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Constitutional Law -- Due Process Clause -- Third Circuit Holds that \$50 Million Punitive Damages Award in Context of a \$48 Million Compensatory Award is Unconstitutionally Excessive -- Inter Medical Supplies, Ltd. v. EBI Medical Systems, Inc., 181 F.3d 446 (3d Cir. 1999).

A. Benjamin Spencer

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CONSTITUTIONAL LAW — DUE PROCESS CLAUSE — THIRD CIRCUIT HOLDS THAT \$50 MILLION PUNITIVE DAMAGES AWARD IN CONTEXT OF A \$48 MILLION COMPENSATORY AWARD IS UNCONSTITUTIONALLY EXCESSIVE. — *Inter Medical Supplies, Ltd. v. EBI Medical Systems, Inc.*, 181 F.3d 446 (3d Cir. 1999).

In 1996, the Supreme Court, in *BMW of North America, Inc. v. Gore*,¹ struck down a punitive damages award on the ground that it was “grossly excessive” in violation of the Due Process Clause of the Fourteenth Amendment.² Since *BMW*, many courts have faced the challenge of applying its principles to determine whether punitive damages awards surpass the constitutional limit.³ Last June, in *Inter Medical Supplies, Ltd. v. EBI Medical Systems, Inc.*,⁴ the Third Circuit faced this difficulty when it considered whether a \$50 million punitive damages award, granted in conjunction with a \$48 million compensatory damages award, was excessive under the Due Process Clause.⁵ Interpreting *BMW* as holding that economic harms are less worthy of large punitive damages awards than physical harms,⁶ the Third Circuit panel concluded that “EBI’s conduct . . . was not sufficiently egregious to warrant a punitive damages award of \$50 million”⁷ and hence reduced the award to \$1 million.⁸ In doing so, the Third Circuit neglected *BMW*’s core holding — that large punitive damages awards are constitutional when a defendant has notice that his conduct may result in such awards.⁹ As a result, the Third Circuit has armed its lower courts with the ability to invalidate many punitive damages awards that raise no real due process concerns under *BMW*.

In 1983, Orthofix, S.r.l. (“Orthofix”) agreed that EBI Medical Systems, Inc. (“EBI”) would serve as the exclusive North American distributor of its products.¹⁰ The parties renewed their agreement in 1990, after which time the relationship between Orthofix and EBI de-

¹ 517 U.S. 559 (1996).

² U.S. CONST. amend. XIV, § 1; *BMW*, 517 U.S. at 586 (“[W]e are fully convinced that the grossly excessive award imposed in this case transcends the constitutional limit.”).

³ See, e.g., *FDIC v. Hamilton*, 122 F.3d 854, 861–62 (10th Cir. 1997) (applying the *BMW* factors to invalidate a punitive damages award 27 times the amount of the compensatory award).

⁴ 181 F.3d 446 (3d Cir. 1999).

⁵ See *Inter Med. Supplies*, 181 F.3d at 467.

⁶ See *id.*

⁷ *Id.*

⁸ See *id.* at 468–69.

⁹ See *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 574 (1996).

¹⁰ See *Inter Med. Supplies*, 181 F.3d at 451. Orthofix is a manufacturer of medical devices, including External Dynamic Axial Bone Fixator Systems, which are used in the treatment of severe fractures. See *Inter Med. Supplies, Ltd. v. EBI Med. Sys., Inc.*, 975 F. Supp. 681, 685 (D.N.J. 1997).

teriorated.¹¹ Upon realizing that it would not be renewed as the exclusive North American distributor of Orthofix products, EBI implemented a plan to compete with Orthofix by creating and distributing its own external bone fixator.¹² This plan was largely successful: the defendants profited by approximately \$97 million¹³ while Orthofix suffered \$95 million in lost profits¹⁴ and also lost its status as a major force in the United States market for external bone fixation devices.¹⁵

In response to EBI's actions, Orthofix and several related entities¹⁶ brought suit against EBI, asserting various contract and tort claims as well as statutory offenses.¹⁷ At trial in the United States District Court for the District of New Jersey, a jury found EBI liable for breach of contract, breach of the duty of good faith and fair dealing, tortious interference with prospective economic advantage, tortious interference with contract, defamation, unfair competition, and violation of the Lanham Act.¹⁸ The jury awarded the plaintiffs \$48 million in compensatory damages and \$100.6 million in punitive damages.¹⁹ The defendants then filed a motion for remittitur of the jury's punitive damages award.²⁰ The district court found that the original punitive award did "not run afoul of the Constitution" because it was consistent with the principles of *BMW*.²¹ However, finding the punitive damages award to be unreasonable under New Jersey's Punitive Damages Act,²² the district court ordered a remittitur, which reduced the

¹¹ See *Inter Med. Supplies*, 181 F.3d at 451.

