



## The Roberts Court and Liability Reform

By Ted Frank

*It was expected that the Supreme Court's October Term 2006, which ended in June of this year, would result in decisions of great significance for the prospect of liability reform. And indeed this was so. But the surprise was that the greatest impact came not from the cases that immediately and directly raised issues of importance, but rather from unexpected turns in the Court's decisions in other cases.*

In its most recent term, the Supreme Court deferred decisions on the constitutionality of punitive damages and the power of the administrative branches to declare preemptive effect to regulation by making minimalist incremental decisions, but it also took some dramatic steps in other cases that will have a lasting effect. The Roberts Court regularly recognizes the limits of litigation and the dangers of judicial aggrandizement, while expressing an increasing willingness to get involved in the nitty-gritty of business litigation cases that the Rehnquist Court largely avoided. We should therefore be cautiously optimistic about future developments as important cases about federal preemption and the scope of securities laws come before the Court in October Term 2007.

### Punting on Punitives

In 1999, an Oregon jury found Philip Morris 50 percent responsible for Jesse Williams's inoperable lung cancer from forty-five years of smoking two packs a day, awarded \$821,485 in compensatory damages (capped at \$521,485), and then an uncapped \$79.5 million in punitive damages—a ratio of 97-to-1 or 152-to-1. Philip Morris appealed. Not only had the lower court refused to instruct the jury not to punish Philip Morris for alleged conduct committed against all other Oregon smokers (as the plaintiffs had asked in

closing argument), but earlier Supreme Court decisions—*State Farm v. Campbell*<sup>1</sup> and *BMW v. Gore*<sup>2</sup>—had suggested that a 10-to-1 ratio was a constitutional maximum. Nevertheless, the Oregon Supreme Court upheld the decision after an earlier remand from the U.S. Supreme Court,<sup>3</sup> holding there was no prohibition “from using punitive damages to punish a defendant for harm to non-parties,”<sup>4</sup> and the Supreme Court again accepted Philip Morris's petition for certiorari.

But since 2003, two justices of the six-justice majority in *Campbell* are no longer on the Court, replaced by Chief Justice John Roberts and Justice Samuel Alito. With Justices Antonin Scalia and Clarence Thomas repeatedly holding that the Fourteenth Amendment did not constrain punitive damages awards, there was some question whether the Roberts Court would revisit those precedents and take the Supreme Court out of the business of reviewing whether punitive damages were “grossly excessive.”

The result was anticlimactic. The respondents tactically chose not to ask the Supreme Court to revisit *Gore*'s or *Campbell*'s “grossly excessive” standard, and the Court avoided the question.<sup>5</sup> The Supreme Court reversed and remanded for further consideration: while it was permissible to consider actual or potential harm suffered by others in determining the reprehensibility of conduct, it was impermissible to punish a defendant for such harm. While this ruling affects the *Williams* case and perhaps a handful of other cases currently on

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appeal, I do not completely agree with those who called it “a big win for the business community.”<sup>6</sup> The majority decision asks juries to perform an exceptionally nuanced evaluation, and it is hard to see how it will have any practical effect. Trial lawyers giving closing arguments will be able to present the same unfairly prejudicial evidence of alleged wrongdoing to nonparties when asking for punitive damages. The post-*Williams* world presents the same standardless system that the Court found problematic in *Williams* itself. Worse, the Court’s decision might be read implicitly to express apparent willingness to uphold a 152-to-1 ratio of punitive to compensatory damages, even as the compensatory damages themselves are frequently unmoored by uncapped noneconomic damages.<sup>7</sup>

The long-term danger is that if the Court cannot find a majority to establish clear standards, the Court may come to agree with Justice Scalia’s opinion that federal constitutional review of punitive damages awards is unworkable. Meanwhile, businesses continue to be whipsawed by irrational punitive damages awards: less than a month after the *Williams* decision was released, a California jury awarded \$50 million in punitive damages against DaimlerChrysler for injuries caused in part by a vehicle whose owner had ignored twelve recall notices and whose driver had committed several unsafe acts.<sup>8</sup>

