24. Compensatory Damages

If you see me walking down the street
Staring at the sky and draggin' my two feet
You just passed me by; it still makes me cry
But you can make me whole again

– Atomic Kitten, 2001

The Idea of Compensatory Damages

The central idea of compensatory damages is to compensate a plaintiff for an injury. This is sometimes described as "making the plaintiff whole." In other words, compensatory damages are about making the plaintiff as well off as the plaintiff would have been had the tortious conduct not occurred.

Damages are meted out in dollars. Thus, the aim is to award the plaintiff an amount of money such that if the plaintiff were hypothetically sent back in time to the point before the compensable injury happened, the plaintiff would be indifferent when faced with the choice of (1) nothing happening or (2) suffering the injury and getting the damages award.

This is a fiction, of course. Imagine having the choice of (1) nothing happening or (2) having the roof of your home cave in and getting a check to cover the repairs and the expense of living in a hotel for a while. Who would be indifferent to that?

Moreover, it is entirely impossible to conceive of being indifferent to the loss of a loved one. The conceptual troubles begin to mount when you consider this kind of question: How much money would you have to be offered before you would be indifferent to the loss of a parent, spouse, or child? One might say that "no amount of money" could compensate for this loss. So, does that mean it would take an *infinite* amount of money? Of course, there's no such thing as an infinity of money in the real world. But let's take that idea as far as we can: Suppose your child is killed through the negligence of a large

multinational oil company. Should you then get everything the company has to give – its entire market value of a half trillion dollars? That's as close as the company can come to infinity. On the other hand, since "no amount of money" is adequate, perhaps it's just as well for the court to award $0. Both of these extremes seem unacceptable. We are left with this question: How can you put a price on something that is priceless? When it comes to tort damages, this is not a rhetorical question.

In addition to serving to make it up to the plaintiff, compensatory damages also serve a deterrence function. Professor Richard A. Epstein writes, "The greatest triumph of the tort is the faceless injuries it prevents, not the major ones it compensates." TORTS, p. 437 (1999). When defendants know that they will have to pay for the negative consequences of their actions, they have the incentive to undertake the care that will prevent the harm in the first place.

Compensatory damages come in two kinds: pecuniary damages and nonpecuniary damages.

Pecuniary or Special Damages

Some compensatory damages are natively denominated in dollars. Repair costs, car rental, lost wages, medical bills, prosthetics, etc. These are **pecuniary damages**.

Pecuniary damages go by various names. Sometimes they are called "economic damages," a phrase which uses the word "economic" in a limited, non-technical sense to mean "having to do with money." Another label used for the same thing is "special damages," a common phrasing in the context of defamation. The term "special" is confusing here, because these damages are quite common. If, however, you think of "special" as meaning "specific," then the term makes sense, since special damages are damages that can be assigned a specific amount in dollars and cents as a matter of straightforward bookkeeping.

In a simple case, calculating pecuniary damages is often as easy as referring to a written estimate for repairs. In a more complicated case, you might need to do some accounting work to reduce medical

bills and various income losses to a single number. In a complex business case, calculating pecuniary damages can become extremely complicated and might involve making a number of assumptions.

Case: *Texaco v. Pennzoil*

This case exemplifies how the assumptions used in calculating pecuniary damages can have an enormous effect on the size of the verdict.

Texaco v. Pennzoil

Court of Appeals of Texas, First District
February 12, 1987

729 S.W.2d 768. TEXACO, INC., Appellant, v. PENNZOIL, CO., Appellee. No. 01-86-0216-CV. Before WARREN, JACK SMITH and SAM BASS, JJ.

Justice JAMES F. WARREN:

This is an appeal from a judgment awarding Pennzoil damages for Texaco's tortious interference with a contract between Pennzoil and the "Getty entities" (Getty Oil Company, the Sarah C. Getty Trust, and the J. Paul Getty Museum).

The jury found, among other things, that:

> (1) At the end of a board meeting on January 3, 1984, the Getty entities intended to bind themselves to an agreement providing for the purchase of Getty Oil stock, whereby the Sarah C. Getty Trust would own 4/7 th of the stock and Pennzoil the remaining 3/7 th; and providing for a division of Getty Oil's assets, according to their respective ownership if the Trust and Pennzoil were unable to agree on a restructuring of Getty Oil by December 31, 1984;
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> (2) Texaco knowingly interfered with the agreement between Pennzoil and the Getty entities;
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> (3) As a result of Texaco's interference, Pennzoil suffered damages of $7.53 billion;

> (4) Texaco's actions were intentional, willful, and in wanton disregard of Pennzoil's rights; and,
>
> (5) Pennzoil was entitled to punitive damages of $3 billion.

~Though many facts are disputed, the parties' main conflicts are over the inferences to be drawn from, and the legal significance of, these facts. There is evidence that for several months in late 1983, Pennzoil had followed with interest the well-publicized dissension between the board of directors of Getty Oil Company and Gordon Getty, who was a director of Getty Oil and also the owner, as trustee, of approximately 40.2% of the outstanding shares of Getty Oil. On December 28, 1983, Pennzoil announced an unsolicited, public tender offer for 16 million shares of Getty Oil at $100 each.

Soon afterwards, Pennzoil contacted both Gordon Getty and a representative of the J. Paul Getty Museum, which held approximately 11.8% of the shares of Getty Oil, to discuss the tender offer and the possible purchase of Getty Oil. In the first two days of January 1984, a "Memorandum of Agreement" was drafted to reflect the terms that had been reached in conversations between representatives of Pennzoil, Gordon Getty, and the Museum.

