

# Daily Journal

## If Award Is Not Reduced, Philip Morris May File for Bankruptcy

By Howard N. Madris

**O**n Oct. 4, a Los Angeles jury issued a \$28 billion punitive damages verdict against Philip Morris. The award was in addition to the \$750,000 in economic damages and \$100,000 for pain and suffering that the jury previously had awarded the plaintiff, a 64-year-old former smoker with lung cancer. *Bullock v. Philip Morris Inc.*, BC249171 (L.A. Super. Ct. Oct. 4, 2002). It is quite possible that the punitive damages portion of the award will be reduced substantially on constitutional grounds, either by the trial judge pursuant to post-trial motions or on appeal.

However, if the trial judge does not reduce the award Philip Morris could probably file for Chapter 11 relief in order to avoid posting a supersedeas bond during the appeal process.

Compensatory and punitive damages serve distinct purposes. Compensatory damages are designed to compensate the plaintiff for the losses suffered due to the defendant's wrongful conduct. In contrast, punitive damages, which have been described as "quasi-criminal," operate as "private fines" that are intended to punish the defendant and deter future misdeeds. *Cooper Indus. v. Leatherman Tool Group Inc.*, 532 U.S. 424 (2000).

The Due Process Clause of the 14th Amendment to the U.S. Constitution limits the imposition of punitive damages. The clause makes the Eighth Amendment's prohibition against excessive fines and cruel and unusual punishment applicable to the U.S. states. Of its own force, the clause also prevents states from imposing "grossly excessive" punishments against tort-feasors. *Cooper Industries*.

The U.S. Supreme Court has set forth three factors for analyzing whether the amount of a punitive damages award is constitutional. In determining the propriety of such an award, a court must consider the degree or reprehensibility of the

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**would presumably 'severely disrupt' its business.**

defendant's misconduct, the disparity between the harm or potential harm suffered by the plaintiff and the punitive damages award, and the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases. *BMW of N. Am. v. Gore*, 517 U.S. 559 (1996).

The most commonly cited indicator of an excessive punitive damages award is the second of these three factors, which takes into account the ratio of punitive to compensatory damages. *Gore*. There is no "mathematical bright line" as to whether a ratio will pass constitutional muster. *Gore*. However, the ratio must not "jar one's constitutional sensibilities." *Pacific Mutual Life Ins. Co. v. Haslip*, 499 U.S. 1 (1991).

In recent years, the Supreme Court has considered the ratio of

punitive to compensatory damages in several cases. For instance, in *Haslip*, the court upheld approximately a 4-to-1 ratio of punitive to compensatory damages, even though the ratio was "close to the line" of unconstitutionality, and despite the fact that the ratio of punitive damages to the plaintiff's out-of-pocket costs was approximately 200:1.

In contrast, in *Gore*, the Supreme Court found that a 500:1 ratio of punitive to compensatory damages (where the punitive damages were \$2,000,000) was "grossly excessive." However, the court considered that the defendant's conduct in that case (failure to disclose that certain "new" cars it was selling had been repainted) was not particularly reprehensible and had caused only minor economic harm.

The *Gore* court also noted that the \$2 million punitive damages award could not be justified on the ground that it was designed to achieve future deterrence, because there was no consideration as to whether a lesser sanction would achieve such deterrence.

Based on these recent Supreme Court decisions, it is highly questionable whether the jury's award in *Bullock* will pass constitutional muster. Certainly, the conduct in which the jury found Philip Morris to have engaged was highly reprehensible. The jurors obviously were persuaded by the plaintiff's arguments and evidence that Philip Morris concealed the dangers of cigarettes with a widespread disinformation campaign dating back to the 1950s, which the plaintiff's counsel, Michael Piuze, characterized in his closing argument to the jury as "the largest fraud scheme ever perpetrated by corporations anywhere."