The *Williams* decision is notable for expressly forbidding a “state to use a punitive damages award to punish a defendant for injury that it inflicts upon nonparties or those whom they directly represent, *i.e.*, injury that it inflicts upon those who are, essentially, strangers to the litigation.”<sup>9</sup> This language, new to punitive damages jurisprudence, would seem to forbid the use of punitive damages in class action litigation in which a defendant does not “have an ‘opportunity to present every available defense’”<sup>10</sup>—and thus to forbid the certification of wide-ranging punitive damages classes as done in the *Dukes v. Wal-Mart*<sup>11</sup> or *Schwab*<sup>12</sup> tobacco litigation.

## Preemption Pushing Off

*Watters v. Wachovia Bank, N.A.*<sup>13</sup> raised the intriguing question of what deference was owed to administrative agencies that found their regulations preempted contradictory state law. In 2001, the Office of the Comptroller of the Currency (OCC) promulgated 12 C.F.R. § 7.4006, which preempted state law with respect to

national bank operating subsidiaries. Wachovia Bank sued the state of Michigan, seeking a declaration that it was not subject to the state’s banking laws. The Sixth Circuit agreed in the 2005 decision *Wachovia Bank, N.A. v. Watters*,<sup>14</sup> holding that it owed deference to the regulatory determination of the OCC. Michigan appealed, and the case attracted briefs from a number of amici seeking to propound legal rules regarding the authority of administrative agencies to declare state law preempted and also seeking to establish what deference courts owed such determinations.

But the Supreme Court avoided the question entirely, holding 5-to-3<sup>15</sup> that the National Bank Act (NBA) mandated the result the OCC reached, and that the OCC’s regulation merely “clarifies and confirms what the NBA already conveys.”<sup>16</sup> The three dissenting judges—a unique lineup of John Paul Stevens, Roberts, and Alito—argued that preemption was not available to federal agencies without express Congressional authorization, and even then, was entitled to something less than full *Chevron* deference, a strong hint that the Roberts Court will continue the Court’s historic, if ahistoric,<sup>17</sup> distaste for preemption.

The preemption question, however, will return in October Term 2007. *Riegel v. Medtronic, Inc.* will review a divided Second Circuit decision upholding Food and Drug Administration (FDA) preemption of state-law tort claims over a medical device approved by the FDA. The Second Circuit decision<sup>18</sup> is correct as a matter of federal statutes,<sup>19</sup> Supreme Court precedent, and sound public policy. The Roberts Court, however, seems more willing than the Rehnquist Court to accept certiorari to affirm rulings in which there are circuit splits, and may simply be seeking to clarify the law. This is because the Eleventh Circuit and a number of state courts have refused to recognize FDA preemption in these circumstances, perhaps because of litigation positions taken in 1999 by the Clinton administration FDA discouraging preemption.

The Supreme Court is also likely to grant certiorari in *Wyeth v. Levine*, an appeal from an especially egregious decision of the Vermont Supreme Court, which held that liability could accrue for failure to warn even when the pharmaceutical manufacturer’s request for stronger warnings on the label was explicitly rejected by the FDA. If preemption is not available as a defense and a manufacturer can be held liable for declining to adopt warnings

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that the FDA specifically rejected, then the efficacy of the FDA (and the ability of pharmaceutical manufacturers to operate) will be entirely at the mercy of the states. Though it will be possible for the Supreme Court to reverse on narrower grounds, a decision in this case is likely to implicate the FDA's recent controversial statement in the preamble to a final rule arguing for federal preemption of state-law failure-to-warn claims on the grounds that FDA approval of labeling reflects both a ceiling as well as a floor.<sup>20</sup> An affirmance, though unlikely, would effectively entirely wipe out the preamble's position until Congress or formal rulemaking intervenes.