Under the plan set out in the Memorandum of Agreement, Pennzoil and the Trust (with Gordon Getty as trustee) were to become partners on a 3/7 ths to 4/7 ths basis respectively, in owning and operating Getty Oil. Gordon Getty was to become chairman of the board, and Hugh Liedtke, the chief executive officer of Pennzoil, was to become chief executive officer of the new company.

The Memorandum of Agreement further provided that the Museum was to receive $110 per share for its 11.8% ownership, and that all other outstanding public shares were to be cashed in by the company at $110 per share. Pennzoil was given an option to buy an additional 8 million shares to achieve the desired ownership ratio. The plan also provided that Pennzoil and the Trust were to try in good faith to agree upon a plan to

restructure Getty Oil within a year, but if they could not reach an agreement, the assets of Getty Oil were to be divided between them, 3/7 ths to Pennzoil and 4/7 ths to the Trust.

The Memorandum of Agreement stated that it was subject to approval of the board of Getty Oil, and it was to expire by its own terms if not approved at the board meeting that was to begin on January 2. Pennzoil's CEO, Liedtke, and Gordon Getty, for the Trust, signed the Memorandum of Agreement before the Getty Oil board meeting on January 2, and Harold Williams, the president of the Museum, signed it shortly after the board meeting began. Thus, before it was submitted to the Getty Oil board, the Memorandum of Agreement had been executed by parties who together controlled a majority of the outstanding shares of Getty Oil.

The Memorandum of Agreement was then presented to the Getty Oil board, which had previously held discussions on how the company should respond to Pennzoil's public tender offer. A self-tender by the company to shareholders at $110 per share had been proposed to defeat Pennzoil's tender offer at $100 per share, but no consensus was reached.

The board voted to reject recommending Pennzoil's tender offer to Getty's shareholders, then later also rejected the Memorandum of Agreement price of $110 per share as too low. Before recessing at 3 a.m., the board decided to make a counter-proposal to Pennzoil of $110 per share plus a $10 debenture. Pennzoil's investment banker reacted to this price negatively. In the morning of January 3, Getty Oil's investment banker, Geoffrey Boisi, began calling other companies, seeking a higher bid than Pennzoil's for the Getty Oil shares.

When the board reconvened at 3 p.m. on January 3, a revised Pennzoil proposal was presented, offering $110 per share plus a $3 "stub" that was to be paid after the sale of a Getty Oil subsidiary ("ERC"), from the excess proceeds over $1 billion. Each shareholder was to receive a pro rata share of these excess proceeds, but in any case, a minimum of $3 per share at the end of five years. During the meeting, Boisi briefly informed the board of the status of his inquiries of other companies that

might be interested in bidding for the company. He reported some preliminary indications of interest, but no definite bid yet.

The Museum's lawyer told the board that, based on his discussions with Pennzoil, he believed that if the board went back "firm" with an offer of $110 plus a $5 stub, Pennzoil would accept it. After a recess, the Museum's president (also a director of Getty Oil) moved that the Getty board should accept Pennzoil's proposal provided that the stub be raised to $5, and the board voted 15 to 1 to approve this counter-proposal to Pennzoil. The board then voted themselves and Getty's officers and advisors indemnity for any liability arising from the events of the past few months. Additionally, the board authorized its executive compensation committee to give "golden parachutes" (generous termination benefits) to the top executives whose positions "were likely to be affected" by the change in management. There was evidence that during another brief recess of the board meeting, the counter-offer of $110 plus a $5 stub was presented to and accepted by Pennzoil. After Pennzoil's acceptance was conveyed to the Getty board, the meeting was adjourned, and most board members left town for their respective homes.

That evening, the lawyers and public relations staff of Getty Oil and the Museum drafted a press release describing the transaction between Pennzoil and the Getty entities. The press release, announcing an agreement in principle on the terms of the Memorandum of Agreement but with a price of $110 plus a $5 stub, was issued on Getty Oil letterhead the next morning, January 4, and later that day, Pennzoil issued an identical press release.

On January 4, Boisi continued to contact other companies, looking for a higher price than Pennzoil had offered. After talking briefly with Boisi, Texaco management called several meetings with its in-house financial planning group, which over the course of the day studied and reported to management on the value of Getty Oil, the Pennzoil offer terms, and a feasible price range at which Getty might be acquired. Later in the day, Texaco hired an investment banker, First Boston, to represent it

with respect to a possible acquisition of Getty Oil. Meanwhile, also on January 4, Pennzoil's lawyers were working on a draft of a formal "transaction agreement" that described the transaction in more detail than the outline of terms contained in the Memorandum of Agreement and press release.

On January 5, the Wall Street Journal reported on an agreement reached between Pennzoil and the Getty entities, describing essentially the terms contained in the Memorandum of Agreement. The Pennzoil board met to ratify the actions of its officers in negotiating an agreement with the Getty entities, and Pennzoil's attorneys periodically attempted to contact the other parties' advisors and attorneys to continue work on the transaction agreement.

The board of Texaco also met on January 5, authorizing its officers to make an offer for 100% of Getty Oil and to take any necessary action in connection therewith. Texaco first contacted the Museum's lawyer, Lipton, and arranged a meeting to discuss the sale of the Museum's shares of Getty Oil to Texaco. Lipton instructed his associate, on her way to the meeting in progress of the lawyers drafting merger documents for the Pennzoil/Getty transaction, to not attend that meeting, because he needed her at his meeting with Texaco. At the meeting with Texaco, the Museum outlined various issues it wanted resolved in any transaction with Texaco, and then agreed to sell its 11.8% ownership in Getty Oil.