¹² See *Inter Med. Supplies*, 975 F. Supp. at 685. EBI employees "used reverse engineering" of Orthofix products to replicate construction of Orthofix components, "substituted EBI manufactured parts for Orthofix ones," and "never informed medical professionals of the substitution, in effect passing off [it]s own components for those of Orthofix." *Inter Med. Supplies*, 181 F.3d at 452-53. In addition to unlawfully replicating Orthofix's technology, EBI's plan included deceiving customers into thinking that its products were merely "upgrades to or newer versions of the Orthofix products that EBI had been selling for years." *Id.* at 453.

¹³ See *Inter Med. Supplies*, 975 F. Supp. at 700.

¹⁴ See *id.* at 691.

¹⁵ See *id.* at 685.

¹⁶ The relevant plaintiffs in this action were Orthofix, an Italian company, and Inter Medical Supplies, a Cyprus-based marketing affiliate of Orthofix and a worldwide distributor of Orthofix products. See *id.*

¹⁷ See *id.* at 684.

¹⁸ See *id.* The relevant portion of the Lanham Act, which deals with trademark infringement, is found at 15 U.S.C. §§ 1114, 1125(a) (1998).

¹⁹ See *Inter Med. Supplies*, 975 F. Supp. at 684. The jury also awarded Inter Medical Supplies \$875,399.00 to compensate it for unpaid goods sold and delivered to EBI. See *id.* EBI counter-claimed for breach of contract, breach of the duty of good faith and fair dealing, tortious interference with prospective economic advantage, and tortious interference with contract and was awarded \$1.00 for those claims. See *id.*

²⁰ See *id.* at 685. The defendants also filed a renewed motion for judgment as a matter of law, and in the alternative, for a new trial. See *id.* The court denied both motions. See *id.*

²¹ *Id.* at 696.

²² N.J. STAT. ANN. § 2A:15-5.14(a) (West 1999).

amount of the punitive award to \$50 million.²³ The defendants then appealed to the United States Court of Appeals for the Federal Circuit, but because Orthofix had earlier abandoned its patent claim, the action was transferred to the Third Circuit.²⁴

A divided Third Circuit panel upheld the district court's finding with respect to liability and the amount of compensatory damages but rejected its ruling on punitive damages.²⁵ Writing for the majority, Judge Sloviter²⁶ found that even the reduced amount of punitive damages was excessive in violation of the Due Process Clause²⁷ and further reduced the punitive damages to \$1 million.²⁸ The majority reached its conclusion by applying the *BMW* "guideposts,"²⁹ as they had been interpreted by the Tenth Circuit in *Continental Trend Resources, Inc. v. OXY USA, Inc.*³⁰ Judge Sloviter decided to rely on the first of the three *BMW* guideposts — reprehensibility — as the main consideration in evaluating the excessiveness of the punitive damages award.³¹ Referring primarily to *Continental Trend Resources*, the *Inter Medical Supplies* majority cited several factors used to determine the reprehensibility of a defendant's conduct, including "whether it caused economic rather than physical harm," whether it "involve[d] deliberate false statements rather than omissions," and whether it was "aimed at a vulnerable target."³² Applying those factors, the majority concluded that because the harm EBI inflicted upon Orthofix was economic and because Orthofix was not a financially vulnerable target, "EBI's conduct . . . was not sufficiently egregious to warrant a punitive damages award of \$50 million."³³ Having reached this conclusion, the majority determined that "the proper, reasonable punitive damages award is no more than \$1 million."³⁴

In dissent, Judge Garth sharply criticized the majority for deviating from the Third Circuit's previously established standard of review and

²³ See *Inter Med. Supplies*, 975 F. Supp. at 702.

²⁴ See *Inter Med. Supplies*, 181 F.3d at 454.

²⁵ See *id.* at 470.

²⁶ Judge Magill joined in Judge Sloviter's opinion.

²⁷ See *id.* at 467. The court did not find the reduced award to violate the New Jersey Punitive Damages Act. See *id.* at 465.

²⁸ See *id.* at 468–69.

²⁹ The three "guideposts" for evaluating the excessiveness of punitive damages awards outlined in *BMW* are the degree of reprehensibility of the defendant's conduct, the ratio of the punitive damages to the compensatory damages, and the civil or criminal sanctions available for comparable misconduct. See *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 575 (1996).

³⁰ 101 F.3d 634 (10th Cir. 1996).