### Bork's Vindication

The Supreme Court's reticence to issue sweeping opinions in *Williams* and *Watters* was duplicated in other important cases, including *Federal Election Commission v. Wisconsin Right to Life, Inc.*<sup>21</sup> (substantially narrowing, but refusing to overrule *McConnell v. Federal Election Commission*'s<sup>22</sup> limitations on First Amendment protections for political speech), *Hein v. Freedom From Religion Foundation*<sup>23</sup> (narrowing, but refusing to overrule taxpayer-standing doctrine of *Flast v. Cohen*<sup>24</sup>), and *Parents Involved in Community Schools v. Seattle School District No. 1*<sup>25</sup> (failing to obtain five votes for bright-line rule requiring race neutrality in educational assignments). But in one area—antitrust—the Roberts Court was willing to act boldly.

Robert Bork, in his book *The Antitrust Paradox*, provided devastating criticism of the irrationality of mid-1970s U.S. antitrust laws, which, through decades of economically incoherent court opinions, condemned practices that were efficient and benefited consumers. In a series of opinions since 1977—*Continental T.V., Inc. v. GTE Sylvania Inc.*<sup>26</sup>; *Broadcast Music Inc. v. Columbia Broadcasting System, Inc.*<sup>27</sup>; *Jefferson Parish Hospital Dist. No. 2 v. Hyde*<sup>28</sup>; *NCAA v. Board of Regents of Univ. of Oklahoma*<sup>29</sup>; *Spectrum Sports Inc. v. McQuillan*<sup>30</sup>; *State Oil Co. v. Khan*<sup>31</sup>; and *Verizon v. Trinko*<sup>32</sup>—Bork's arguments and principles of efficiency prevailed over reflexive condemnation of business practices. In October Term 2006's *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*,<sup>33</sup> one of the last, and most ancient, of the irrational precedents, 1911's *Dr. Miles Medical Co. v. John D. Park & Sons Co.*,<sup>34</sup> which prohibited vertical price restraints, fell.

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### The Bork revolution in antitrust is all but complete.

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As Bork noted, there is a distinct difference between horizontal price-fixing and the demand of a manufacturer that a retailer not sell below a certain price. Such a practice is only rational if the manufacturer believes that the price guarantee would increase sales. The archetypical example is when a customer receives benefits from a full-service retailer. If discounters can underprice the full-service retailer, they can free-ride off of the superior service of the latter, reducing the availability of full-service retailers to promote interbrand competition. (Nothing stops a brand from choosing to market itself as a low-service, low-price alternative.) A per-se rule against vertical price restraints is especially irrational when a manufacturer can accomplish the same economic result—albeit less efficiently—through exclusive service areas. In *Leegin*, a 5-to-4 majority of the Roberts Court overruled the long-ridiculed *Dr. Miles* rule in an opinion written by Justice Anthony Kennedy, who has the seat that was originally intended for Bork, and held vertical price restraints to be subject to the “rule of reason,” and thus legal without a specific showing of anticompetitive effect.

The Bork revolution in antitrust is all but complete, with only the *Von's Grocery* merger case<sup>35</sup> remaining on the books, and even that case is largely disregarded by merger-enforcement authorities since the days of Justice Department antitrust chief William Baxter. There is, however, a slim chance that another challenged supermarket merger, that of Whole Foods Markets and Wild Oats, might provide occasion for the Supreme Court to revisit the precedent.

### The Limits of Litigation

October Term 2006 featured a landmark decision for liability reform, though not in *Williams* or *Watters*. Perhaps the most significant civil litigation case of the term was the little-noticed *Bell Atlantic Corp. v. Twombly*. The case—seemingly about whether a strained case of conspiracy theory brought by notorious trial lawyers Milberg Weiss could be dismissed on the pleadings—was not even argued by the main office of the solicitor general, but by the more specialized assistant attorney general for antitrust, Thomas Barnett, suggesting a narrow focus for the case. But much more was decided.