That evening, Texaco met with Gordon Getty to discuss the sale of the Trust's shares. He was informed that the Museum had agreed to sell its shares to Texaco. Gordon Getty's advisors had previously warned him that the Trust shares might be "locked out" in a minority position if Texaco bought, in addition to the Museum's shares, enough of the public shares to achieve over 50% ownership of the company. Gordon Getty accepted Texaco's offer of $125 per share and signed a letter of his intent to sell his stock to Texaco, as soon as a California temporary restraining order against his actions as trustee was lifted.

At noon on January 6, Getty Oil held a telephone board meeting to discuss the Texaco offer. The board voted to withdraw its

previous counter-proposal to Pennzoil and unanimously voted to accept Texaco's offer. Texaco immediately issued a press release announcing that Getty Oil and Texaco would merge.

Soon after the Texaco press release appeared, Pennzoil telexed the Getty entities, demanding that they honor their agreement with Pennzoil. Later that day, prompted by the telex, Getty Oil filed a suit in Delaware for declaratory judgment that it was not bound to any contract with Pennzoil. The merger agreement between Texaco and Getty Oil was signed on January 6; the stock purchase agreement with the Museum was signed on January 6; and the stock exchange agreement with the Trust was signed on January 8, 1984.~

DAMAGES

In its 57th through 69th points of error, Texaco claims that the evidence was legally and factually insufficient to support the jury's~ damage awards.

Texaco attacks Pennzoil's use of a replacement cost model to prove its compensatory damages. It urges that:~ the court should have instructed the jury that the correct measure of Pennzoil's compensatory damages was the difference between the market price and contract price of Getty stock at the time of the breach;~ compensatory damages are excessive;~ and prejudgment interest should not have been allowed.

In a cause involving a tortious interference with an existing contract, New York courts allow a plaintiff to recover the full pecuniary loss of the benefits it would have been entitled to under the contract. The plaintiff is not limited to the damages recoverable in a contract action, but instead is entitled to the damages allowable under the more liberal rules recognized in tort actions.

New York courts have cited and relied extensively on the Restatement (Second) of Torts in deciding damages issues~.

Section 774A of the Restatement (Second) of Torts (1977), reads in pertinent part:

> (1) One who is liable to another for interference with a contract ... is liable for damages for
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> (a) the pecuniary loss of the benefits of the contract ...; [and]
>
> (b) consequential losses for which the interference is a legal cause....~

Pennzoil relied on two witnesses to prove the amount of its damages: Dr. Thomas Barrow and Dr. Ronald Lewis. Dr. Barrow holds a Ph.D. in petroleum engineering from Stanford University, and a bachelor's and master's degree from the University of Texas in geology and petroleum engineering. He has been president of Humble Oil & Refining Company, a senior vice-president of Exxon Corporation, chairman and chief executive officer of Kennecott Corporation, and president of Standard Oil of Ohio. He sits on the board of directors of many major corporations and charitable institutions.

Dr. Lewis is employed by Pennzoil as a vice-president in charge of offshore operations. He holds a bachelor of science degree and a master of science degree in petroleum engineering from Colorado School of Mines, and a Ph.D. with emphasis on petroleum engineering from the University of Texas. He has held responsible positions with the government, Mobil Oil Company, and Pennzoil, and taught petroleum engineering for seven years.

Texaco presented no witnesses to refute the testimony of Dr. Barrow or Dr. Lewis.

Dr. Barrow prepared three damages models, as follows:

> (1) a replacement cost model,
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> (2) a discounted cash flow model, and
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> (3) a cost acquisition model.

Because the jury based its award of damages on the replacement cost model, the other two models will not be discussed. By Dr. Barrow's testimony, Pennzoil showed that because of Texaco's interference with its Getty contract, it was deprived of its right to acquire 3/7th's of Getty's proven reserves, amounting to

1.008 billion barrels of oil equivalent (B.O.E.), at a cost of $3.40 a barrel. Pennzoil's evidence further showed that its cost to find equivalent reserves (based on its last five years of exploration costs) was $10.87 per barrel. Therefore, Pennzoil contended that it suffered damages equal to 1.008 billion B.O.E. times $7.47 (the difference between $10.87, the cost of finding equivalent reserves, and $3.40, the cost of acquiring Getty's reserves) or $7.53 billion. The jury agreed.

Texaco first alleges that the trial judge should have instructed the jury that the measure of Pennzoil's damages was the difference between the market value of Getty Oil stock and its contract price at the time of the breach. We reject this contention. The Getty/Pennzoil agreement contemplated something more than a simple buy-sell stock transaction. Pennzoil's cause of action against Texaco was in tort, not in contract, and Pennzoil's measure of damages was the pecuniary loss of the benefits it would have been entitled to under the contract. There was ample evidence that the reason Pennzoil (and later, Texaco) wanted to buy Getty was to acquire control of Getty Oil's reserves, and not for any anticipated profit from the later sale of Getty stock. There was evidence that such fluctuations in market price are primarily of interest to holders of small, minority share positions.

The court in Special Issue No. 3 correctly instructed the jury that the measure of damages was the amount necessary to put Pennzoil in as good a position as it would have been in if its agreement, if any, with the Getty entities had been performed. If the measure of damages suggested by Texaco was correct, then there would have been no necessity to submit an issue at all, because no issue of fact would have existed, there being no dispute about the market value of the stock or the contract price of the stock at the time of the breach.

Texaco next contends that the replacement cost theory is based on the speculative and remote contention that Pennzoil would have gained direct access to Getty's assets. Texaco strongly urges that Pennzoil had a "good faith" obligation under its alleged contract to attempt to reorganize and restructure Getty

Oil rather than to divide its assets. We agree. Under New York law, a duty of fair dealing and good faith is implied in every contract. But a duty of good faith and fair dealing does not require that Pennzoil completely subordinate its financial well-being to the proposition of reorganization or restructuring.