³¹ See *Inter Med. Supplies*, 181 F.3d at 467.

³² *Id.* (quoting *Continental Trend Resources*, 101 F.3d at 638).

³³ *Id.* The majority noted that the contractual relationship between the parties and "the jury's finding that Orthofix itself breached the distributor agreement" also weighed in its consideration of the egregiousness of EBI's conduct. *Id.*

³⁴ *Id.* at 468–69.

for failing to apply *BMW*'s guideposts properly.³⁵ Regarding standard of review, Judge Garth felt that the proper standard required giving "super-deference" to a district court's determination, "especially after a grant of remittitur."³⁶ Under this standard, Judge Garth would not have disturbed the district court's ruling.³⁷ Judge Garth also concluded that the reduced amount of punitive damages was constitutionally sound under the "guideposts" established by *BMW*.³⁸ He noted that under the *BMW* Court's conception of reprehensibility, which takes into account "intentionality, repetitive conduct, and conduct involving deliberate false statements," each of which were "found by the jury to have occurred in this case," EBI's conduct was sufficiently egregious to be considered reprehensible under the *BMW* standard.³⁹

Far from adhering to the Court's decision in *BMW*, the *Inter Medical Supplies* majority misapplied the *BMW* test. Though characterizing its conclusions as constitutionally required, the findings of the majority are not mandated by *BMW*. The majority's divergence from *BMW* is due in large part to its failure to focus on the core concern of the *BMW* Court — whether a defendant had notice that the punitive damages award could be as large as it was — as well as the majority's unwarranted emphasis on whether the harm was physical or economic.

The due process considerations highlighted by the Court in *BMW* were whether the defendant received fair notice of both the possibility of punishment for conduct and the severity of the penalty that a state might impose for that conduct.⁴⁰ The three "guideposts" described by

³⁵ See *id.* at 471, 476 (Garth, J., dissenting).

³⁶ *Id.* at 471. Judge Garth referred to *Keenan v. City of Philadelphia*, 983 F.2d 459 (3d Cir. 1992), as the most recent and relevant expression of the Third Circuit's standard of review for evaluating the excessiveness of punitive damages awards. See *Inter Med. Supplies*, 181 F.3d at 471. According to *Keenan*, review of such questions "is severely limited. . . . Where the district judge has granted a remittitur, deference to the trial court is heightened." *Keenan*, 983 F.2d at 472 (citation omitted) (internal quotation marks omitted). The majority in *Inter Medical Supplies* disagreed, relying instead upon *Dunn v. Hovic*, 1 F.3d 1371 (3d Cir. 1993), wherein the court stated that:

[w]e cannot leave the amount of punitive damages solely to the trial court because it is evident to us that the Supreme Court in [*Pacific Mutual Life Insurance Co. v. Haslip*, 499 U.S. 1 (1991)], approved review by an appellate court to "determin[e] whether a particular award is greater than reasonably necessary to punish and deter."

Dunn, 1 F.3d at 1385 (quoting *Haslip*, 499 U.S. at 19); see *Inter Med. Supplies*, 181 F.3d at 469.

³⁷ See *Inter Med. Supplies*, 181 F.3d at 471 (Garth, J., dissenting).

³⁸ See *id.* at 476.

³⁹ *Id.* (stating that the evidence that EBI engaged in a series of continuous and intentional deceptive acts was "more than sufficient to justify the jury's finding of reprehensible conduct, which is the 'most important indicium' among the guideposts." (quoting *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 575 (1996))). Judge Garth additionally noted that the ratio of compensatory to punitive damages was well within the amount permitted under the *BMW* test. See *id.* at 477 (noting that the district court's "remittitur of \$50,000,000 . . . when compared to the compensatory damages of \$48,000,000, is essentially a 1:1 ratio, and well within the guidepost of *BMW*").

⁴⁰ *BMW*, 517 U.S. at 574.

the Court⁴¹ were intended to aid in the latter determination.⁴² The degree of reprehensibility of the defendant's conduct — the first of these guideposts — facilitates this determination presumably because one who has willfully engaged in particularly egregious conduct cannot claim to be surprised that significant punitive consequences may result from his or her behavior.⁴³

