Awards issued during the 4.5 years surveyed, where a brokerage firm was not the subject of the punitive assessment-- in 5 Member/Customer disputes and 6 Customer/Employee disputes. Thus, the 91 Awards reflected in this Chart represent 43% of the 210 Awards assessed against a broker-dealer. The 5,063 Awards reflected in column 2, "Total # of Awards," represent about 46% of all Awards surveyed during the period.

* Shearson's proportionality ratio is skewed somewhat by Harper v. SLH, a high-ratio case in which \$1.040 million in punitives were assessed. \$15M was assessed against SLH directly. The remaining amounts were assessed against Shearson representatives. Only \$25,000 in compensatory damages were awarded.