The directors of Pennzoil would have had a duty to the company's shareholders to obtain the greatest benefit from the merger assets, by either restructuring, reorganizing, or taking the assets in kind. If taking the assets in kind would be the most advantageous to Pennzoil, its directors would, in the absence of a great detriment to Getty, have a duty to take in kind. So the acquisition of a pro rata share of Getty Oil's reserves would be more than a mere possibility, unless the restructuring or reorganization of Getty would be just as profitable to Pennzoil as taking the assets in kind.

Next, Texaco urges that the jury's use of the replacement cost model resulted in a gross overstatement of Pennzoil's loss because:

> (a) Pennzoil sought to replace Getty's low value reserves with reserves of a much higher value;
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> (b) Pennzoil based its replacement cost on its costs to find oil only during the period from 1980 to 1984, rather than over a longer period;
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> (c) Pennzoil improperly included future development costs in its exploration costs;
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> (d) Pennzoil used pre-tax rather than post-tax figures; and
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> (e) Pennzoil failed to make a present value adjustment of its claim for future expenses.

Our problem in reviewing the validity of these Texaco claims is that Pennzoil necessarily used expert testimony to prove its losses by using three damages models. In the highly specialized field of oil and gas, expert testimony that is free of conjecture and speculation is proper and necessary to determine and estimate damages. Texaco presented no expert testimony to refute the claims but relied on its cross-examination of

Pennzoil's experts to attempt to show that the damages model used by the jury was flawed. Dr. Barrow testified that each of his three models would constitute an accepted method of proving Pennzoil's damages. It is inevitable that there will be some degree of inexactness when an expert is attempting to make an educated estimate of the damages in a case such as this one. Prices and costs vary, depending on the locale, and the type of crude found. The law recognizes that a plaintiff may not be able to prove its damages to a certainty. But this uncertainty is tolerated when the difficulty in calculating damages is attributable to the defendant's conduct.

In his replacement cost model, Dr. Barrow estimated the cost to replace 1.008 billion barrels of oil equivalent that Pennzoil had lost. Dr. Barrow admitted that some of Getty's reserves consisted of heavy crude, which was less valuable than lighter crude, and that he had made no attempt to determine whether there was an equivalency between the lost Getty barrels and the barrels used to calculate Pennzoil's exploration costs. Dr. Barrow also testified that there was no way to determine what grade of reserves Pennzoil would find in its future exploration; they could be better or worse than the Getty reserves. Finally Dr. Barrow testified that in spite of his not determining the value equivalency, the replacement cost model was an accepted method of figuring Pennzoil's loss. Dr. Lewis testified that with improved refining technology, the difference in value between light and heavy crude was becoming less significant.

Texaco next urges that Pennzoil should have calculated replacement cost by using a longer time period and industry wide figures rather than using only its own exploration costs, over a five year period. Dr. Lewis admitted that it might have been more accurate to use a longer period of time to estimate exploration costs, but he and Dr. Barrow both testified that exploration costs had been consistently rising each year and that the development cost estimates were conservative. Dr. Barrow testified that in his opinion, Pennzoil would, in the future, have to spend a great deal more than $10.87 a barrel to find crude. Dr. Lewis testified that industry wide exploration costs were

higher than Pennzoil's, and those figures would result in a higher cost estimate than the $10.87 per barrel used by Pennzoil.

Next, Texaco claims that Pennzoil inflated its exploration costs by $1.86 per barrel by including "future development cost" in its historical exploration costs. Both Dr. Lewis' and Dr. Barrow's testimony refuted that contention. Texaco neither offered evidence to refute their testimony, nor did its cross-examination reveal that this was an unwarranted cost.

Texaco also claims that Pennzoil should have used post-tax rather than pre-tax figures in figuring its loss calculations. First, it contends that there are large tax incentives for exploration and development that are not applicable to acquisition of reserves. Second, it contends that there was a $2 billion tax penalty attached to the Pennzoil/Getty agreement, and Pennzoil's $900 million share of that penalty would have increased its $3.40 pre-tax acquisition cost by nearly a dollar.

Dr. Barrow testified that the fact that Pennzoil included $997 million as recapture tax in its costs of acquiring the Getty reserves, made the pre-tax comparison between the $3.40 per barrel to acquire Getty reserves and the $10.87 per barrel for Pennzoil to find new oil, "apples and apples"; in other words, the $997 million tax adjustment compensated for the tax benefits reaped when discovering, as compared with purchasing, reserves. Further, there was no conclusive proof that the Internal Revenue Service would have assessed a $2 billion penalty to Getty's purchase of the Museum's shares under the Pennzoil/Getty agreement, as alleged by Texaco. Several witnesses, familiar with tax law, testified that it was unlikely that such a tax would be imposed; therefore it was for the jury to decide when assessing damages, whether Pennzoil's pro rata share of the speculative tax penalty should reduce the amount of its damages.

Texaco's contention that Pennzoil's cost replacement model should be discounted to present value ignores the fact that Pennzoil's suit is not for future damages but for those already sustained. Pennzoil would have had an interest in the Getty reserves immediately if the agreement had been consummated,

and it did not seek damages for reserves to be recovered in the future. The cases cited by Texaco are inapposite here because all involve damages that the plaintiff would incur in the future, such as lost wages or future yearly payments. Also, Texaco requested no jury instruction on a discount or a discount rate; therefore, any complaint of the court's failure to submit the issue or instruction is waived. *See* Tex.R.Civ.P. 279. Nor was Texaco entitled to an omitted finding by the court under rule 279, because the omitted discount and discount rate were not issues "necessarily referable" to the damages issue.