Milberg Weiss brought a wildly implausible allegation of a violation of Section 1 of the Sherman Act, claiming that there was a conspiracy by incumbent local exchange

carriers (ILECs) not to compete, even though each ILEC would have its own incentive to engage in the parallel conduct alleged. The problem is that Federal Rule of Civil Procedure 8, as interpreted by the longstanding Supreme Court precedent *Conley v. Gibson*,<sup>36</sup> requires a court to deny a motion to dismiss a complaint for failure to state a claim “unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.”<sup>37</sup> This overly permissive standard permitted all manner of complaints to go forward for expensive fishing expeditions in discovery, thus encouraging nuisance settlements to avoid the expense for defendants of developing enough evidence to take a case to summary judgment. Some courts had tried to get around this problem by having heightened pleading standards for antitrust cases, but nothing in the Federal Rules permitted a double standard.

The Supreme Court cut the Gordian knot by disclaiming *Conley v. Gibson*’s “no set of facts” standard as incorrect and confusing, and requiring complaints to meet instead a plausibility standard under Rule 8. The Court expressly noted the danger of “a largely groundless claim . . . tak[ing] up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value”:<sup>38</sup>

It is no answer to say that a claim just shy of a plausible entitlement to relief can, if groundless, be weeded out early in the discovery process through “careful case management,” post at 4, given the common lament that the success of judicial supervision in checking discovery abuse has been on the modest side. See, e.g., Easterbrook, *Discovery as Abuse*, 69 B. U. L. Rev. 635, 638 (1989) (“Judges can do little about impositional discovery when parties control the legal claims to be presented and conduct the discovery themselves”). And it is self-evident that the problem of discovery abuse cannot be solved by “careful scrutiny of evidence at the summary judgment stage,” much less “lucid instructions to juries,” post, at 4; the threat of discovery expense will push cost-conscious defendants to settle even anemic cases before reaching those proceedings. Probably, then, it is only by taking care to require allegations that reach the level suggesting conspiracy that we can hope to avoid the potentially enormous expense of discovery in cases with no “reasonably founded hope that the [discovery] process will reveal relevant evidence” to support a §1 claim.<sup>39</sup>

A whole class of meritless federal cases suddenly became much less valuable. The Supreme Court has given federal courts the authority to shut down strike suits at an early stage, and has also taken away some of the power of trial lawyers to extract millions of dollars from innocent defendants through the threat of expensive litigation—a threat that in recent years became much more powerful as the advent of e-mail and other e-discovery creates millions of pages of discovery production in even routine cases. The Court’s remedy is far from complete, of course; individual trial judges can still refuse to dismiss cases that should be dismissed, and the lack of interlocutory appeal or fee-shifting possibilities means that defendants in such courts are no better off than they were pre-*Twombly*. But it is surely a step in the right direction to rebalance the risks of false positives against false negatives.

Most encouragingly, *Twombly*’s striking language about the expense and public policy implications of unfettered litigation is impressive, but it is far from unique in October Term 2006. In case after case during that term, the Roberts Court expressed a shrewd recognition of the costs of litigation and the limits of the judiciary.

*Tellabs, Inc. v. Makor Issues & Rights, Ltd.* repeated the Court’s recognition that “Private securities fraud actions . . . if not adequately contained, can be employed abusively to impose substantial costs on companies and individuals whose conduct conforms to the law.”<sup>40</sup> *Leegin* criticized the *Dr. Miles* rule as “a flawed antitrust doctrine that serves the interests of lawyers—by creating legal distinctions that operate as traps for the unwary—more than the interests of consumers—by requiring manufacturers to choose second-best options to achieve sound business objectives.”<sup>41</sup>