Taking its lead from the Tenth Circuit, the *Inter Medical Supplies* majority focused primarily on the reprehensibility component to evaluate the excessiveness of the punitive damages award.⁴⁴ In evaluating the reprehensibility of EBI's behavior, the majority emphasized the *BMW* Court's finding that the plaintiff's injury was "purely economic in nature"⁴⁵ to support its conclusion that EBI's conduct, "which inflicted only economic harm," was insufficiently reprehensible to warrant a \$50 million punitive damages award.⁴⁶ While the *BMW* Court acknowledged a distinction between economic and physical harms,⁴⁷ it never indicated that economically harmful conduct could not be sufficiently egregious to warrant substantial punitive damages. To the contrary, the *BMW* Court noted that the "infliction of economic injury, especially when done intentionally through affirmative acts of misconduct . . . can warrant a substantial penalty."⁴⁸ The Court elaborated by stating that "trickery and deceit are more reprehensible than negligence"⁴⁹ and that "evidence that a defendant has repeatedly engaged in prohibited conduct while knowing or suspecting that it was unlawful would provide relevant support for an argument that strong medicine is required to cure the defendant's disrespect for the law."⁵⁰

Although the *Inter Medical Supplies* majority acknowledged extensive, willful, and repeated wrongdoing on the part of the defendants,⁵¹ it ignored these statements from *BMW*. The majority recognized the

⁴¹ See *supra* note 29.

⁴² See *BMW*, 517 U.S. at 574.

⁴³ For example, because murder is regarded as a particularly reprehensible act that is universally condemned as unacceptable behavior, one who deliberately kills a person can expect that a significant penalty may attach to the offense. Compare this to a jaywalker, whose act is much less universally condemned and whose harm is relatively minor; the expectation of severe penal sanctions is significantly lessened, and the imposition of such sanctions would be quite surprising.

⁴⁴ See *Inter Med. Supplies*, 181 F.3d at 467 (relying upon Tenth Circuit cases in which "punitive damages awards were [found to be] excessive even though not all three of the indicia of excessiveness identified by the Supreme Court were present").

⁴⁵ *BMW*, 517 U.S. at 576. The economic harm to the plaintiff in *BMW* was \$4,000. See *id.* at 565.

⁴⁶ *Inter Med. Supplies*, 181 F.3d at 467.

⁴⁷ See *BMW*, 517 U.S. at 576 (noting that "non-violent crimes are less serious than crimes marked by violence").

⁴⁸ *Id.*

⁴⁹ *Id.* (citation omitted) (internal quotation marks omitted).

⁵⁰ *Id.* at 576-77.

⁵¹ See *Inter Med. Supplies*, 181 F.3d at 467.

jury's findings that "EBI acted with either actual malice or a wanton and willful disregard of persons who foreseeably might be harmed, that EBI's plan involved acts of deception and, at least, reckless disregard of the consequences to Orthofix, and that those acts continued over an extended period of time with full awareness of the harm to Orthofix."⁵² That the majority felt that *BMW* commanded a further reduction under these circumstances is striking: these findings mirror exactly the considerations that the *BMW* Court stated were indicative of reprehensibility.⁵³

A proper understanding and application of the *BMW* guideposts would have led the *Inter Medical Supplies* majority to recognize that the punitive damages award in this case was constitutional. The criteria for an acceptable award established by the *BMW* Court are met here: the fraudulent, ongoing, and willful nature of the defendants' conduct⁵⁴ made it sufficiently reprehensible. The ratio of punitive damages to compensatory damages was virtually one to one, satisfying the second *BMW* guidepost.⁵⁵ Regarding the third guidepost, the *BMW* Court stressed that "a reviewing court engaged in determining whether an award of punitive damages is excessive should accord substantial deference to legislative judgments concerning appropriate sanctions for the conduct at issue."⁵⁶ Looking to such legislative judgments in this case, New Jersey, where EBI voluntarily chose to do business, has determined that punitive damages awards are warranted when a party is found to have acted with "actual malice" or "a wanton and willful disregard of persons who foreseeably might be harmed."⁵⁷ Further, New Jersey has authorized punitive damages up to a limit of "five times the liability of that defendant for compensatory damages."⁵⁸ Beyond demonstrating that the legislature has decided to allow punitive damages in the amount awarded in this case, these facts also show that EBI had more than enough notice that substantial punitive damages were possible. With each of the guideposts of *BMW* satisfied, the *Inter Medical Supplies* majority's conclusion that the reduced award violated due process simply missed the mark.

⁵² *Id.*

⁵³ See *BMW*, 517 U.S. at 576.

⁵⁴ See *Inter Med. Supplies*, 181 F.3d at 467.

⁵⁵ Under the district court's original remittitur the exact ratio of punitive damages to compensatory damages was 1.04:1.

⁵⁶ *BMW*, 517 U.S. at 583 (citations omitted) (internal quotation marks omitted).

⁵⁷ N.J. STAT. ANN. 2A:15-5.12(a) (West 1999).

⁵⁸ N.J. STAT. ANN. 2A:15-5.14(b) (West 1999).