Texaco's Points of Error 57 through 60 are overruled.

In its 69th point of error, Texaco claims that the court erroneously applied New York Law when it allowed prejudgment interest, because most of the damages are to compensate for expenses to be incurred over the next 25 years. We have previously considered and rejected Texaco's contention that Pennzoil's recovery, or any part thereof, was for future damages.

Under New York law, a plaintiff in an action for inducing a breach of contract is entitled as a matter of right to interest on the amount of recovery, measured from the date of the accrual of the cause of action. *De Long Corp. v. Morrison-Knudsen Co.,* 14 N.Y.2d 346, 251 N.Y.S.2d 657, 200 N.E.2d 557 (1964).

Point of Error 69 is overruled.~

Questions to Ponder on *Texaco v. Pennzoil*

A. Consider what $7.53 billion in compensatory damages means. Did you think killing another human being was the worst thing a person could do? Not according to tort law. A DOJ study in 2004 found the median award in for wrongful death cases to be $961,000. That's more than 7,500 times smaller than Pennzoil's compensatory award for a business deal gone bad. Is there something wrong with that? Does it counsel some adjustment to our tort system? Or does it reflect an uncomfortable truth about the value of human life?

B. Why didn't Texaco present its own witnesses on the issue of damages, instead of "[relying] on its cross-examination of Pennzoil's

experts to attempt to show that the damages model used by the jury was flawed"? Was that a defensible, calculated risk? Or was that a huge lawyering mistake?

Historical Note on *Texaco v. Pennzoil*

Texaco, whose name is a contraction of "The Texas Company," was America's first nationwide brand of gasoline. In the 1980s, Texaco was the fifth largest corporation in the United States.

The $10.53 billion dollar judgment against Texaco was the biggest in U.S. history. It's a lot of money – even to an enormous oil company. Texaco wanted to appeal the judgment, and in the meantime stay the execution of the judgment. By staying the execution of the judgment, Texaco would not have to fork over the money until the appeal was over. The problem for Texaco was that Texas court rules required a stay of execution of judgment to be supported with a bond. That way, if the appeal failed, the plaintiff would still be assured of getting its money. But bonding companies don't have $10.53 billion in cash on hand any more than huge oil companies do. Texaco appealed to the U.S. Supreme Court, challenging the bonding requirement as unconstitutional, but in a unanimous decision, the Supreme Court rebuffed the oil giant.

In a concurrence, Justice Stevens wrote,

> ~Texaco makes a sympathetic argument, particularly when it describes the potential adverse impact of this litigation on its employees, its suppliers, and the community at large. But the exceptional magnitude of those consequences is the product of the vast size of Texaco itself — it is described as the fifth largest corporation in the United States — and the immensity of the transaction that gave rise to this unusual litigation. The character of harm that may flow from this litigation is not different from that suffered by other defeated litigants, their families, their employees, and their customers. The price of evenhanded administration of justice is especially high in some cases, but our duty to deal equally with the

> rich and the poor does not admit of a special exemption for multibillion-dollar corporations or transactions.

Pennzoil Co. v. Texaco, Inc., 481 U.S. 1, 65 (1987).

Texaco filed for bankruptcy within days of the announcement of the Supreme Court's decision, a move that blocked Pennzoil's collection efforts. (Federal bankruptcy's automatic stay halts all judgment collections.) It was the largest corporate bankruptcy in U.S. history to that point. After about a year, Texaco reached a $3 billion settlement with Pennzoil that allowed it to emerge from Chapter 11 with deep wounds. Eventually, Texaco was purchased by and absorbed into Chevron. Today, Texaco exists as an alternative brand used by Chevron for its retail gasoline sales.

Nonpecuniary or General Damages

Where the question of damages becomes particularly difficult is with nonpecuniary damages – damages that are not natively measured in dollars. The leading example of nonpecuniary damages is what's known as "pain and suffering." In addition, courts may award nonpecuniary damages for loss of enjoyment of one's life, which might include an inability to engage in a favored activity, such as playing the piano or cross-country skiing. In a defamation case, nonpecuniary damages might be awarded for the loss of one's good reputation.

Nonpecuniary damages also go by the names "non-economic damages" and "general damages." The latter label is typical in defamation cases, where it is contrasted with special damages. While special damages can be pinpointed with specificity, general damages are "general" in the sense that they are vague and impossible to pin down with precision.

The question of how to assign a specific dollar amount to someone's pain and suffering or lost enjoyment of life is a thorny one. But plaintiffs' attorneys are entitled to argue the point to juries, and juries must do the best they can to assign a fair dollar value.

Case: *Spell v. McDaniel*

The following case illustrates how nonpecuniary damages can exceed pecuniary damages by orders of magnitude.

Spell v. McDaniel

United States Court of Appeals for the Fourth Circuit
July 24, 1987

824 F.2d 1380. Henry Z. SPELL, Appellee, v. Charles D. McDANIEL, Individually and as Patrolman, City of Fayetteville Police Department, and John P. Smith, City Manager, City of Fayetteville, Defendants, and other cases consolidated with this one. Nos. 85-1524, 85-1523, 85-1691, 85-1714 and 85-1757. Before PHILLIPS, CHAPMAN and WILKINSON, Circuit Judges.

Circuit Judge JAMES DICKSON PHILLIPS:

This is a 42 U.S.C. § 1983 action in which after two trials Henry Spell was awarded substantial damages against the City of Fayetteville, North Carolina (the City), and Charles McDaniel, a City police officer, as a result of physical injury inflicted on Spell by McDaniel while Spell was in McDaniel's custody following Spell's arrest. McDaniel and the City have appealed~.