The Court intervened on several occasions in which the Ninth Circuit overstepped its bounds and improperly let plaintiffs’ cases go forward: *Safeco Insurance Company of America v. Burr* (claiming not reckless violation of Fair Credit Reporting Act for objectively and reasonably interpreting statute as permitting prohibited conduct; unanimously reversing Ninth Circuit decision<sup>42</sup>), *GEICO General Insurance Company v. Edo* (same<sup>43</sup>), and *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.* (unanimously rejecting the Ninth Circuit’s adoption of actionable “predatory buying” under antitrust laws without showing of profitable recoupment<sup>44</sup>). Even the fractured 5-to-4 First Amendment decision in *Morse v. Frederick*<sup>45</sup>, the “Bong Hits 4 Jesus” case, had 9-to-0 unanimity when it came to the question of whether the Ninth Circuit erred in letting the suit go forward

instead of granting qualified immunity to the school officials.<sup>46</sup>

In another antitrust suit, *Credit Suisse First Boston v. Billing*, a 7-to-1 majority rejected a complaint of antitrust conspiracy in initial public offering pricing, holding that the extensive Securities and Exchange Commission regulation of the subject made parallel civil litigation problematic. As Justice Stephen Breyer explained,

Antitrust plaintiffs may bring lawsuits throughout the Nation in dozens of different courts with different nonexpert judges and different nonexpert juries. . . . [T]here is no practical way to confine antitrust suits so that they challenge only activity of the kind the investors seek to target, activity that is presently unlawful and will likely remain unlawful under the securities law. Rather, these factors suggest that antitrust courts are likely to make unusually serious mistakes in this respect.<sup>47</sup>

The language almost mirrors that of Judge Frank H. Easterbrook in his great *The Limits of Antitrust* article,<sup>48</sup> but, importantly, this point should hardly be confined to the relationship between antitrust and securities regulation. Courts are poorly situated to decide a wide variety of matters on which they pass judgment: appropriate automobile design; warnings on drug labels and other drug-safety issues; the standard of care in medicinal judgment calls; and the day-to-day regulation and administration of education, transportation, prison, and medical systems, among other matters for which courts have shown a disturbing propensity to make expensive mistakes.

## Looking toward October Term 2007

October Term 2007 will bring other cases implicating civil justice issues. *Riegel*, already mentioned, will explore the scope of FDA preemption. *Sprint/United Management Company v. Mendelsohn* will explore whether plaintiffs may introduce collateral “me too” evidence of discrimination unrelated to that of the complainant. The Court will also revisit its earlier rejection of secondary liability<sup>49</sup> in the case of *Stonebridge Investments v. Scientific-Atlanta, Inc.*, which has been the subject of intense lobbying by the plaintiffs bar because of the billions of dollars of potential liability from strike suits against deep-pocketed parties peripheral to alleged securities fraud.<sup>50</sup>

The Court did not invariably avoid judicial aggrandizement this term, most notably failing to do so when it

found standing in the carbon-dioxide regulation case of *Massachusetts v. EPA*.<sup>51</sup> But the Roberts Court’s willingness to grant certiorari in the sort of business-litigation cases the Rehnquist Court largely avoided (even when appellate courts hide their decisions in unpublished opinions), combined with the repeatedly expressed recognition—even by the liberal wing of the Court—that more liability is not always preferable, suggests that October Term 2006 bodes well for future judicial reform of a frequently abusive civil justice system.

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Research assistant Sara Wexler and AEI editorial associate Nicole Passan worked with Mr. Frank to edit and produce this Liability Outlook.