Nonetheless, in *Bullock*, the punitive damages award of \$28 billion appears to "jar one's constitutional sensibilities." *Haslip*. In *Bullock* the ratio of punitive to compensatory damages exceeds 32,000:1. The ratio of punitive damages to the \$100,000 in damages awarded for pain and suffering is 280,000:1. The award is approximately one-third of Philip Morris' entire market capitalization and approximately three times Philip Morris' net profits for the year ended June 30, 2002. Perhaps a somewhat lower punitive damages award (maybe a nine-figure sum) might have the same deterrent effect. See *Gore*.

If the trial judge does not drastically lower the \$28 billion punitive damages award, Philip Morris might have no choice but to file for bankruptcy protection in order to stay the plaintiff from collecting on the judgment during the appeal process without having to post an appeal bond. 11 U.S.C. Section 362. Absent a bankruptcy filing, Philip Morris would have to post an appeal bond of more than \$42 billion (150 percent of the judgment) to obtain a stay pending appeal. Code of Civil Procedure Section 917.1(b).

However, the plaintiff might move to dismiss the bankruptcy as a "bad-faith" filing. Bankruptcy Code Section 1112(b) authorizes a Bankruptcy Court to dismiss a Chapter 11 case for "cause." Numerous courts have held that a lack of good faith in filing constitutes cause for dismissal as a bad faith filing. See, for example, *In re Marsch*, 36 F.3d 825 (9th Cir. 1994).

The existence of good faith "depends on an amalgam of factors

and not upon a specific fact." *In re Arnold*, 806 F.2d 937 (9th Cir. 1986). *Marsch* is the only published 9th U.S. Circuit Court of Appeals decision addressing whether a bond bankruptcy can be filed in good faith. In *Marsch*, the 9th Circuit ordered dismissal pursuant to Section 1112(b). The debtor had filed to avoid bonding her appeal of a judgment requiring that she return the value of stock she received from her former husband.

In ordering dismissal under Section 1112(b), the 9th Circuit recognized that some courts have held that filing bankruptcy to stay collection during an appeal without posting bond is a bad faith "litigation tactic" designed to "act as a substitute for a supersedeas bond," thereby warranting dismissal.

But other courts have held that Chapter 11 may be used to avoid posting an appeal bond provided that the debtor establishes that satisfaction of the judgment would "severely disrupt the debtor's business," and that the debtor cannot satisfy the judgment with "nonbusiness assets," noted the *Marsch* court.

The 9th Circuit held that dismissal was proper because the debtor was not involved in a business venture and had the financial means to pay the judgment. However, it explicitly left open whether a petition filed solely to avoid bonding an appeal is in bad faith, even where the collection of the judgment would severely disrupt the debtor's business and the debtor lacks the ability to pay the judgment.

Several bankruptcy courts in the 9th Circuit have held that good faith may exist if a Chapter 11 petition is a business debtor's only means of staying a judgment pending appeal. In

the case of *In re Boynton*, 184 B.R. 580 (Bankr. S.D. Cal. 1995), the court stated that "[g]enerally, two types of cases have allowed a Chapter 11 filing in lieu of a supersedeas bond. These are (1) where there is a multinational company faced with mass tort litigation; or (2) where a large debt would force the debtor to close its business and liquidate." See also *In re Glenn McKittrick Byrd*, 172 B.R. 970 (Bankr. W.D. Wash. 1994).

Conversely, one court held that a bond bankruptcy is inherently in bad faith even if the debtor's business clearly lacks the ability to post an appeal bond. *In re Karum Group Inc.*, 66 B.R. 436 (Bankr. W.D. Wash. 1986).

If the trial judge does not substantially lower the punitive damages award, a Philip Morris Chapter 11 bankruptcy would probably be in good faith. The company presumably is unable to post a \$42 billion appeal bond. Furthermore, outside of bankruptcy, the seizure of more than \$28 billion of Philip Morris' assets would presumably "severely disrupt" its business.

In sum, the enormity of the punitive damages award has several implications. The award is so great that it may well violate the U.S. Constitution. Alternatively, the award is so high that if the trial judge does not reduce it Philip Morris would probably be able to file a Chapter 11 petition in good faith in order to obtain a stay during the appeal process.