We find no reversible error in the trials and therefore affirm the judgment on the merits against McDaniel and the City.~

I

Spell, admittedly inebriated on alcohol and quaaludes, was stopped by Officer McDaniel while driving an automobile in the City of Fayetteville. After talking with Spell and finding a quantity of quaaludes in his automobile, McDaniel arrested him along with a passenger in Spell's automobile, handcuffed the two of them and took them in a patrol car to the police station. There Spell was subjected to various sobriety tests, including a breathalyzer test, and was formally charged with driving while impaired and with the possession of quaaludes. ↳Spell later pled guilty to the possession charge which was contained in a multi-

count indictment that also charged two counts of narcotics trafficking for which he was convicted after trial. At the time of trial of this § 1983 action, he was serving a seven year sentence growing out of those convictions, a fact brought out to the jury in Spell's own testimony on direct examination. Just after Spell completed the breathalyzer test and was returned, still handcuffed and inebriated, to McDaniel's direct custody, McDaniel, possibly angered by Spell's failure to respond to his questioning, and in any event without any physical provocation, brutally assaulted Spell. When Spell warded off a blow toward his head by raising his arms, McDaniel seized his handcuffed arms, pulled them down and violently kneed Spell in the groin. The blow to Spell's groin ruptured one of his testicles, necessitating its surgical removal. This resulted in irreversible sterility and of course in considerable associated pain and suffering. These are the essential facts necessarily accepted in substance by the jury in finding McDaniel liable. They were disputed by McDaniel, who denied making any assault on Spell and speculated that the conceded injury resulted from a pre-arrest occurrence. Though acceptance of these facts required outright rejection of McDaniel's testimony and that of another officer circumstantially corroborating McDaniel's, there was more than ample evidence supporting the critical finding. The district court, denying defendant's motion for judgment n.o.v. and alternatively for new trial, expressed flat incredulity at the testimony offered to support McDaniel's denial that he ever physically assaulted Spell.

Spell then brought this § 1983 action naming as defendants McDaniel, the City of Fayetteville, the City Manager, the City Chief of Police, the Director of the police department's Internal Affairs Division and two police department command sergeants. He structured the action as one against McDaniel in his individual and official capacities; against the City Manager, Smith, the Police Chief, Dixon, the Internal Affairs Division Director, Johnson, and the two command sergeants, Dalton and Holman, in their several official capacities; and against the City as a suable municipal corporation.~

> [T]he City contends that the district court abused its discretion in declining to set aside the second jury's compensatory award of $900,000 as excessive. Here again, of course, the district court's ruling is a discretionary one, and indeed is one that we review with even more than ordinary deference. See *Grunenthal v. Long Island Rail Road Co.*, 393 U.S. 156, 160 (1968) (only to determine if "untoward, inordinate, unreasonable or outrageous"); *Simmons v. Avisco, Local 713, Textile Workers Union,* 350 F.2d 1012, 1020 (4th Cir.1965) (only to determine whether "not merely excessive but 'monstrous'").
>
> Under this standard we cannot find error in the district court's ruling; indeed it seems to us eminently sound. Although Spell's medical expenses were relatively low ($2,041), his hospital stay short (four days), and his ability to function sexually not permanently impaired, the evidence showed that the assault caused him intense pain, that his damaged testicle enlarged five to seven times its normal size as a result, that it was like "a smashed piece of fruit" with the outer covering torn and the internal contents passing through the tear, that surgical removal of the testicle led to permanent disfigurement and that, on account of an earlier illness, the assault left Spell irreversibly sterile.~
>
> We therefore affirm the judgment against McDaniel and the City on the merits~.

Questions to Ponder About *Spell v. McDaniel*

A. The district court is entrusted with discretion to rule on a defendant's motion to set aside the jury's verdict as excessive, and an appeals court will not easily overturn the decision resulting from that exercise of discretion. As the circuit court says here, the district court's decision is to be treated with "even more than ordinary deference." Why do you suppose that is? Does it make sense?

B. Logically speaking, should it make any difference to the calculation of compensatory damages whether the defendant or plaintiff was sympathetic? Regardless of whether it should, does it in fact make such a difference? Are you surprised that a jury awarded $900,000 to a drug trafficker? Was it in part because of a belief that

the Officer McDaniel lied about kneeing Mr. Spell? Do you think the verdict would have been different if McDaniel had admitted to the kneeing?

Caps on Nonpecuniary Damages

For many years, tort reform advocates have looked to change various aspects of the civil tort system in order to reign in perceived abuses that negatively impact businesses. One object of the tort-reform movement has been to place upper limits on nonpecuniary damages. Most states now have some kind of cap on nonpecuniary damages, either for medical malpractice cases or for all tort cases.

The forerunner of this trend was California – perhaps surprising considering the state's liberal reputation. In 1975, California passed the Medical Injury Compensation Reform Act. The law places a $250,000 limit on nonpecuniary damages in medical liability cases. Cal. Civ. Code § 333.2.

The enactment of the cap in California helped precipitate a movement to enact similar caps across the country. Some examples: In 1995, North Dakota capped noneconomic damages in medical liability cases to $500,000. N.D. Cent. Code. § 32-42-02. In 2003, West Virginia capped noneconomic damages in medical liability cases to a maximum of $500,000, with a stricter cap of $250,000 applying in some circumstances. W.V. Code § 55-7B-8. In 2011, Tennessee passed a maximum cap of $1 million, with a lower limit of $750,000 in most cases. The limitation is not applicable where the defendant acted intentionally, was intoxicated, or falsified records.