## Notes

1. 538 U.S. 408 (2003).
2. 517 U.S. 559 (1996).
3. 540 U.S. 801 (2003).
4. *Williams v. Philip Morris USA*, 340 Or. 35, 51–52, 127 P.3d 1165, 1175 (2006).
5. *Philip Morris USA v. Williams*, No. 05-1256, slip op. at 5 (2007) (to be published at 549 U.S. \_\_\_).
6. See, e.g., [www.iht.com/articles/2007/02/20/business/smoke.php](http://www.iht.com/articles/2007/02/20/business/smoke.php) (quoting Robin Conrad).
7. See the discussion of *Buell-Wilson v. Ford* in Ted Frank, *Rollover Economics: Arbitrary and Capricious Product Liability Regimes*, AEI LIABILITY OUTLOOK, January 2007.
8. *Mraz v. DaimlerChrysler Corp.*, No. BC332487 (Los Angeles County Superior Court, Cal. 2007), discussed at [www.overlawyered.com/2007/03/the\\_richard\\_mraz\\_case\\_55m\\_in\\_l.html](http://www.overlawyered.com/2007/03/the_richard_mraz_case_55m_in_l.html) and [www.overlawyered.com/2007/03/mraz\\_v\\_chrysler\\_an\\_exchange\\_wi.html](http://www.overlawyered.com/2007/03/mraz_v_chrysler_an_exchange_wi.html).
9. *Philip Morris*, *supra*, slip op. at 5.
10. *Id.* at 6.
11. 474 F.3d 1214 (9th Cir. 2007).
12. 449 F. Supp. 2d 992 (E.D.N.Y. 2006) (Weinstein, J.).
13. No. 05-1342 (2007) (to be published at 550 U.S. \_\_\_).
14. 431 F.3d 556 (6th Cir. 2005).
15. Justice Thomas recused himself from the case.
16. *Watters*, *supra*, slip op. at 16.
17. Richard A. Epstein & Michael S. Greve, *Conclusion: Preemption Doctrine and Its Limits*, in FEDERAL PREEMPTION: STATES’ POWERS, NATIONAL INTERESTS, 309-337 (Richard A. Epstein & Michael S. Greve ed. 2007).
18. 451 F.3d 104 (2d Cir. 2006).
19. 21 U.S.C. § 360k(a).
20. Requirements on Content and Format of Labeling for Human Prescription Drug and Biological Products, 71 Fed.

Reg. 3922 (Jan. 24, 2006) (to be codified at 21 CFR Parts 201, 314, and 601).

21. No. 06-969 (2007) (to be published at 551 U.S. \_\_).
22. 540 U.S. 93 (2003).
23. No. 06-157 (2007) (to be published at 551 U.S. \_\_).
24. 392 U.S. 83 (1968).
25. No. 05-908 (2007) (to be published at 551 U.S. \_\_).
26. 433 U.S. 36 (1977).
27. 441 U.S. 1 (1979).
28. 466 U.S. 2 (1984).
29. 468 U.S. 85 (1984).
30. 506 U.S. 447 (1993).
31. 522 U.S. 3 (1997).
32. 540 U.S. 398 (2004).
33. No. 06-480 (2007) (to be published at 551 U.S. \_\_).
34. 220 U.S. 373 (1911).
35. 384 U.S. 270 (1966).
36. 355 U.S. 41 (1957).
37. *Id.* at 45-46.
38. No. 05-1126, slip op. at 11 (2007) (to be published at 550 U.S. \_\_).
39. *Id.* at 12.
40. No. 06-484, slip op. at 1 (2007) (to be published at 551 U.S. \_\_).

41. *Leegin*, No. 06-480 (2007) slip op. at 25.

42. No. 06-84 (2007) (to be published at 551 U.S. \_\_).

43. *Id.*

44. No. 05-381 (2007) (to be published at 549 U.S. \_\_).

45. No. 06-278 (2007) (to be published at 551 U.S. \_\_).

46. This is not to say that the Court was reflexively pro-defendant. In *Watson v. Philip Morris*, No. 05-1284 (2007) (to be published at 551 U.S. \_\_), the Court unanimously rejected the tobacco company's and Eighth Circuit's aggressively expansive interpretation of federal jurisdiction under 28 U.S.C. § 1442(a)(1), which will result in the remand of three meritless consumer class actions to plaintiff-friendly state courts in Arkansas, Missouri, and Minnesota, the last two of which already have disregarded basic due process protections in certifying expansive classes.

47. No. 05-1157, slip op. at 16 (2007) (to be published at 551 U.S. \_\_).

48. 63 Tex. L. Rev. 1 (1984).

49. 511 U.S. 164 (1994).

50. Ted Frank, *Will the Bush Administration Cave In to Political Pressure from Trial Lawyers?* AEI ON THE ISSUES, June 2007; Peter J. Wallison, *The Stoneridge Case and the Need to Control Class Actions*, AEI ON THE ISSUES, June 2007.

51. No. 05-1120 (2007) (to be published at 549 U.S. \_\_).