California's cap remains among the nation's lowest, and it has not been adjusted for inflation since its enactment. Because of inflationary effects, the cap has shrunk in real terms by a factor of four. (An award of $250,000 in 1975 dollars would have been equivalent to $1.1 million in 2014.) The Golden State's trendsetting and nation-leading nonpecuniary damages cap is an interesting counterpoint to the role the state has so often played as a pioneer of plaintiff-friendly shifts in doctrine, including strict products liability and market-share liability. See *Greenman v. Yuba Power Products,* 59 Cal.2d 57. (Cal. 1963) (strict products liability; in Chapter 14) and

Sindell v. Abbott Labs, 26 Cal. 3d 588 (Cal. 1980) (market-share liability; in Chapter 7).

Mitigation

Plaintiffs have a **duty to mitigate** their losses. This means that, given the injury they sustained at the hands of a defendant, plaintiffs must do what they reasonably can to prevent their losses from growing larger.

A plaintiff who receives a cut to the leg, for instance, must promptly seek medical care and get stitches. If the plaintiff waits until the wound becomes infected and eventually gangrenous, so that amputation is necessary, the plaintiff is not entitled to damages for a lost limb. Instead, the plaintiff would be entitled to damages measured by the medical expense of getting stitches and the accompanying pain and suffering that would have been associated with the injury treated in that manner.

The Collateral Source Rule

The collateral source rule provides that a plaintiff is entitled to recovery from the defendant for tortiously caused damages regardless of whether or not a third party has stepped in to help the plaintiff pay some or all of those costs.

Before the modern era, the collateral source might have been a rich uncle or a religious charity. These days, the collateral source is likely to be an insurer. In fact, an automobile negligence case might involve injuries that are almost entirely covered by insurance – physicians' fees, hospital bills, medicine, physical therapy. None of this can be used to diminish the defendant's responsibility or the plaintiff's recovery.

The fairness of the collateral source rule has been widely questioned. The argument is as follows: If the goal of tort law is to make the plaintiff whole, and if a plaintiff is already made whole by someone other than the defendant, then the plaintiff has no more need for redress. Worse, it may be argued, a successful plaintiff who has also been the beneficiary of a collateral source has received a double recovery.

There are a few responses to this line of criticism. One is to question the assumption that the only goal of compensatory damages in tort law is to return the plaintiff to a pre-injury state. Another goal advanced for compensatory damages is to deter injury-producing behavior by would-be defendants. If businesses are never compelled to pay the costs of the injuries they cause, they might lack the needed incentives to be careful.

Another response is that if someone is going to receive a windfall – either the plaintiff by getting a double recovery, or the defendant by getting off scot-free – then it seems preferable that the plaintiff should receive the windfall, since the plaintiff is the blameless one.

A full debate about the collateral-source rule must also take into account the practical reality of how insurance works. Plaintiffs rarely receive a double recovery because insurance policies generally carry a right of **subrogation**: Once an insurance company pays a claim, it has the right to get reimbursed by the plaintiff if and when the plaintiff gets a tort recovery. Because of this, insurers benefiting from subrogation rights – subrogees – are said to "stand in the shoes" of their subrogor (the plaintiff) in being able to obtain compensation from the tortfeasor who ultimately necessitated the insurance payout.

Issues of Time: Past and Future Losses

Meritorious plaintiffs are entitled to one lawsuit and one judgment. This is sometimes called the **single-recovery rule**. The judgment must include all of the plaintiff's damages – past, present, and future. Present damages yield no particular difficulties. But past and future damages necessitate some special handling.

Pre-judgment Interest

For damages sustained in the past, the plaintiff is entitled to pre-judgment interest. Consider it this way: With past damages, the plaintiff was entitled to compensation at some specific moment in the past, perhaps at the moment of injury. Yet the meritorious plaintiff will not get a check until the end of her or his lawsuit. It's as if the plaintiff lent the tortfeasor money during that intervening time.

Pre-judgment interest means that the "loan" advanced to the defendant is not interest-free.

How pre-judgment interest is applied differs among the jurisdictions. In some states, interest runs from the date the complaint is filed. In others, interest begins accumulating at the moment of injury. Interest rates vary as well. In Arkansas, the interest rate is set by the state constitution at 6%, and it begins running at the time of loss. Ark. Const. art. 19, § 13. In New Mexico, the rate for actions based on "tortious conduct" is 15%, beginning on the date the complaint is served. N.M. Stat. § 56-8-4. Other states peg interest rates to one of several rates published by the Federal Reserve or even leave it up to the judge in the lawsuit to determine on a case-by-case basis. Other states do not provide for pre-judgment interest in tort suits at all.

The differences among jurisdictions are important, because pre-judgment interest can add up to real money. In a jurisdiction with an interest rate on the higher end, and if interest begins running at the time of loss, a judgment rendered six years later might be nearly doubled by accumulated interest.

Figuring Future Losses

Although past losses present their difficulties, future losses create much thornier questions. An injured plaintiff whose long-term medical prognosis will require more treatment and more surgeries will not be able to bring another lawsuit at a later time. This means that juries routinely face the difficult prospect of trying to determine what the plaintiff will need to expend in the future for continuing care. For a plaintiff rendered unable to work, the jury will be called upon to determine the plaintiff's lost wages over the rest of her or his life. This involves considering several questions: How long is the plaintiff likely to live? What were the plaintiff's career prospects? What will medical care and medical monitoring cost? The issue often comes down to a battle of expert witnesses, each of whom compiles analyses that are presented to the jury.

Regardless of how the jury and court resolve these issues, once the judgment becomes final, it is legally irrelevant what actually happens to the plaintiff. An injured plaintiff whose condition turns out to be

much worse – and much more expensive – than anticipated at the time of trial will be out of luck. A plaintiff given large amount of money in anticipation of expensive long-term care whose fortunes turn around when a new medical breakthrough completely reverses the injury is doubly lucky – that plaintiff has the cure and gets to keep the money.

Reducing Future Losses to Net Present Value and Accounting for Inflation

Once a court has decided on an appropriate figure for future losses, there remains the problem of figuring how to account for the changing value of money through time.

A dollar today is worth more than a dollar tomorrow – because in the meantime, money in the bank earns interest. If $10,000 of expenses will be incurred 10 years from now, an award of $10,000 today would require the defendant to wildly overpay.

Financial analysts and economists use a concept called "net present value" to compare money in the future to money in the present. Calculating net present value is the reverse of calculating the growth of money over time using compounded interest.

To calculate the net present value of a lump sum of money at some point in the future, you need to assume an interest rate (commonly called the "discount rate").

For an example, let's say we want to find the net present value of $10,000 three years in the future. Let's assume the effective year-over-year rate of interest is 10%. The net present value is $7,513.15.

To see how this is calculated, it is best to first see it done from the other direction, translating $7,513.15 into its value three years from now:

- After one year, $7,513.15 will increase by 10%. We add $7,513.15 to $751.31 (which is 10% of $7,513.15), and get $8,264.46. We can do this in one step by multiplying $7,513.15 by 1.10 (which is to multiply the number by itself plus 10% of itself).

- After year two, we multiply \$8,264.46 by 1.10 to get \$9,090.91.
- After year three, we multiply \$9,090.91 by 1.10 to get \$10,000.

To translate future value into present value, we do the reverse at each step, dividing by 1.10 instead of multiplying:

$$\$10{,}000 \div 1.10 \div 1.10 \div 1.10 = \$7{,}513.15$$

Let's simplify this:

$$\$10{,}000 \div (1.10 \times 1.10 \times 1.10) = \$7{,}513.15$$

And simplify again:

$$\$10{,}000 \div 1.10^3 = \$7{,}513.15$$

Now, replacing the numbers with symbols, we get a formula:

$$V_F \div (1 + r)^t = V_P$$

In the formula, V_F is the future value, r is the effective interest rate (or "discount rate"), t is time in units (such as years) that corresponds to the interest rate, and V_P is present value.

Compare the formula to the example above. If you look back and forth a few times, you should be able to see exactly how the formula works.

If you want to reduce to present value (to "discount" in financial jargon) a cash flow over time – that is, a continuous stream of money – as opposed to a single amount of money at a some predetermined point in the future – then the calculation is much more complex, and it helps to use calculus. But we can leave that task to the accountants.

Having an idea of how discounting works, we are left with an important question: What discount rate is appropriate for reducing future losses to net present value? Unfortunately, there is no easy answer. Interest rates change over time, and no one can predict with certainty what will happen to rates in the future. Thus, in absence of a controlling statute or rule, courts will permit expert testimony from economists about reasonable assumptions for future interest rates

and what the net present value of a future loss is based on those assumptions.

Although one might justifiably feel some sense of accomplishment after having carefully discounted future losses to present value, that analysis ignores another looming complication: Inflation.

Over time, inflation causes a dollar to lose purchasing power. Because of this, inflation works in the opposite direction of interest. The number of dollars in a bank account grows over time thanks to interest, but the value of each dollar declines thanks to inflation.

The opposing effects of inflation and interest have tempted some to argue that both inflation and interest can be assumed to net to zero, so that a lump sum for the future can be awarded without any adjustment. But that approach – while perhaps enticing for its simplicity – seems to be unsound policy. Under usual economic conditions, interest steadily outpaces inflation so that money will grow in real terms over time. The Ninth Circuit, for instance, has admonished trial courts not to take the lazy way out:

> By today's holding that the trier of facts in awarding damages may take into consideration estimated changes in the purchasing power of money, we do not mean to imply that the lower court may use our holding as an excuse not to discount an award to its net present value. In other words, the court may not assume that the discount rate and the inflation rate will net to zero. The lower court must first estimate future income and expenses, taking into account estimated changes in the purchasing power of the dollar, and then discount this future net income stream to its present value. Nor do we intend to have our holding of today read as authorizing the court to arbitrarily draw an estimate of inflation out of thin air. [¶] As with any other element of damages, we must require the estimate of future inflation to be supported by competent evidence. The court is to be especially wary of the pitfalls~ inherent in making predictions about the future of

> economic conditions. By our holding we allow the trier of fact in awarding damages to take into account only such estimates of future changes in the purchasing power of money as are based on sound and substantial economic evidence, and as can be postulated with some reliability

U.S. v. English, 521 F.2d 63, 75-76 (9th Cir. 1975).

Calculations can be made easier when the discount rate is set such that it already takes into account the effects of anticipated inflation. (And stated discounted rates are often inclusive of inflationary effects.) But easing the arithmetic does not address the underlying uncertainty in the calculation. When you combine the difficulty of estimating future losses with the uncertainty of future interest rates and inflation, you end up with a monetary award that is sagging under the weight of layers of assumptions. What is more, the award can be pricey to deduce, given the expert testimony it requires. In the eyes of the courts, however, this imperfect justice is preferable to the overt injustice of awarding plaintiffs windfalls or of depriving them of recovery altogether.

Problem on Discounting Future Losses to Net Present Value

After a bench trial, the judge determines that Amelia has received a latent injury that is more likely than not going to require extensive surgery in the future. The judge accepts as a model for damages that Amelia is likely to need $1 million in medical care at a point in time 10 years in the future. The judge also accepts expert testimony establishing an annual discount rate inclusive of inflation of 3.9%. What should be Amelia's award today, discounted to present value?